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Exploring the Limits of the Concept of Legitimate Expectations in Investment Treaty Law: A Study in Comparative Law and the Development of International Law

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Thesis Submitted in Partial Fulfilment of the
Requirements for the degree of Doctor of Philosophy

School of Law
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2014

Declaration for SOAS PhD thesis

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Thesis Abstract

This thesis aims to identify more clearly the rationale, the constituent elements and the methodology of the concept of legitimate expectations in the field of investment treaty law. It addresses the problems associated with the concept's development in the application of the standards of fair and equitable treatment and indirect expropriation.

The thesis adopts a comparative perspective. More developed legal regimes have been referring to legitimate expectations and to a similar concept of investment-backed expectations. Their experiences can assist in addressing questions about the concept's nature in investment treaty law. The enquiry focuses on seven such regimes, namely those of: the USA, England, Australia, European Union, European Convention on Human Rights, general international law and World Trade Organisation.

The analysis shows that the concept of legitimate expectations is equitable. It safeguards fairness and trust in the actions of public authorities. It demands balancing of the private interest behind legitimate expectations and the public interest underlying the measures that frustrate them.

The analysis identifies three common types of legitimate expectations, namely: legitimate expectations related to the legal and factual situation of an investment, legitimate expectations arising from specific representations and legitimate expectations related to invalidation of State acts. It also identifies the limits of the concept. It should cover neither expectations of immunity from general legislative or regulatory changes, nor investor's subjective expectations of treatment, nor expectations of a proprietary nature.

The comparative analysis clarifies the concept's limits, the methodology required for its application and the fundamental questions the tribunals need to address. This greater clarity will facilitate a comprehensive case-by-case discussion among system participants. This discussion will contribute to the development of a concept capable of balancing the private and public interests persuasively and thus of supporting the long-term sustainability of the investment treaty system as a whole.

TABLE OF CONTENTS

List of Tables

A. Table of Abbreviations

AB	Appellate Body
BIT	bilateral investment treaty
CETA	Comprehensive Economic and Trade Agreement between Canada and the EU
CFI	Court of First Instance
CIL	customary international law
ECHR	European Convention on Human Rights
ECJ	Court of Justice of the European Union
ECT	Energy Charter Treaty
ECtHR	European Court of Human Rights
DFATD	Department of Foreign Affairs, Trade and Development of Canada
FET	fair and equitable treatment
FIPA	Foreign Investment Promotion and Protection Agreement
FTA	free trade agreement
GATT	General Agreement on Tariffs and Trade
HCA	High Court of Australia
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IIA	international investment agreement
ILC	International Law Commission
ITA	investment treaty arbitration
ITL	investment treaty law
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
P 1/1	Article 1 of Protocol 1 of the ECHR

PCIJ	Permanent Court of International Justice
RIBE	reasonable investment-backed expectations
USSC	U.S. Supreme Court
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organisation

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Cargill, Incorporated v United Mexican States, ICSID Case No. ARB(AF)/05/2, Award of 18 September 2009

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2. Canada

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14/61 Koninklijke Nederlandische Hoogovens en Staalfabrieken N.V. v High Authority of the European Coal and Steel Community [1962] ECR 485

111/63 Lemmerz-Werke GmbH v High Authority of the European Coal and Steel Community [1965] ECR 835

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1/73 Westzucker GmbH v Einfuhr- und Vorratsstelle für Zucker [1973] ECR 723

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78/74 Deuka Deutsche Kraftfutter GmbH B.J. Stolp and Einfuhr- und Vorratsstelle für Getreide und Futtermittel [1975] ECR 421

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84/78 Tomadini and Administrazione delle finanze dello Stato [1979] ECR 1801

98/78 Firma A. Racke v Hauptzollamt Mainz [1978] ECR 69

99/78 Weingut Gustav Decker KG v Hauptzollamt Landau [1979] ECR 101

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Beyeler v Italy (2001) 33 EHRR 52

Campbell and Fell v The United Kingdom (1985) 7 EHRR 165

Centro Europa 7 S.R.L v Italy, App no 38433/09 (ECtHR, 7 June 2012), Concurring Opinion of Judge Vajic

Colak v Germany, App no 9999/82 (ECtHR, 6 December 1988)

Draon v France (2006) 42 EHRR 40

Draon v France, App no 1513/03 (ECtHR Grand Chamber, 21 June 2006)

Fedorenko v Ukraine (2008) 46 EHHR 6

Gasus Dosier- und Fördertechnik GmbH v Netherlands (1995) 20 EHRR 403

Gratzinger and Gratzingerova v Czech Republic, App no 39794/98 (ECtHR Grand Chamber, 10 July 2002)

James v United Kingdom (1986) 8 EHHR 123

Jantner v Slovakia, App no. 39050/97 (ECtHR, 4 March 2003)

Kopecký v Slovakia (2005) 41 EHRR 43

Lithgow v United Kingdom (1986) 8 EHHR 329

Malhous v The Czech Republic, App no 33071/96 (ECtHR, 12 July 2001)

Marckx v Belgium (1979-1980) 2 EHRR 330

Pine Valley Developments Ltd. v Ireland (1992) 14 EHHR 319

Pressos Compania Naviera S.A. v Belgium (1996) 21 EHRR 301

Pressos Compania Naviera S.A. v Belgium (Article 50), App no 17849/91 (ECtHR, 3 July 1997)

Spacek Sro v Czech Republic (2000) 30 EHRR 1010

Sporrong and Lönrroth v Sweden (1983) 5 EHRR 35

Stretch v The United Kingdom (2004) 38 EHRR 12

Von Hannover v Germany (No. 2) (2012) 55 EHHR 15

Von Maltzan v Germany, App nos 71916/01, 71917/01 and 10260/02 (ECtHR Grand Chamber, 2 March 2005)

E. Treaties, National Legislation and Announcements

1. IIAs and Model IIAs

2004 US Model BIT: Treaty Between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment

2004 Model FIPA: Agreement Between Canada and […] for the Promotion and Protection of Investments

2012 US Model BIT: Treaty Between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment

Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA**)** of 27 February 2009

ASEAN Comprehensive Investment Agreement of 26 February 2009

Australia – Chile Free Trade Agreement of 30 July 2008

Bilateral Agreement for the Promotion and Protection of Investments between the Government of the Republic of Colombia and the Government of the People's Republic of China of 22 November 2008

Comprehensive Economic and Trade Agreement between Canada and the EU, Draft text of 13 November 2013

Dominican Republic – Central America Free Trade Agreement of 5 August 2004

North American Free Trade Agreement of 1 January 1994

Pakistan and Federal Republic of Germany Treaty for the Promotion and Protection of Investments of 25 November 1959

2. NAFTA Treaty Statements

NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions of 31 July 2001

3. GATT and WTO

Agreement Establishing the World Trade Organization of 15 April 1994

General Agreement on Tariffs and Trade, 1947

General Agreement on Tariffs and Trade, 1994, Annex 1A to the Agreement Establishing the WTO of 15 April 1994

Dispute Settlement Understanding, Annex 2 to the Agreement Establishing the WTO of 15 April 1994

4. Other Treaties, Conventions, Rules and Statutes

Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 14 October 1966

Convention for the Protection of Human Rights and Fundamental Freedoms of 4 November 1950 North American Free Trade Agreement of 1 January 1994

Rules of Procedure for Arbitration Proceedings (Arbitration Rules), International Centre for Settlement of Investment Disputes

Statute of the International Court of Justice

Statute of the Permanent Court of International Justice of 16 December 1920

Vienna Convention on the Law of Treaties of 23 May 1969

5. National Legislation and Legislative Announcements

Bipartisan Agreement on Trade Policy (Bipartisan Trade Deal) of 2007 (US)

Bipartisan Trade Promotion Authority Act of 2002, Sec. 2102(3), 111 Stat. 2001-2002 995

The Constitution of the United States of America 1787

Human Rights Act 1998

Chapter 1 Introduction: Comparative Law Methodology and Development of Investment Treaty Law ('ITL')

A. Introduction

The inspiration for this thesis lies in the unprecedented rise of references to legitimate expectations in investment treaty law ('ITL') and investment treaty arbitration ('ITA'). They have become ubiquitous since about 2003.[1] Despite this popularity the concept is mired in controversy, inconsistent approaches and lack of systematic consideration by scholars.[2] Nevertheless, it is an important overarching concept used for clarifying and applying the vague treaty standards. There is a dire need for its clarification and coherence that could consolidate its role as an effective tool.

This thesis uses comparative law methodology as a technique of investigating the concept of legitimate expectations. Its aim is to inform the discussion about the concept in this nascent area of international law by exploring parallels between its use in investment treaty law ('ITL') and in a broad spectrum of other legal regimes. This will help in understanding better what the investment tribunals have been doing so far and in informing clearer, more persuasive and coherent use of the concept in the future. It is hoped that over time such persuasiveness and coherence will contribute to the authoritative development of ITL.

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[1] Andrew Newcombe, Lluís Paradell, *Law and Practice of Investment Tribunals, Standards of Treatment* (Kluwer Law International 2009) 278.

[2] Fietta noted that 'continuing failure of some of the most pre-eminent arbitral tribunals to address [the issue], in a clear, consistent, and analytical manner' (Stephen Fietta, 'Expropriation and the 'Fair and Equitable' Standard: The Developing Role of Investors' 'Expectations' in International Investment Arbitration' (2006) 23 J.Int'l Arb. 375, 375); Snodgrass observed 'little systemic consideration of the scope or limits of the protection' and no 'discussion on the authority for providing protection for such expectations' (Elizabeth Snodgrass, 'Protecting Investors' Legitimate Expectations: Recognising and Delimiting a General Principle' (2006) 21 ICSID Rev. 1, 2, 10-11); Potestà refers to 'abundant and disordered jurisprudence on the issue' (Michele Potestà, 'Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept' (2013) 28 ICSID Rev. 88, 89). See also Newcombe & Paradell (n 1) 279; Chris Yost, 'A Case Review and Analysis of the Legitimate Expectations Principle as It Applies Within the Fair and Equitable Treatment Standard' (2009) ANU College of Law Research Paper No. 09-01 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1364996> accessed 16 April 2014; Abhijit PG Pandya, Sandy Moody, 'Legitimate Expectations in Investment Treaty Arbitration: An Unclear Future?' (2010) 1 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1631507> accessed 16 April 2014; Ivar Alvik, *Contracting with Sovereignty, State Contracts and International Arbitration* (Hart Publishing 2011) 197.

B. Thesis, Research Questions and Working Assumptions

The research presented here asks questions about the foundations of the concept of legitimate expectations as well as its constituent elements. It is based on a working assumption that the concept of legitimate expectations involves two sets of elements. First, it requires some conduct of a State and reliance on it by an individual in a way that creates expectations of that individual about the future conduct of the State. Secondly, it concerns subsequent conduct of the State that frustrates those expectations and the legal consequences of such frustration. The key questions underlying these mechanisms are: when are expectations legitimate and in what circumstances the State bears the legal consequences of their frustration.

The main thesis of this research is that

> the concept of legitimate expectations is a tool used by investment tribunals to concretise vague investment treaty standards of fair and equitable treatment (FET) and indirect expropriation; that a comparative approach to this practice can inform its more persuasive use in the future, balancing the interests of foreign investors and host States; and that such approach can contribute to the development of the nascent investment treaty regime in a more authoritative way.

The analysis follows the classic comparative structure.[3] First, it presents the essential relevant elements of the compared legal systems, one by one. It then uses this material as a basis for critical comparison, taking ITL as its central point. It ends with conclusions about available options for future investment tribunals and/or treaty drafters.

As explained in more detail in section E, the comparison involves eight legal regimes: US law, English law, Australian law, European Union ('EU') law, jurisprudence of the European Court of Human Rights ('ECtHR'), general international law, the law of the World Trade Organisation ('WTO') and ITL. With regard to each of them, the analysis covers the following issues:

- origins and rationale of the concept of legitimate expectations (or investment-backed expectations);

[3] Konrad Zweigert, Hein Kötz, *Introduction to Comparative Law* (Tony Weir tr, 3rd rev edn, Clarendon Press, Oxford 1998) 6.

- situations in which the concept is used and sources of legitimate expectations;
- reasonableness and/or legitimacy of expectations; and
- balancing of expectations with State regulatory powers.

With the exception of 'investment-backed expectations', a term used in US law on this issue, the analysis focuses exclusively on the legal phenomena labelled 'legitimate expectations'. It is assumed that the concepts labelled as such answer to specific needs of a given legal regime.

The general mechanism underlying legitimate expectations is that of reliance: party A relies on conduct of party B and frustration of expectations arising from that reliance may bring legal consequences for party B. This mechanism underpins perhaps every legal relationship.[4] As a result, the concept of legitimate expectations is sometimes associated with other concepts based on reliance. An in-depth analysis of such concepts is outside the scope of this analysis. This concerns in particular the concepts of estoppel, *venire contra factum proprium* and *pacta sunt servanda*.[5]

This analysis also does not cover the contractual paradigm of the concept of legitimate expectations.[6] This paradigm focuses on contracts between States and foreign investors. The concept of legitimate expectations in this context refers to *mutual* legitimate expectations of investors and host States, informed by the long-term equilibrium of their contractual relationship.[7] This paradigm calls for a separate

[4] See e.g. Maurice Mendelson, 'The Formation of Customary International Law' (1998) 272 Recueil des Cours 159, 186 and Michael Byers, *Custom, Power and the Power of Rules* (Cambridge University Press 1999) 107 with regard to public international law.

[5] *International Thunderbird Gaming Corporation v The United Mexican States*, UNCITRAL (NAFTA), Separate Opinion by Thomas Wälde [*Thunderbird*/Wälde] paras. 25-27; Newcombe & Paradell (n 1) 279; Yost (n 2) 33-36; Hector A Mairal, 'Legitimate Expectations and Informal Administrative Representations' in: SW Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 422-426; Chester Brown, 'The Protection of Legitimate Expectations as a "General Principle of Law": Some Preliminary Thoughts' (2009) 6 TDM 1, 9. See also earlier writings by Dolzer, who associated these concepts with 'legitimate reliance' and 'original expectations', ideas which later merged into his conceptualisation of legitimate expectations (see Rudolf Dolzer, 'New Foundations of the Law of Expropriation of Alien Property' (1981) 75 AJIL 553, 579-587. The development of his conceptualisation can be traced through: 'Indirect Expropriations: New Developments?' (2002) 64 N.Y.U.Envtl.L.J. 64, 78-79; 'The Impact of International Investment Treaties on Domestic Administrative Law' (2005) 37 N.Y.U. J. Int'l L. & Pol. 953, 968-969 and 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (2005) 39 Int'l Law 87, 100-103 by the same author).

[6] *Thunderbird*/Wälde, para. 27.

[7] *Award in the Matter of an Arbitration between Kuwait and the American Independent Oil Company* (AMINOIL), 21 ILM 976 1982 [AMINOIL], paras. 148-149; Rosalyn Higgins,

comparative research of specific mechanisms used for these types of contracts in national legal systems, such as the French concept of *contract administratif*.[8] It does not lend itself to a comparative analysis together with public law and public international law concepts labelled 'legitimate expectations'.

The central point of the present analysis is ITL.[9] It is assumed that the concept of legitimate expectations is relevant to two investment treaty standards: fair and equitable treatment ('FET') standard and indirect expropriation. Investment treaties ('IIAs')[10] formulate them broadly. The standards cannot be defined *in abstracto*. Their application is heavily fact-specific and therefore controversial. The obligation to accord FET 'offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures that have been taken against its interests'.[11] Investment tribunals have interpreted it to include a wide range of State conduct – an approach often criticised as excessive. [12] Indirect expropriation occurs when legitimate governmental regulation crosses the point beyond which the burden on the regulated person should be borne by the society as a whole. Defining this crossing point or the criteria

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'Legal Preconditions of Foreign Investment' in Pat Rogers (ed), *Themes and Theories* (Oxford University Press 2009); *State Contracts: UNCTAD Series on Issues in International Investment Agreements* (United Nations 2004) Sales No. E.05.II.D.5, 45. Traces of this approach can be found in recent investment treaty award, see e.g. *Total S.A. v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability of 27 December 2010 [*Total*], para. 313 and *Impregilo S.p.A. v Argentine Republic*, ICSID Case No. ARB/07/17, Award of 21 June 2011 [*Impregilo*], para. 330.

[8] M Sornarajah, *International Law on Foreign Investment* (3rd edn, Oxford University Press 2010) 86; UNCTAD (n 7) 4.

[9] A more detailed background of the investment treaty regime is presented in Chapter 2.

[10] The term 'IIAs' (international investment agreements) denotes bilateral investment treaties as well as investment chapters in free trade agreements and similar treaties.

[11] Peter Muchlinski, *Multinational Enterprises and the Law* (2nd rev edn, Oxford University Press 2007) 639.

[12] See e.g. Stephen Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (1999) 70 BYIL 99; Dolzer, 'FET: A Key Standard' (n 5); Christoph Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 JWIT 357; Campbell McLachlan, Laurence Shore, Matthew Weiniger, *International Investment Arbitration. Substantive Principles* (Oxford University Press 2007) Chapter 7; Newcombe & Paradell (n 1) Chapter 6; Roland Kläger, '*Fair and Equitable Treatment' in International Investment Law* (Cambridge University Press 2011); Hussein Haeri, 'A Tale of Two Standards: "Fair and Equitable Treatment" and the Minimum Standard in International Law – The Gillis Wetter Prize' (2011) 27 Arb Intl 24; Alexandra Diehl, *The Core Standard of Investment Protection: Fair and Equitable Treatment* (Kluwer Law International 2012); UNCTAD, *Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II: A sequel* (United Nations 2012) Sales No. E.11.II.D.15.

facilitating its identification has proven difficult in practice, as suggested by the extensive literature on the subject.[13]

Both standards, the FET and indirect expropriation, address the key risk for foreign investors - the regulatory risk. As a result, investors often pursue parallel claims based on both standards in relation to the same facts. Many commentators focus on the FET standard because most references to legitimate expectations by investment tribunals are linked to this standard. However, there is a significant cross-fertilisation between expectations-based concepts used in the context of expropriation and expectations-based concepts used in the context of FET and procedural fairness. Investment tribunals and commentators use these concepts in relation to both standards

One aspect of this cross-fertilisation concerns the US law concept of investment-backed expectations. This concept is linked with the concept of legitimate expectations by a number of commentators.[14] Moreover, references to 'investment-

[13] See e.g. Rosalyn Higgins, 'The Taking of Property by the State. Recent Developments in International Law' (1982) 176 Recueil des Cours 259; Rudolf Dolzer, 'Indirect Expropriation of Alien Property' (1986) 1 ICSID Review 1; Gaëtan Verhoosel, 'Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking a "Reasonable" Balance between Stability and Change' (1998) 29 Law & Pol.Int.Bus. 451; Thomas Wälde, Abba Kolo, 'Environmental Regulation, Investment Protection and "Regulatory Taking" in International Law (2001) 50 ICLQ 811; Rudolf Dolzer, Felix Bloch, 'Indirect Expropriation: Conceptual Realignments?' (2003) 5 International Law FORUM du droit international 155; Jan Paulsson, Zachary Douglas, 'Indirect Expropriation in Investment Treaty Arbitrations' in Horn N, Kröll SM (eds), *Arbitrating Foreign Investment Disputes. Procedural and Substantive Legal Aspects* (Kluwer Law International 2004); Christoph Schreuer, Rudolf Dolzer, *Principles of International Investment Law* (Oxford University Press 2008) Chapter 6; Brigitte Stern, 'In Search for the Frontier of Indirect Expropriation' in Arthur Rovine (ed), *CIAM: The Fordham Papers*, vol 1 (Martinus Nijhoff Publishers 2008) 59; Lucy Reed, Daina Bray, 'Fair and Equitable Treatment: Fairly and Equitably Applied in Lieu of Unlawful Indirect Expropriation?' in Rovine A (ed), *CIAM: The Fordham Papers* vol 1 (Martinus Nijhoff Publishers 2008) 13; Newcombe & Paradell (n 1) Chapter 7; Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15 J.I.E.L. 223.

[14] See e.g. Dolzer (n 13) 62; Wälde & Kolo (n 13) Parts III-IV; Vaughan Lowe, 'Regulation or Expropriation?' (2002) 55 C.L.P. 447 461; Dolzer, 'New Developments' (n 5) 78-79; Thomas Wälde, 'Energy Charter Treaty-based Investment Arbitration, Controversial Issues' (2004) 5 JWIT 373, 387; Yves L Fortier, Stephen L Drymer, 'Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor' (2004) 19 ICSID Rev. 293, 306-308; Jack Coe Jr, Noah Rubins, 'Regulatory Expropriation and the Tecmed Case: Context and Contributions' in Weiler T (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005) 624-625; Andrew Newcombe, 'The Boundaries of Regulatory Expropriation in International Law' (2005) 20 ICSID Rev. 1, 35-38; Fietta (n 2) 378; Snodgrass (n 2) 28; *Thunderbird*/Wälde, para. 119.

backed expectations' have been introduced into a number of IIAs[15] and already interact with investment tribunals' approach to the concept of legitimate expectations.[16] Consequently, incorporation of the US law concept of investment-backed expectations into this comparative analysis is justified.

C. Reasons for this Research: Development of International Law through the Rhetorical Argumentation.

The reasons for undertaking this particular research project can be divided into causes and desired effects. They arise from the twin needs for persuasiveness and balancing.

The persuasiveness-related cause for this research rests in the current state of conceptualisation of the concept of legitimate expectations in ITL. The need for comparative approach is a result of dissatisfaction with the development of the concept so far, characterised by its low explainability and incoherence. This is explained in more detail in Chapter 2. [17] It shows the insufficiency of staying within the four corners of the IIAs at this stage of the development of the regime.[18] One way to remedy this situation is to seek explanations in more developed legal systems.

Increased persuasiveness is the major goal of this comparative analysis. [19] A comparative background creates a level playing field for the various approaches to legitimate expectations that may have influenced the system participants so far. Awareness of this diversity will enable them to make better informed and explainable choices when the concept is used in the future. Over time, the persuasiveness of such choices will help make the concept of legitimate expectations more coherent. It

[15] See Chapter 6, Stection C.

[16] *Railroad Development Corporation (RDC) v Republic of Guatemala*, ICSID Case No. ARB/07/23, Award of 29 June 2012 [*RDC*].

[17] See Chapter 2, Section D.

[18] The need for comparative approach diminishes once the regime develops tools to deal with its specific issues. Anthea Roberts, 'Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System' (2013) 107 AJIL 45 53; Thomas Wälde, 'The Specific Nature of Investment Arbitration' in P Khan, T Wälde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff Publishers 2007) 118.

[19] See also Stephan Schill, 'Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach' (2011) 52 Va.J.Int'l L. 57 88; Wälde (ibid) 110.

will also contribute to the development of its uniform interpretative methodology.[20] It may also influence the future wording of IIAs.[21]

Persuasiveness of arguments used by investment tribunals contributes to the effective development of international law, understood as a continuing process of authoritative legal decision-making.[22] The rules of this decentralised and non-hierarchical legal system are not detailed and precise. International courts and tribunals applying those rules need to fill the *lacunae* resulting from this lack of normative detail. They do so by employing various tools and techniques.[23] In case of IIAs these tools and techniques fall within the realm of treaty interpretation. The concept of legitimate expectations is one of such tools. Filling the *lacunae* often requires creativity and may involve policy-making choices. However, the courts and tribunals need to avoid perceptions that they abuse their powers as treaty interpreters. Persuasive explanation of decisions is a powerful technique to change such perceptions.[24]

The development of international law understood as a decision-making process is not based on a neutral 'discovery' and application of appropriate rules by investment tribunals. Rather, the tribunals must decide which of the many possible approaches to apply. These choices are context-dependent and require 'harder work in identifying sources and applying norms' than when applying established rules.[25] Forging of a 'right' rule occurs in a process of rhetorical argumentation among various system-participants.[26] International law is not based on the principle of binding precedent. Consequently, this discursive process[27] and the legal decision-

[20] Schill (n 19) 88-89; Snodgrass (n 2) 58.

[21] Schill (n 19) 88; Snodgrass (n 2) 3.

[22] Rosalyn Higgins, *Problems and Process. International Law and How We Use It* (Oxford University Press (1994) 2.

[23] Higgins (n 22) 10; Vaughan Lowe, 'The Politics of Law-Making: Are the Method and Character of Norm Creation Changing' in Byers M (ed), *The Role of Law in International Politics: Essays in International Relations and International Law* (Oxford University Press 2001) 211.

[24] Higgins (n 22) 4-7; Alexander Orakhelashvili, *The Interpretation of Acts and Rules in Public International Law* (Oxford University Press 2008) 29-36, 196-197; Dolzer, 'New Foundations' (n 5) 578; Lowe (n 23) 216.

[25] Higgins (n 22) 8.

[26] Lowe (n 23) 219, 220.

[27] Thomas M Franck, *Fairness in International Law and Institutions* (Oxford University Press 1998) 7.

making are continuous[28], and the references to past decisions are usually insufficient.[29] What matters is the persuasiveness of the rhetorical argumentation used to justify decisions made in an individual case. Persuasiveness influences repeat use of a rule and its consistency.[30] The source of a persuasive argument is not always important[31], as long as it involves a 'rhetorical, topical argument addressed to the invisible college of international lawyers'.[32] Such rhetorical argumentation, if adopted by tribunals, contributes to the persuasiveness of their legal decision-making.

The persuasiveness of the decision-making in applying the concept of legitimate expectations depends on the systematic and open analysis of the relevant factors.[33] This opens the final decision to public scrutiny and prevents perceptions of bias or subjectivity in the decision-making from forming.[34]

The second reason for the comparative research into the concept of legitimate expectations is balancing. Greater coherence of the concept requires analysis of balancing between investors' expectations of stability and the host State's regulatory interests. The relevance of balancing in this context is based on four sub-reasons, namely: the systemic importance of balancing in international law in general and in ITL in particular; limited guidelines on balancing in IIAs; the key role of the concept of legitimate expectations in the balancing process; and inconsistent approaches to balancing in practice.

Balancing is important at a systemic level. As argued by Franck, international law has at its core the managing the tension between stability and change.

Expectations of any investor, domestic or foreign, inevitably clash with the workings of a political system. The former is interested in stability while the latter needs the ability to change. These interests often cannot be simultaneously satisfied. It is accepted that a State will not always respect investor's expectations.[35] The question

[28] Higgins (n 22) 2-3.

[29] ibid 2.

[30] Lowe (n 23) 215.

[31] Higgins (n 22) 10; Lowe (n 23) 220.

[32] Lowe (n 23) 219.

[33] Higgins (n 22) 5.

[34] ibid 3; Orakhelashvili (n 24) 196.

[35] Franck (n 27) 439; Lowe (n 14) 450.

is *how* the two interests should be balanced and when should the frustration of investor's expectations be protected.

The question of balancing is a question about regulatory risk allocation. The allocation may differ depending on whether it occurs under national law, customary international law ('CIL') or ITL. Balancing of the two interests in stability and change needs to be fair procedurally, i.e. occur through a process perceived as right by system participants, and substantively, i.e. satisfy the participants' expectations of justice.[36] The risk allocation will therefore depend on what is perceived as 'fair', 'just' or 'right' in a given legal regime.[37] The balancing will therefore touch upon the fundamental values of that regime.[38] In ITL, which is a nascent legal regime, this balancing mechanism and the fundamental values are at the early stages of development.

In developing this balancing mechanism investment tribunals are provided with little guidance. Different values compete here. The need to attract foreign capital requires an investment climate that is friendly and protective, and guarantees stability and credibility of host States' commitments.[39] On the other hand, the host State needs to exercise its powers to regulate its economy in the public interest.[40] The scales were seemingly tipped by the wording of early IIAs which expressly referred to the former but not the latter set of values. This created a presumption against balancing. An argument was advanced that IIAs should be interpreted in favour of investment protection.[41] This trend was strengthened by the *zeitgeist* of the 'retreat of the State'.[42] However, recent approaches are more in line with Franck's proposition. It is

[36] Franck (n 27) 7-8.

[37] ibid 7, 440.

[38] ibid 7.

[39] See e.g. Dolzer, 'New Foundations' (n 5) 574; Franck (n 27) 439; Andrew T Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1997) 38 Va.J.I.L. 639, 659-660.

[40] Lowe (n 14) 450, 460; Wälde & Kolo (n 13) 820; Verhoosel (n 13); Peter Muchlinski, '"Caveat investor"? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard' (2006) 55 ICLQ 527, 528.

[41] See e.g. *SGS Société Générale de Surveillance S.A. v Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction of 29 January 2004 [*SGS v Philipines*], para. 116; *MTD Equity Sdn. Bhd. & MTD Chile S.A. v The Republic of Chile*, ICSID Case No. ARB/01/7, Award of 25 March 2004 [*MTD*], para. 104; Wälde (n 18) 107-108; Dolzer, 'Impact of Investment Treaties' (n 5) 953; Newcombe & Paradell (n 1) 116.

[42] Thomas Wälde, 'A Requiem for the "New International Economic Order" The Rise and Fall of Paradigms in International Economic Law' (1995) 1-2 CEPMLP Journal; Dolzer, 'Impact of Investment Treaties' (n 5) 955.

recognised that balancing is necessary for the system's future viability.[43] This goes hand-in-hand with three other trends. First, a major recalibration was brought about by the 'public law' approach to ITL. It added the public law paradigm to the private law approach that dominated the investment regime at the beginning.[44] Secondly, a new generation of IIAs expressly requires tribunals to balance investor's interests with other values such as health, safety, labour standards or public welfare.[45] Thirdly, the *zeitgeist* now animates arguments that the world has 'reached or perhaps passed the peak of globalisation and trade liberalisation'.[46] The 2008 global financial crisis also inspired a rethink of the space needed for regulatory flexibility.

The concept of legitimate expectations is strongly associated with stability and change.[47] The need to strike a fair balance between these two interests is at the concept's core.[48] However, even the more detailed IIAs do not provide guidance as to *how* that balance should be struck. Tribunals are called here to make value judgements.[49] These decisions show what is considered to be legitimately expected and worthy of protection by ITL.

The balancing is influenced by the tribunals' perceptions about how ITL should operate. With regard to legitimate expectations these perceptions have a crucial impact on the way in which the risk will be allocated between the investor and the State. This is generally reflected in the assessment of legitimacy of investor's expectations.[50] More specifically, it is visible in the concept of investment conditions

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[43] Roberts (n 18) 91; Brigitte Stern, 'The Future International Investment Law: A Balance Between the Protection of Investors and the States' Capacity to Regulate' in Alvarez JE et al (eds), *The Evolving International Investment Regime: Expectations , Realities, Options* (Oxford University Press 2011) 192; Schill (n 19) 69.

[44] Wälde (n 18) 60-61; Gus van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press 2007); Santiago Montt, *State Liability in Investment Treaty Arbitration. Global Constitutional and Administrative Law in the BIT Generation* (Hart Publishing 2008); Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010); Roberts (n 18) 78 et seq.

[45] Roberts (n 18) 80; Suzanne A Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13 JIEL 1037.

[46] Gabrielle Kaufmann-Kohler, 'Arbitral Precedent: Dream, Necessity or Excuse? The 2006 Freshfields Lecture' (2007) 23 Arb Intl 357, 378.

[47] UNCTAD (n 12) 63; Kläger (n 12) 169-186; Newcombe & Paradell (n 1) 278-279.

[48] Yost (n 2) 49; Trevor Zeyl, 'Charting the Wrong Course: The Doctrine of Legitimate Expectations in Investment Treaty Law' (2011) 49 Alta.L.Rev. 203, 235; Potestà (n 2) 122.

[49] Spears (n 45) 1071-1072.

[50] See Chapter 7, Section D.1-2.

'offered' or 'represented' to the investor by the host State[51] and in the approaches to invalidation of State acts tainted by illegality (*ultra vires* situations).[52]

The term 'legitimate expectations' has three meanings reflecting different approaches to the issue of balancing. First, it can mean expectations of a foreign investor that require balancing with the interests of the host States. These are 'legitimate expectations-weak sense' that identify one side of the balancing process but not its outcome.[53] Secondly, 'legitimate expectations' may indicate investor's interests that prevail over the host State's interest. This approach is based on a circular logic that State actions frustrating expectations are inherently arbitrary and therefore in breach of an IIA. These 'expectations-strong sense' can be abused to shift the balance towards foreign investors.[54] In fact, they do not involve any balancing at all. Lastly, 'legitimate expectations' may refer to the outcome of the balancing between the interests of investors and host States.

The comparative analysis can suggest solutions to the question of balancing and elucidate the role of the concept of legitimate expectations in this mechanism. It can suggest more specific factors that could be included in this balancing process to strengthen the persuasiveness and therefore fairness and justice of the process and its results.[55] To this attention now turns.

D. The Comparative Method: Persuasiveness through Broad Comparative Approach - General Observations

This section explains the comparative law methodology in international law. The next section focuses on the details of methodology used in this thesis.

The comparative law method is often used to explore and develop national laws. It is approached more cautiously in international law.[56] The comparative approach helps to understand new concepts and to address novel problems. It allows for an enquiry

[51] See Chapter 7, Section D.3.

[52] See Chapter 8, Section D.4.

[53] Montt (n 44) 222.

[54] ibid 222-223.

[55] Schill (n 19) 88.

[56] Valentina Vadi, 'Critical Comparisons: The Role of Comparative Law in Investment Treaty Arbitration (2010-2011) 39 Denv.J.Int'l L.& Pol'y 67, 79; William E Butler, 'Introduction' in Butler WE (ed), *International Law in Comparative Perspective* (Sijthoff & Noordhoff 1980) 1, 1; David Kennedy, 'The Methods and the Politics' in Legrand P, Munday R (eds), *Comparative Legal Studies: Traditions and Transitions* (Cambridge University Press 2003) 348-349.

into the legal systems that have already grappled with similar questions.[57] International law is no stranger to analogies. This is how it developed. Borrowing from other law regimes has always been practiced by international courts and tribunals. Over time, as the system matured, guidelines have been introduced to channel the use of analogies.[58] The two main formal channels for comparative analogies in international law are the principle of systemic integration[59] and the concept of 'general principles of law'[60], which is one of the sources of international law.[61]

The principle of systemic integration belongs to the general rule of treaty interpretation and mandates the interpreter to take into account together with the context of a treaty 'any relevant rules of international law applicable in the relations between the parties'.[62] Its goal is to prevent development of international law into specialist regimes existing as isolated compartments, using conflicting rules and threatening the quality and coherence of international law as a whole.[63] This threat is connected with the phenomenon of fragmentation.[64]

The concept of 'general principles of law recognised by civilized nations' is one of the most doctrinally divisive concepts in international law.[65] It aims to introduce an objective criterion concerning the sources the tribunals can use in resorting to comparative analogies.[66]

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[57] Vadi (n 56) 77; Roberts (n 18) 47.

[58] Hersch Lauterpacht, *Private Sources and Analogies of International Law (With Special Reference to International Arbitration)* (Longmans, Green and Co. Ltd. 1927); Georg Schwarzenberger, 'The Inductive Approach to International Law' (1947) 60 Harv.L.R. 593; James Crawford, *Brownlie's Principles of Public International Law* (8th edn, Oxford University Press 2012) 35; HC Gutterige, 'Comparative Law and the Law of Nations' in Butler WE (ed), *International Law in Comparative Perspective* (Sijthoff & Noordhoff 1980) 13.

[59] Article 31(3)(c) of the Vienna Convention on the Law of Treaties ('VCLT').

[60] Article 38(1)(c) of the Statute of the ICJ (the 'ICJ Statute').

[61] Zweigert & Kötz (n 3) 7-8; Gutterige (n 58) 13, 16.

[62] Article 31(3)(c) of the VCLT.

[63] Campbell McLachlan, 'The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention' (2005) 54 ICLQ 279, 284.

[64] See Chapter 2, Section B.

[65] Butler (n 56) 7. See generally: Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (Stevens & Sons 1953). For summary of diverse scholarly positions see: VD Degan, *Sources of International Law* (Martinus Nijhoff Publishers 1997) 14-19.

[66] Gutterige (n 58) 16, 21.

The principle of systemic integration and the general principles of law do not instruct tribunals how to use comparative analogies.[67] They provide a general guidance. A tribunal introducing a gap-filling, concept inspired by comparative analogies it can do so only after careful consideration. The comparative solution needs to satisfy the demands for justice and equity that underlie the operation of international law.[68] The aim of comparative analogies is also to maintain or increase coherence of international law as a whole.[69]

In applying legal comparisons international tribunals use their creative function in a subtle way:

> An international tribunal chooses, edits and adapts elements from other developed systems. The result is a body of international law the content of which has been influenced by domestic law but which is still its own creation.[70]

The tribunals' discretion in applying legal comparisons is subject to the general limits of their powers of adjudication, namely the perceptions of persuasiveness, objectivity and absence of abuse.[71] The process of using comparative analogies is subject to the general validating mechanism described in Chapter 2.[72]

The choice of comparators presents a problem for developing an international law concept by recourse to national legal systems. It affects general principles of law. Although its reference to the 'standard of civilisation' is nowadays discredited[73], it is construed as referring to principles common to 'advanced' or 'principal' legal systems of the world.[74] The ICJ judges represent 'the main forms of civilization and of the principal legal systems of the world'.[75] This may enable the ICJ to identify a general principle of law. However, this mechanism is not available for investment tribunals. They consist of one or three arbitrators whose selection is unrelated to the legal system they represent. Commentators argue that the threshold of

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[67] Lauterpacht (n 58) ix; Gutterige (n 58) 16; Crawford (n 58) 35.

[68] Gutterige (n 58) 16, 21; Zweigert & Kötz (n 3) 8; Lauterpacht (n 58) xi; Lowe (n 23) 216, 220; Dolzer, 'New Foundations' (n 5) 578.

[69] Crawford (n 70) 35; Lowe (n 25) 216.

[70] Crawford (n 58) 35.

[71] See Chapter 2, Section C; Vadi (n 60) 96.

[72] See Chapter 2, Section B.

[73] Degan (n 65) 68-69.

[74] ibid 70; Schill (n 19) 92; Wälde (n 18) 102.

[75] Article 9 of the ICJ Statute.

representativeness can be reached by comparing common and civil law legal systems because they constitute the legal traditions that have influenced most national legal systems.[76] However, although the choice of comparators is important, it is the qualitative rather than quantitative analysis that matters.[77]

Neither the choice of comparators nor their analysis is neutral. It involves elements of policy-making.[78] The purpose of comparative analysis influences the choice of comparators [79] and the choice of comparators influences the results of the comparative exercise.[80] Some comparative choices are therefore controversial.[81]

References to analogies are a common feature in ITL. They are used by investment tribunals to remedy the limited utility of the VCLT to treaty interpretation. [82] References to a broad variety of legal regimes in search of analogies and comparisons arise from the hybrid nature of the investment treaty regime. The *sui generis* convergence of these analogies by investment tribunals influences the development of the system and informs its emerging identity.[83]

This thesis is by no means the first attempt at a comparative approach to the concept of legitimate expectations. However, past experiences do not create a coherent whole that could serve as a springboard for further analysis. Three issues make the choice of the comparative methodology difficult: the comparisons had different goals; they were based on different understandings of the concept of legitimate expectations and they concentrated on a variety of aspects of the concept.

As to differences in goals of comparative analysis, the most frequent of these is the critical assessment of the practice of investment tribunals. They are criticised for applying the concept of legitimate more broadly and less clearly than other legal systems[84] and that they accord less deference to the States' sovereign powers than

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[76] Schill (n 19) 92-93; Snodgrass (n 2) 29-30; Dolzer (n 13) 60-61. Yost ((n 2) 37-38) is sceptical towards such approach.

[77] Schill (n 19) 93.

[78] Dolzer, 'New Foundations' (n 5) 578.

[79] Schill (n 19) 90.

[80] Vadi (n 56) 84.

[81] One commentator observed that references to national laws with regard to expropriation of alien property revealed 'ideological predilections' (Crawford (n 58) 36). See e.g. Dolzer, 'New Foundations' (n 5) 582; Wälde & Kolo (n 13) 821-824; Wälde (n 18) 102-103.

[82] Vadi (n 56) 89-94; Roberts (n 18) 51-52. See Chapter 2, Section C.

[83] Roberts (n 18) 92-93.

[84] Fietta (n 2) 379; Pandya & Moody (n 2) 1.

other legal systems.[85] Another goal is to show that protection of legitimate expectations is a general principle of law.[86] Yet another is to differentiate between references to legitimate expectations under indirect expropriation and the FET standard.[87] Sometimes the comparison does not have a specific goal, concentrating simply on highlighting differences and similarities.[88]

The differences in understanding of the concept of legitimate expectations reflect lack of coherence as to its meaning. Some commentators approach the concept as a *principle of protection* of legitimate expectations[89] while others as legitimate expectations of stable and predictable legal and administrative framework.[90] Different understandings of legitimate expectations may sometimes be confused. Mairal analyses protection of legitimate expectations arising from informal administrative representations but concludes by referring to legitimate expectations based on State's commitments in IIAs.[91]

Commentators concentrate on a various aspects of this widespread concept. Some concentrate on expectations arising from administrative representations[92]; others research a broader notion of government conduct as a source of expectations[93]; still others focus on expectations related to deprivation of property rights.[94] A number of commentators use the comparative perspective to argue that investment tribunals should be more cautious in balancing investor's legitimate expectations with host State's right to govern and regulate.[95]

No single comparative methodology emerges from the previous approaches to the concept of legitimate expectations. This reflects general absence of such set methodology in international law. The methodology used may be placed on a sliding scale. On the one hand analogies are introduced without much explanation.[96]

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[85] Zeyl (n 48) 234-235; Potestà (n 2) 122.

[86] Snodgrass (n 2); Brown (n 5).

[87] Fietta (n 2) 376-378.

[88] Mairal (n 5) 449-452.

[89] Snodgrass (n 2) 31; Brown (n 5) 9.

[90] Zeyl (n 48) 207-208.

[91] Mairal (n 5) 415, 418, 451.

[92] ibid; Fietta (n 2) 376-377.

[93] Snodgrass (n 2).

[94] Fietta (n 2) 378.

[95] ibid 3; Zeyl (n 48) 235; Potestà (n 2) 122.

[96] Pandya & Moody (n 2) 1.

Commentators may merely acknowledge 'apparent similarities' and 'clear parallels'[97] between concepts used by investment tribunals and those found in other legal systems. Others select legal systems on a functional basis. Here, they are often guided by recognition that the role of investment tribunals is similar to that of administrative or constitutional judicial review.[98] Many commentators assume that there is a single concept of legitimate expectations which investment tribunals are tapping into[99], which presumably legitimises borrowing from other legal systems.

At the top of this sliding scale is the argument that the concept of legitimate expectations is a general principle of law as understood under Article 38(1)(c) of the ICJ Statute.[100] While some commentators attempt to provide evidence that such general principle exists[101], others assume its existence[102], while yet others are inconclusive.[103] Some commentators admit that, even if a general principle of legitimate expectations exists, it may only be an 'emerging' one, the precise scope or content of which is still developing.[104]

In theory, recognition that 'protection of legitimate expectations' is a general principle of law would have an impact on the development of international investment law. Such a general principle would be treated as a source of law and therefore be directly *applicable* in the process of interpretation. It would validate a more specific approach to the concept.[105] This approach, if successful, would have an advantage over using simple analogies, which can slow down the development of the law by introducing many competing analogies.[106]

Snodgrass argued that the principle of protection of legitimate expectations *is* a general principle of law.[107] By defining it as a 'principle of protection' she narrowed

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[97] Fietta (n 2) 376-378.

[98] Fietta (n 2) 376; *Thunderbird*/Wälde, para. 27.

[99] Dolzer, 'New Developments' (n 5) 78; Mairal (n 5) 413; Zeyl (n 48).

[100] Snodgrass (n 2); Mairal (n 5) 415.

[101] Snodgrass (n 2); Brown (n 5); Potestà (n 2) 98.

[102] Mairal (n 5) 415; Zeyl (n 48) 204-205.

[103] Yost (n 2) 36-39; André von Walter, 'The Investor's Expectations in International Investment Arbitration' in Reinisch A, Knahr C (eds), *International Investment Law in Context* (Eleven International Publishing 2008) 197-198; Dolzer, 'New Developments' (n 5) 78.

[104] Brown (n 5) 9; Potestà (n 2) 98.

[105] Snodgrass (n 2) 11.

[106] Roberts (n 18) 52.

[107] Snodgrass (n 2).

her investigation to specific points of the operation of the concept. Such approach provides an 'attractive intellectual framework' offering a detailed synthesis of a number of legal systems that could be further refined and developed in practice.[108] It ignores without explanation the other approaches to legitimate expectations used in ITL/ITA. Moreover, it attempts to prove the existence of *a rule of law* rather than *a general principle of law*. Perhaps for these reasons Snodgrass' proposition has not been adopted in practice.

Previous comparative analyses mention a plethora of different legal regimes that use references to legitimate expectations. They include national laws of Argentina, Australia, Belgium, Brazil, Canada, Chile, Colombia, Denmark, England, Germany, Greece, Italy, New Zealand, the Netherlands, Scotland, South Africa, Switzerland, USA, and Venezuela.[109] They also include public international law[110] and in the practice of international and supra-national courts and tribunals, such as the Court of Justice of the European Union ('ECJ') and the General Court (referred to jointly as the 'EU Courts')[111], the European Court of Human Rights ('ECtHR')[112], the panels and the Appellate Body operating under the General Agreement on Tariffs and Trade ('GATT') within the World Trade Organisation ('WTO') [113] , the World Bank Administrative Tribunal[114], the Administrative Tribunal of the International Labour Organisation.[115] These legal regimes are often invoked to show the geographical scope of the concept of legitimate expectations. Only a number of them have been researched in more depth. [116] However, they set a direction for constructing comparative methodology for this thesis, to which we now turn.

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[108] ibid 3-4.

[109] Francisco Orrego Vicuña, 'Of Contracts and Treaties in the Global Market' (2004) 8 Max Planck Yrbk UN L 341, 355-356; Fietta (n 2) 376-378; Snodgrass (n 2) 26-28; Yost (n 2) 36; Mairal (n 5) 417-419; Zeyl (n 48) 211-216; Potestà (n 2) 94-98; *Thunderbird*/Wälde, para. 28. See also *Total,* para. 128.

[110] Brown (n 5) 1-2; See also *Total,* paras. 131-134.

[111] Fietta (n 2) 376-377; Snodgrass (n 2) 26; Brown (n 5) 4; Yost (n 2) 36; Mairal (n 5) 417; Zeyl (n 48) 216; Potestà (n 2) 94-95; *Thunderbird*/Wälde, para. 27. See also *Total,* para. 130.

[112] Brown (n 5) 6; *Thunderbird*/Wälde, para. 27; Dolzer, 'New Developments' (n 5) 78. See also *Total*, para. 124.

[113] Brown (n 5) 7; *Thunderbird*/Wälde, para. 29.

[114] Vicuña (n 109) 356.

[115] Brown (n 5) 7.

[116] Snodgrass (n 2); Mairal (n 5); Potestà (n 2).

E. Methodology of This Thesis: Choice of Comparators, Sources

As indicated in section B, the goals of this analysis will be achieved by analysing foundations, constitutive elements and operation of the concept of legitimate expectations in a comparative light. Consequently, the comparators used in this analysis should constitute a representative and manageable set of legal regimes. These must be regimes capable of supporting argumentation that is relevant and persuasive for ITL.

This requires selection directed not merely at the use of a label of 'legitimate expectations'. It needs to take into account similarities among the various regimes as well as critique that may influence the persuasiveness of arguments in ITL. Apart from national law regimes it needs to include international law regimes, to ensure that investment tribunals proceed in harmony with international law as a whole.

This analysis employs concepts from eight legal systems: (1) the US law concept of investment-backed expectations; the concepts of legitimate expectations used in (2) English law and in (3) Australian law; the concepts of legitimate expectations used in (4) EU law and in (5) the jurisprudence of the ECtHR; the concept of legitimate expectations used in (6) general public international law as well as in (7) the specialised international law regime concerning trade – WTO law and, finally (8) the concept of legitimate expectations used in ITL.

These legal perspectives on the concept of legitimate expectations represent diverse paradigms relevant for the development of ITL. The public law paradigm of national laws includes administrative judicial review (English law, Australian law, EU law) and constitutional judicial review (EU law and US law). The public international law paradigm is represented by general international law, WTO law and the ECHR as specialised international law regimes, and EU law as a *sui generis* supra-national legal regime.[117] These paradigms represent various frameworks for understanding of ITL on a macro level, i.e. as a system.[118] They often compete with one another leading to conceptual disagreements between commentators and arbitrators. The concept of legitimate expectations is a good example of such clashes.[119] A

[117] Roberts describes this paradigm as comprising of international law regimes concerning State's right to regulate and act at a national level but does not include the EU law within it (Roberts (n 18) 46).

[118] ibid 46.

[119] Splits within tribunals on the use of the concept of legitimate expectations were clearly articulated in e.g. *Thunderbird*/Wälde; *Suez, Sociedad General de Aguas de Barcelona*

comparative analysis reveals the foundations of such clashes. It thus contributes to the regime's maturation by allowing for a more informed use of the various approaches.

An important connecting factor between the European approach to legitimate expectations, represented by English law, EU law and the jurisprudence of the ECtHR, is their reference to the German law concept of *Vertrauensschutz*.[120] *Vertrauensschutz* is the German language equivalent of the English phrase 'legitimate expectations'. The exploration of concept of legitimate expectations is aided by the German language monograph by Müller – a source not explored in this context so far.[121]

One criterion informing the selection of comparators for this analysis is frequency with which a given legal regime is cited by counsel, tribunals and commentators.[122] This limits the number of legal systems referring to the concept of legitimate expectations to those that are most relevant to ITL. Of a large number of legal systems referred to by commentators, the ones most frequently analysed in greater detail are English law, EU law and US law. An important counterweight to US law is provided by the ECtHR jurisprudence, which also concerns property protection but represents a European perspective, while an important counterweight to English law is provided by Australian law, where strong arguments were made against substantive protection of legitimate expectations.

Cultural factors also influence the selection of comparators. The phrases 'legitimate expectations' and 'investment-backed expectations' are terms of art undefined in ITL. The way in which counsel and arbitrator understand and approach these concepts will be informed by the use of these concepts in the legal systems familiar to a given

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S.A. and InterAgua Servicios Integrales del Agua S.A. v Argentina, ICSID Case No. ARB/03/17, Separate Opinion of Arbitrator Pedro Nikken [*Suez/InterAgua*/Nikken]; *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A. v Argentina*, ICSID Case No. ARB/03/19 and *AWG Group v Argentina*, UNCITRAL, Separate Opinion of Arbitrator Pedro Nikken [*Suez/Vivendi*/Nikken]; *Lemire v Ukraine*, ICSID Case No. ARB/06/18, Dissenting Opinion of Arbitrator Dr. Jürgen Voss of 1 March 2011 and *Merrill & Ring Forestry L.P. v The Government of Canada*, UNCITRAL, Award of 31 March 2010 [*Merrill*], paras. 233, 242.

[120] See Chapter 3, Section C.1; Chapter 4, Sections B.1 and C.1. See also *Thunderbird*/Wälde, para. 27; Stephan Schill, 'Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law' in Schill SW (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 165; Dolzer, 'New Foundations' (n 5) 579-580.

[121] Jorg P Müller, *Vertrauensschutz im Völkerrecht* (Carl Heymanns Verlag KG 1971).

[122] Wälde (n 18) 103, 110.

practitioner.[123] Indirect evidence indicates a strong influence of common law.[124] In ITA counsel and arbitrators most often have a background in US and English law. US and British nationals are respectively the first and the third most frequently appointed arbitrators by nationality.[125] Moreover, many arbitrators of different nationality were trained and practice in England or in a legal system rooted in common law, such as Australia or Bangladesh. The same applies to counsel. A survey of investment treaty cases active in 2013 reveals that in almost 80% at least one party was represented by a US or a London-based law firm or counsel.[126]

As noted above, no selection of comparators is neutral. The selection for the purposes of this thesis follows the public law and public international law paradigms. As a result, it can be viewed as falling within the public law approach conceptualising ITA as judicial review.[127] However, we do not insist that a 'pure' public law approach is the correct approach to ITL. Rather, the focus here is on presenting the concept of legitimate expectations in a broader perspective to clarify its use by investment tribunals so far and influence its more persuasive use in the future. This may mean conscious and open acceptance as well as rejection of certain aspects of the concept resulting from this comparative analysis.

The analysis that follows is based on qualitative research. Its primary sources are mainly decisions and awards of relevant courts, tribunals and other dispute settlement bodies. These are: awards of investment tribunals in ITL/ITA context; reports of GATT/WTO panels and the Appellate Body; decisions of the EU Courts and opinions of Advocates-General in the EU context; decisions of the ECtHR in the ECHR context and decisions of the US Supreme Court and the English and

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[123] Roberts (n 18) 56.

[124] Direct evidence is limited partly due to minimal public access to pleadings. A survey among arbitrators and counsel would also be of limited utility since the the other legal systems inspire instinctive understandings rather than express transplants.

[125] ICSID Caseload – Statistics (Issue 2013-2) July 2013, p. 20 <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement133> accessed 16 April 2014.

[126] Survey of data available in the Investment Treaty Arbitration database (<http://italaw.com/> accessed 16 April 2014) shows that in 38 disputes (35.2%) both parties were so represented and in 48 disputes (44.4%) at least one party was so represented. In some cases the parties were represented by more than one law firm and/or counsel of which some were London- or US-based and some were based in other countries (e.g. France or Canada). Only in 22 cases (20.4%) none of the party was represented by a London- or US-based law firm or counsel.

[127] van Harten (n 44), Montt (n 44), Schill (n 44).

Australian courts in the national law contexts. Other primary sources play less important role. However, references will be made to the US Constitution, the ECHR, the GATT and to IIAs. Primary sources are less prominent in the context of general public international law because there legitimate expectations are a doctrine-based rather than a judge-made concept.

There is no official centralised reporting mechanism for investment awards. The awards and case materials[128] are available from a number of overlapping sources. Awards issued in ICSID arbitrations[129] are available on the ICSID website[130], although full texts of awards are published only with the parties' consent.[131] A consolidated database on NAFTA awards and case materials[132] is provided in the NAFTA Claims database[133] and on the websites of individual NAFTA parties.[134] A publicly accessible database of investment treaty awards and case materials is compiled in the ITA database[135], while a parallel Investment Claims subscription-only database is provided by Oxford University Press.[136]

English law cases are available in the publicly accessible database provided by British and Irish Legal Information Institute ('BAILII')[137] and Australian law cases in an analogous database provided by Australasian Legal Information Institute

[128] With some exceptions (notably NAFTA (North American Free Trade Agreement) and CAFTA-DR (Dominican Republic – Central America Free Trade Agreement)) case materials, i.e. submissions, correspondence, hearing transcripts as well as tribunals' orders and awards, are not publicly available.

[129] See Chapter 2, Section B.

[130] <https://icsid.worldbank.org/> (all databases mentioned below accessed 16 April 2014).

[131] However, absent such consent ICSID is obliged to 'promptly include in its publications excerpts of the legal reasoning of the Tribunal'. See the Article 48(5) of the Washington Convention and Rule 48(4) of the ICSID Arbitration Rules.

[132] In NAFTA arbitration there is generally 'public access to documents submitted to, or issued by, Chapter Eleven tribunals' (NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, 31 July 2001, Section 1).

[133] <http://www.naftalaw.org/>.

[134] For cases filed against Canada: website of the Department of Foreign Affairs, Trade and Development <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx>, for cases filed against the USA: website of the U.S. Department of State <http://www.state.gov/s/l/c3741.htm>, for cases filed against Mexico: website of <http://www.economia.gob.mx/comunidad-negocios/comercio-exterior/solucion-controversias/inversionista-estado>.

[135] <http://www.italaw.com/>.

[136] <http://oxia.ouplaw.com/>.

[137] <http://www.bailii.org/>.

('AustLII').[138] US Supreme Court cases are available through the US Supreme Court Library of the HeinOnline database.[139] Judgements of the European Courts and the ECtHR are available in publicly accessible internet-based databases: the Curia[140] and the HUDOC[141] respectively. The reports of GATT/WTO panels and the Appellate Body are available in the WTO-administered database.[142] The ICJ website provides access to the judgements of the PCIJ and ICJ.[143]

The secondary research sources include scholarly writings (articles, commentaries, treatises) commenting on and evaluating specific decisions of dispute settlement bodies as well as writings developing more general doctrinal threads of the concept of legitimate expectations and investment-backed expectations. These sources were obtained from various libraries[144] and electronic databases.[145] Another group of secondary sources are reports prepared by international organisations involved in the development of international law and international investment law. Such reports, summaries of existing practice, analyses and policy suggestions are regularly prepared by the United Nations Commission of Trade and Development ('UNCTAD') and the Organisation for Economic Co-operation and Development ('OECD') and are available on their respective websites.[146] Materials relating to the work of the International Law Commission ('ILC') can be found on its website.[147]

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[138] <http://www.austlii.edu.au/>.

[139] <http://heinonline.org>.

[140] <http://curia.europa.eu/jcms/jcms/j_6/>.

[141] <http://hudoc.echr.coe.int/sites/eng/Pages/search.aspx#>.

[142] <http://www.wto.org/english/tratop_e/dispu_e/find_dispu_cases_e.htm#results>.

[143] <http://www.icj-cij.org/pcij/index.php?p1=9 (PCIJ), http://www.icj-cij.org/docket/index.php?p1=3> (ICJ).

[144] In particular the libraries of the School of Oriental and African Studies, London School of Economics and the British Library.

[145] In particular: Cambridge Journals Online <http://journals.cambridge.org/>, Dawsonera <https://www.dawsonera.com/>, HeinOnline <http://heinonline.org>, JSTOR <http://www.jstor.org/> and Oxford Journals Online <http://www.oxfordjournals.org/>.

[146] <http://unctad.org/en/pages/DIAE/International%20Investment%20Agreements%20(IIA)/International-Investment-Agreements-(IIAs).aspx> (UNCTAD); <http://www.oecd.org/daf/inv/investment-policy/oecdworkoninternationalinvestmentlaw.htm> (OECD).

[147] <http://www.un.org/law/ilc/>.

F. Thesis Outline

This introductory chapter presented a working understanding of the concept of legitimate expectations, the main thesis of this work and the key research questions. It also described the goals and explained the methodology of the following comparative analysis.

Chapter two presents the structural context of ITL/ITA. It explains the mechanism through which ITL and the concept of legitimate expectations develop. It shows why the comparative approach to legitimate expectations is necessary for further authoritative and persuasive development of ITL.

Chapter three is divided into two sections and concerns the origins and development of the concept of legitimate expectations in Anglo-American legal systems, namely US constitutional law, English law and Australian law. It focuses on the concept of 'reasonable investment-backed expectations' used in the US doctrine of regulatory takings and on the concept of 'legitimate expectations' used judicial review in England and Australia. Each section ends with system-specific conclusions and the chapter ends with a summary of findings relevant for the concept of protection of legitimate expectations in ITL.

Chapter four is divided into two sections and concerns international and supra-national legal regimes. Section one looks into EU law and the concept of legitimate expectations used by the EU Courts. Section two looks at the jurisprudence of the ECtHR under Article 1 of Protocol 1 to the ECHR ('P 1/1'). ECtHR uses the concept of legitimate expectations here in the area of property protection. Each section ends with system-specific conclusions and the chapter concludes with a general summary.

Chapter five looks at how the concept of legitimate expectations is understood and applied in general international law. It is divided into sections exploring different references to legitimate expectations: in the context of the binding nature of international law, estoppel, unilateral declarations and treaty interpretation. This latter topic is explored through the approach taken in WTO law. The chapter looks at how the GATT/WTO panels and the Appellate Body used the concept of legitimate expectations to interpret the GATT.

Chapters six and seven focus on the concept of legitimate expectations in investment treaty law. Chapter six analyses the development of the concept of protection of investors' expectations in the context of indirect expropriation while

chapter seven looks at the concept of legitimate expectations in the context of the FET standard.

Chapter eight presents the assessment of the comparative contribution of the legal systems analysed in chapters three to five have to the development of the concept of protection of legitimate expectations in ITL. Can they help clarify and consolidate the concept of protection of legitimate expectations in this latter area of law? Could they offer solutions or improvements for the balancing of expectations of investors with the host State's right to regulate in the public interest?

Chapter nine summarises the findings of this comparative exercise by way of conclusions. It makes recommendations for future use of the concept of legitimate expectations by investment tribunals and treaty drafters and suggests areas of further research.

Chapter 2 Investment Treaty Law ('ITL') as a Developing Legal Order: Structural Context of the Comparative Analysis

A. Introduction

ITL is a developing legal regime. Its structure and operation have specific characteristics and pose novel questions requiring creativity in developing answers. The concept of legitimate expectations has played a significant role in this creative process, especially with regard to the FET standard. The ITA practice shows the need to resort to analogies and comparisons with other legal systems in support of proposed solutions. Analogies are also needed to understand and discipline references to legitimate expectations. Investment tribunals are the main engine of the new regime's development. Their authority, and the legitimacy of the developing regime, depends on whether their function is exercised within its inherent limits and responsibilities.

This chapter commences by presenting the structure of the legal regime of ITL/ITA. It then sketches the mechanism of its operation and development, in particular the role played by investment tribunals. Finally, it discusses the problems of this process and shows how the concept of legitimate expectations fits within this broader picture. It concludes by discussing the question why comparative evaluation of the concept of legitimate expectations may contribute to the development of ITL.

B. Key Characteristics of ITL: A Nascent Legal Regime Developing through Interpretation of Vague Treaty Standards

ITL is a nascent legal regime.[148] Its foundations were laid by the mid-1960s' with the first bilateral investment treaties ('BITs')[149] and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Washington Convention). However, for almost three decades thereafter these treaties were of

[148] Andrea Bjorklund, 'Investment Treaty Arbitral Decisions as *Jurisprudence Constante*' (2008) US Davis Legal Studies Research Paper Series, Research Paper No. 158 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1319834> (accessed 16 April 2014) 277; Roberts (n 18) 49.

[149] The first BIT was the 1959 Pakistan – Germany Treaty for the Promotion and Protection of Investments. In the 1970s and 1980s they became part of economic policy of major capital-exporting States (UNCTAD and ICC, *Bilateral Investment Treaties 1959-1991* (United Nations 1992) Sales No. E.92.II.A.16, p. 2).

limited practical importance.[150] Nothing akin to an international investment law regime existed in the minds of courts and commentators. In 1970 the ICJ noted absence of generally accepted international rules on the consequences of unlawful acts committed by host States against foreign investors.[151] The area was mired in 'an intense conflict of systems and interests'[152], resulting in profound disagreements about the content of substantive international law rules.[153] Leading international relations scholars likened a specialised international regime on foreign investment to a 'perpetual motion machine':

> most people would like one for their own purposes; no one has ever built one; and discussions about their construction often take on a certain air of unreality.[154]

Everything changed in the last decade of the 20th century. The end of the Cold War brought a widespread embrace of the liberal market economy, privatisation, deregulation and opening to foreign investment.[155] Increased volumes of foreign direct investment ('FDI') and competition to attract foreign investors meant that for many States the regulation of FDI shifted from the national to the international law level.[156] The 'age of optimism'[157] of the 1990s was marked by belief in the power of globalisation and international law. This resulted in a Cambrian explosion in the number of signed IIAs. Throughout the 1990's it quadrupled from 440 in 1991[158] to

[150] At the end of 1980s, with 265 BITs concluded globally, they were still a 'limited phenomenon' (UNCTC, *Bilateral Investment Treaties* (United Nations 1988) Sales No. E.88.II.A.1, p. 72).

[151] *Case Concerning the Barcelona Traction, Light and Power Company, Limited,* Judgement, ICJ Reports 1970 [*Barcelona Traction case*], p. 88-89.

[152] ibid. 89.

[153] In 1964 in *Sabbatino* the U.S. Supreme Court observed that "There are few if any issues in international law today on which opinion seems to be so divided as the limitations on state's power to expropriate the property of aliens." (*Banco Nacional de Cuba v Sabbatino, Receiver, et al.*, 376 U.S. 398 428-429)

[154] Robert O Keohane, Van Doom Ooms, 'The Multinational Firm and International Regulation' (1975) 29 Int'l Org 169, 169.

[155] van Harten (n 44) 39-40.

[156] UNCTAD, *Trends in International Investment Agreements: An Overview: UNCTAD Series on International Investment Agreements* (United Nations 1999) Sales No. E.99.II.D.23, p. 10; Wälde (n 18) 78.

[157] Gideon Rachman, *Zero-Sum World*. *Politics, Power and Prosperity after the Crash* (Atlantic 2010).

[158] UNCTAD & ICC (n 149) 3.

1,857 in 1999.[159] It then almost doubled again, reaching 3,196 IIAs by the end of 2012.[160] Accessions to the Washington Convention also grew from the 1990s onwards.[161] These treaties created a skeleton of the nascent international legal regime on foreign investment. They are a good example of the international law phenomenon of fragmentation, defined as:

> the emergence of specialized and (relatively) autonomous rules or rule-complexes, legal institutions and spheres of legal practice.[162]

The number of IIAs, which are predominantly bilateral, determines one feature of the emerging regime – the atomised character of its main building blocks.[163] The wording of the treaties is standardised but not identical.[164] In practice they are approached as referring to overarching concepts. These atomised treaties, applied by *ad hoc* tribunals, are developing into a legal regime, resisting 'the temptation of extreme compartmentalization'.[165] Another feature of the IIAs is vagueness of their wording. They are drafted at a considerable level of generality, are often far from clear and open to a range of interpretations.[166] This is also the feature of the substantive treaty provisions that are of interest to our analysis, namely the FET standard and indirect expropriation. They represent general treatment standards rather than specific legal

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[159] UNCTAD, *Bilateral Investment Treaties 1959-1999* (United Nations 2000) Doc. No. UNCTAD/ITE/IIA/2, p. 1< http://unctad.org/en/Docs/poiteiiad2.en.pdf> (accessed 16 April 2014).

[160] UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and Trade for Development* (United Nations 2013) Sales No. E.13.II.D.5, p. 101.

[161] van Harten (n 44) 27.

[162] ILC, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the Study Group of the International Law Commission Finalized by Martii Koskenniemi*, 13 April 2006, A/CN.4/L.682, para. 8.

[163] For this reason some commentators treat as 'overreaching' a suggestion that the treaties might form a 'system' (Bjorklund (n 148) 270).

[164] Peter Muchlinski, 'The Framework of Investment Protection: The Content of BITs' in Sauvant KP, Sachs LE (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009) 38; Newcombe & Paradell (n 1) 1; van Harten (n 44) 27-28; UNCTAD, *International Investment Rule-Making: Stocktaking, Challenges and the Way Forward: UNCTAD Series on International Investment Policies for Development* (United Nations 2008) Sales No. E.08.II.D.1, p. 43; Douglas, Zachary, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) 74 B.Y.B.I.L. 151 159.

[165] Campbell McLachlan, 'Investment Treaties and General International Law' (2008) 57 ICLQ 361 378. See also van Harten (n 44) 28; Kenneth J Vandevelde, 'A Unified Theory of Fair and Equitable Treatment' (2010) 43 N.Y.U. J. Int'l L. & Pol. 43, 47-48; Roberts (n 18) 52; UNCTAD (ibid) 2, 62; Vadi (n 56) 88; Schill (n 19) 94-96.

[166] Bjorklund (n 148) 269; van Harten (n 44) 5.

rules[167], being a result of a political compromise between States.[168] The vagueness of IIAs lies at the heart of the problems with the regime's development.[169]

Other key characteristics of ITL concern its enforcement mechanism. Most IIAs nowadays stipulate that claims relating to compliance by States with their treaty obligations vis-à-vis foreign investors are subject to arbitration.[170] The 'epochal' feature of ITA is the ability of private parties, namely foreign investors, to bring claims directly against those States. These claims may trigger international law responsibly of the host State and are brought before international tribunals.[171] No intermediation of the investor's home State is required, unlike under the older system of diplomatic protection.[172] Another 'revolutionary'[173] element of the regime is that disputes are decided by arbitral tribunals independent from the States – parties to an IIA. Investors can bring treaty claims regardless of any contractual relationship between them and the host States. Here, the mechanism also differs from international commercial arbitration which requires existence of an arbitration agreement between the parties to the dispute.[174]

Most IIAs refer to the International Centre for Settlement of Investment Disputes ('ICSID'), based on the Washington Convention, as the arbitration mechanism.[175] ICSID arbitration has been tailor-made for the resolution of investor-State disputes, although originally not for ITA.[176] It uses as a template commercial arbitration and is

[167] Anthea Roberts, 'Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States' (2010) 104 AJIL 179, 190; Newcombe & Paradell (n 1) 91-92; Wälde (n 18) 95.

[168] Toby Landau, 'Reasons for Reasons: The Tribunal's Duty in Investor-State Arbitration' (2009) 14 ICCA Congress Series: *50 Years of the New York Convention: ICCA International Arbitration Conference* (Kluwer Law International 2009) 195.

[169] UNCTAD (n 12) (with regard to the FET standard).

[170] This became permanent feature of IIAs in the 1990s (van Harten (n 44) 26).

[171] Jan Paulsson, 'Arbitration without Privity' (1995) 10 ICSID Rev. 232, 256; van Harten (n 44) 97; Stephan, W Schill, 'International Investment Law and Comparative Public Law – an Introduction' in Schill SW (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 13.

[172] van Harten (n 44) 6, 9.

[173] ibid 95.

[174] Paulsson (n 171) 233; Wälde (n 18) 59-60; van Harten (n 44) 62-66.

[175] Sornarajah (n 8) 306.

[176] Wälde (n 18) 57 (the Convention was drafted under the presumption that disputes will be based on arbitration clauses included in contracts or national laws on foreign investment).

based on the premise of 'depoliticisation'.[177] The rationale underlying this design was to limit, by contrast with diplomatic protection, State control over the dispute settlement process.[178] ICSID emphasises its independence from the political influences of the host and home States.[179] The private adjudication paradigm means that tribunals consist of 'privately contracted adjudicators' and the ability to review the award once it is rendered is limited.[180] The reason for adopting these novel solutions was to increase confidence in the enforceability of IIAs.[181]

On a 'macro' scale the nascent regime has its own rules and an enforcement mechanism. It is a new and specialised type of law that seeks to address a particular issue, namely the phenomenon of foreign investment.[182] This does not mean that the regime appeared on the map of the fragmented international law fully formed. Rather, it is still 'new and undertheorised', subject to rapid changes and mired by stark divisions concerning its effectiveness and operation.[183]

The fundamental unresolved questions concern, among others, the precise object and purpose of the regime, its relationship to the CIL rules on the treatment of aliens, and the content of its core substantive rules and principles. Because of the early stage and the intensity of its development, its mechanism, to which we now turn, is material for our analysis.

International investment law grows from the root of the highly controversial CIL on protection of aliens.[184] The arrival of BITs meant a 'treatification' of this area[185] that 'starv[ed] custom of independent progressive development'.[186] IIAs are nowadays the main building blocks of international investment law. They are the main point of

[177] Ibrahim F I Shihata, 'Towards a Greater Depolitization of Investment Disputes: The Roles of ICSID and MIGA (1986) 1 ICSID Rev. 1.

[178] Schill (n 171) 13.

[179] Wälde (n 18) 80.

[180] van Harten (n 44) 5; Schill (n 171) 13; Wälde (n 18) 116.

[181] Roberts (n 167) 183.

[182] ILC, *Fragmentation* (n 162) para. 15.

[183] Roberts (n 18) 46, 48-49.

[184] Samuel K B Asante, 'International Law and Foreign Investment: A Reappraisal' (1988) 37 ICLQ 588.

[185] Jeswald W Salacuse, 'The Treatification of International Investment Law' (2007) NAFTA Rev. 155.

[186] McLachlan (n 165) 365.

reference for investment tribunals in adjudicating international law disputes between investors and host States.[187]

However, ITL is only '*in theory* primarily based on treaties'.[188] The main engine of its development are decisions of investment tribunals.[189] This is a consequence of the regime's early stage of development.[190] Tribunals operate in a novel environment where the treaty wording is vague and CIL related to this area is controversial. The standards set out the stage for a broad range of arguments by the parties to a treaty dispute. Under the FET standard the key legal issue is whether the facts of a particular case show fair and equitable or unfair and inequitable treatment of a foreign investor. With regard to indirect expropriation the question is whether a particular regulation is a legitimate regulation or an undue interference with an investment. Characterisation of the facts is crucial and the parties present competing conceptions of a given standard. The tribunal's role is to decide which conception applies to the facts before it.[191]

The early tribunals were looking into 'a void, untouched by those who have the authority to make the law'.[192] The 'first generation' of IIAs provided little assistance in approaching the vague treaty standards. There was an acute need for clarity which the tribunals, as authorised decision-makers, had to satisfy.[193] They have a broad discretion to shape the substantive content of treaty protections and methodology of its application.[194]

The tribunals' discretion is often directed towards 'disputes concerning the legality of state conduct in the regulatory sphere'.[195] It also gives them great power over how the host States exercise their sovereign powers. Most investment disputes concern

[187] Salacuse (n 211) 157.

[188] Wälde (n 18) 44 (emphasis added).

[189] ibid 44; Landau (n 168) 198; Roberts (n 18) 62.

[190] Kaufmann-Kohler (n 46) 375; Gabrielle Kaufmann-Kohler, 'Is Consistency a Myth?' in Gaillard E, Banfatemi Y (eds), *Precedent in International Arbitration* (Juris Publishing 2008) 144; Bjorklund (n 148) 277.

[191] ibid 81; Wälde (n 18) 95.

[192] Jan Paulsson, 'International Arbitration and the Generation of Legal Norms: Treaty Arbitration and International Law' (2006) 13 ICCA Congress Series: *International Arbitration 2006: Back to Basics?* (Kluwer Law International 2007) 886.

[193] Thomas M Franck, *The Power of Legitimacy Among Nations* (Oxford University Press 1990) Chapter 4.

[194] Landau (n 168) 195; Wälde (n 18) 46, 48; van Harten (n 44) 123; Schill (n 171) 13; Bjorklund (n 148) 269.

[195] van Harten (n 44) 101.

regulatory issues, which are a novel subject-matter for an international tribunal. No such disputes could have been brought before onto such forum before.[196] As a result, by resolving those disputes investment awards influence the limits of host State's sovereign regulatory powers.[197]

This function of investment tribunals inspired the public law approach to ITL.[198] According to this approach

> Investment arbitration … is essentially a form of *international judicial review* of governmental (regulatory, administrative and, at times, fiscal) action, although it uses the forms of commercial arbitration.[199]

The public law paradigm is one of many competing for the primacy in theorising ITL/ITA.[200] The public law and the commercial arbitration approaches are the two most important ones. The commercial arbitration approach views ITA as based on equality of arms between the parties to the dispute.[201] The role of investment tribunals is limited to the resolution of a dispute between the parties.[202] The public law approach, as well as public international law approach, is based on the deference to the State, treating States as superior to private actors.[203] The role of tribunals reaches beyond resolution of a specific dispute into the development of ITL.[204] This thesis follows the public international law paradigm in describing the mechanism of development of ITL. Such approach is not seriously contested in practice. More controversially, the public law paradigm is based on the premise that host State's sovereign powers cannot be unduly constrained and the State must retain some flexibility to regulate in the interest of public welfare.[205]

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[196] McLachlan (n 165) 376; van Harten (n 44) 96.

[197] ibid 67, 81; Schill (n 171) 14.

[198] See van Harten (n 44); David Schneiderman, *Constitutionalizing Economic Globalization* (Cambridge University Press 2008); Schill (n 44).

[199] Emphasis added. Wälde (n 14) 389; Thomas Wälde, 'Investment Arbitration under Energy Charter Treaty: An Overview of Selected Key Issues based on Recent Litigation Experience' in Horn N, Kröll SM (eds), *Arbitrating Foreign Investment Disputes. Procedural and Substantive Legal Aspects* (Kluwer Law International 2004) 211.

[200] See generally Roberts (n 18).

[201] ibid 55; Wälde (n 18) 54.

[202] Roberts (n 18) 61-62.

[203] ibid 55.

[204] ibid 62.

[205] ibid 67.

The insistence on the public law paradigm was a reaction to the early practice of investment tribunals. It had a specific goal of influencing the theorisation of investment treaty regime.[206] It is important not to conflate it with the public international law paradigm, since they focus on relationships between unequal and equal parties respectively.[207]

The development of ITL/ITA engages a number of different actors.[208] They participate in a broad mechanism of validation of ITA awards, which has been summarised as follows:

> The actual compilation of a generally accepted set of standards will be an accretive process developed little by little as tribunals make decisions in individual cases, and as those decisions are tested by other tribunals, by publicists and international organisations, and by the states themselves.[209]

This 'testing' legitimises the concretisation of vague treaty standards as well as the process and methodology through which this is achieved.[210] The actors of this legitimisation include not only the parties to the dispute, their counsel and arbitral tribunals. They also include: scholars, intergovernmental and non-governmental organisations who compile and comment on the previous cases, and identify 'lines of jurisprudence'; and States, as parties to the IIAs rather than respondents in the disputes, who refine the wording of IIAs, issue interpretative statements and make their opinions known otherwise, or even withdraw from the regime altogether.[211] Legitimisation leads to the 'natural selection' of 'good' and 'bad' awards[212], consolidation of a *de facto* precedent system and articulation of increasingly specific principles.[213] The broad spectrum of actors also means that the power to develop the

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[206] ibid 63.

[207] ibid 64-64.

[208] Peter Muchlinski, Comments in: 'Transcript from Memorial Symposium for Professor Thomas Wälde. Roundtable on the Question of Convergence in International Law' in Weiler T, Baetens F (eds), *New Directions in Interaitonal Economic Law. In Memoriam Thomas Wälde* (Martinus Nijhoff Publishers 2011) 566; Roberts (n 167) 189.

[209] Bjorklund (n 148) 280; see also Franck (n 193) 61; Wälde (n 18) 46.

[210] Franck (n 193) 61

[211] Bjorklund (n 148) 275; Roberts (n 167) 190-194.

[212] Jan Paulsson, 'The Role of Precedent in Investment Arbitration' in Yannaca-Small K (ed), *Arbitration under International Investment Agreements: A Guide to Key Issues* (Oxford University Press 2010) 711; Bjorklund (n 148) 276.

[213] Vaughan Lowe, 'Fair and Equitable Treatment in International Law. Remarks by Vaughan Lowe' (2006) 100 ASIL PROC. 69 73.

legal discourse on these complex issues goes beyond to the tribunals to other experts at an international level.[214]

C. Dealing with Indeterminate Treaty Standards: Methods and Limits

The crucial role for investment tribunals is to clarify the of vague treaty provisions. A legitimate system must consist of rules that 'communicate what conduct is permitted and what conduct is out of bounds'.[215] Such clarity increases compliance of the treaty parties who know what is expected of them.[216] The process of clarification progresses on a case-by-case basis[217] and is on-going. To be successful it needs to bring about a legal order that is coherent, consistent, stable and predictable.[218] Although some commentators optimistically state that the ITL is developing in a predictable and consistent manner[219], this development also attracts considerable criticism.[220]

The process of clarification of the broad IIAs standards rests on two pillars, treaty interpretation and references to past awards, to which we now turn.

Treaty interpretation is the primary methodology employed by tribunals.[221] Treaties are creatures of international law and their interpretation and operation is based on

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[214] Muchlinski (n 208) 562.

[215] Franck (n 193) 57.

[216] ibid 52.

[217] Dolzer, 'Impact of Investment Treaties' (n 5) 962.

[218] Kaufmann-Kohler (n 46) 374; Landau (n 168) 198.

[219] Kaufmann-Kohler, (n 49) 317.

[220] Landau (n 168) 198-199; UNCTAD (n 12) 12 and (n 185) 105-107.

[221] See generally on: (a) treaty interpretation: Richard K Gardiner, *Treaty Interpretation* (Oxford University Press 2008); Orakhelashvili (n 24); Hersch Lauterpacht 'Restrictive Interpretation and The Principle of Effectiveness in the Interpretation of Treaties' (1949) 26 B.Y.B.I.L. 48; Richard A Falk, 'On Treaty Interpretation and the New Haven Approach: Achievements and Prospects' (1968) 8 Va.J.Int'l L. 323; (b) treaty interpretation in investment treaty context: J Romesh Weeramantry, *Treaty Interpretation in Investment Arbitration* (Oxford University Press 2012); Thomas Wälde, 'Interpreting Investment Treaties: Experiences and Examples' in C Binder et al, *International Investment Law for the 21st Century, Essays in Honour of Christoph Schreuer* (Oxford University Press 2009); Wälde (n 18); Christoph Schreuer, 'International Investment Law and General International Law – From Clinical Isolation to Systemic Integration? Comments by Christoph Schreuer' in in Hofmann R, Tams CJ (eds), *International Investment Law and General International Law – From Clinical Isolation to Systemic Integration?* (Nomos 2011); Kläger (n 12) 38-46, 89-112; Mahnoush H Arsanjani, W Michael Reisman, 'Interpreting Treaties for the Benefit of Third Parties: The "Salvors' Doctrine" and the Use of Legislative History in Investment Treaties' (2010) 104 AJIL 597.

the rules of international law.[222] Consequently, a tribunal resolving treaty a claim must first resort to international law.[223] The VCLT provides that treaties are 'governed by international law'[224] and should be interpreted in accordance with the general rule of interpretation set out in Articles 31-33 of the VCLT.

The first point of reference for investment tribunals is Article 31(1) of the VCLT[225] which provides that

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

Next, Article 31(3)(c) calls the interpreter to take into account 'any relevant rules of international law applicable in the relations between the parties'. The interpreter should take into account any agreements or other instruments relating to the treaty made between the treaty parties, their subsequent practice and any special meaning given by the parties to the terms of the treaty.[226] Preparatory work and the circumstances in which the treaty was concluded can be considered as supplementary means of interpretation.[227]

Despite initial hesitation investment tribunals accepted the role of treaty interpretation and the VCLT in applying IIAs.[228] In practice, Article 31(1) of the VCLT turned out to be of limited utility.[229] Similarly, non-textual and subsidiary means of interpretation are either unavailable or are also of limited usefulness.[230] Tribunals

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[222] Yas Bonfratemi, 'The Law Applicable in Investment Treaty Arbitration' in Yannaca-Small K (ed), *Arbitration under International Investment Law. A Guide to Key Issues* (Oxford University Press 2010) 208; Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press 2009) 81; Newcombe & Paradell (n 1) 77; Wälde (n 18) 95.

[223] Wälde (n 18) 94; Dolzer, 'FET: A Key Standard' (n 5) 92.

[224] Article 2(1)(a) of the VCLT.

[225] McLachlan (n 165) 371-372; Schreuer (n 221) 1.

[226] Article 31(2)-(4) of the VCLT.

[227] Article 32 of the VCLT.

[228] Tarcisio Gazzini, 'Bilateral Investment Treaties' in Gazzini T, De Brabandere E (eds), *International Investment Law: The Sources of Rights and Obligations* (Martinus Nijhoff Publishers 2012) 119-120; Newcombe & Paradell (n 1) 110; Wälde (n 18) 95; McLachlan (n 165) 371.

[229] Roberts (n 18) 50-51; Schreuer (n 221) 1; Wälde (n 18) 95.

[230] Kläger (n 12) 46; McLachlan (n 165) 372. Here, the notable exception is NAFTA which utilises the mechanism of interpretative statements. On ways in which States can influence interpretation by utilising Article 31(3)(a) and (b) of the VCLT see Roberts (n 167).

struggle to interpret the vague treaty standards and to identify the treaties' object and purpose.

The treaty standards, and IIAs in general, are formulated in very vague terms. The general principle of treaty interpretation can only take the tribunals so far in their concretisation and application.[231] The VCLT assumes that it is possible to find an interpretation based on literal and contextual considerations by reference to the object and purpose of a treaty.[232] This assumption is problematic for IIAs. Textual interpretation of the 'fair and equitable treatment' ends up being 'a little more than an exchange of synonyms'.[233] The language of IIAs consists largely of terms of art. Relying on dictionary definitions is not very helpful in decoding them and may even be counter-productive.[234]

Text-based approach to interpretation also causes problems in decoding the object and purpose of IIAs.[235] The practice exposes a rift between two major approaches.[236] According to one, the main purpose of the IIAs is promotion and protection of foreign investments as an end in itself.[237] It mandates creation of an investment-friendly climate to encourage capital flows.[238] Investment treaties merely redress the balance between States and investors. Without a treaty the investor would be at the mercy of the State which has the power to create and abolish rights and thus 'holds most of the high cards'.[239] This led some tribunals to equate the FET standard with the host State's obligation to maintain a stable environment for investment[240] and to interpret

[231] Dolzer, 'Impact of Investment Treaties' (n 5) 962; Gazzini (n 228) 121; Newcombe & Paradell (n 1) 111.

[232] Gazzini (n 228) 120; Kläger (n 12) 45-46.

[233] McLachlan (n 165) 371.

[234] Zachary Douglas, 'The MFN Clause in Investment Arbitration: Treaty Interpretation Off the Rails' (2011) 2 JIDS 97 99, 101; Roberts (n 18) 50; Dolzer, 'FET: A Key Standard' (n 5) 92.

[235] Roberts (n 18) 51; Wälde (n 18) 111.

[236] Stern mentions an approach favouring the interest of the host State but such approach is rare in practice (Stern (n 43) 191).

[237] Newcombe & Paradell (n 1) 115-116 view such approach as 'defensible'.

[238] Rudolf Dolzer, 'Fair and Equitable Treatment in International Law, Remarks by Rudolf Dolzer' (2006) 100 ASIL PROC. 72.

[239] Lowe (n 213) 73-74. See also Wälde (n 18) 106-107.

[240] Newcombe & Paradell (n 1) 113-114.

ambiguities in a treaty in favour of foreign investors.[241] This approach is criticised for overly favouring foreign investors.[242]

The other approach requires close scrutiny of the treaty object and purpose and a balanced approach to treaty interpretation.[243] The application of IIAs should leave more flexibility to host States than allowed the first proposition. The balanced approach can be interpreted out of treaty preambles referring to economic development and cooperation.[244] It can also be adopted regardless of the specific text of a treaty preamble[245] because it is indispensable for the long-term survival of ITL. A regime that overly favours foreign investors may discourage treaty parties from admitting investments in the first place.[246]

The second key method of developing ITL are references to past ITA awards. From the end of the 1990s the number of ITA awards grew steeply. Within two decades from the first award[247], at the end of 2012, the regime saw 514 publicly known ITA disputes.[248] They generated a significant number of awards, decisions and orders that contributed greatly to the development of ITL. References to previous awards are found in virtually every investment award and are the tribunals' preferred method of supporting their decisions.[249] Such method is generally acceptable, even though there is no doctrine of binding precedent in ITL.[250] References to previous awards

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[241] *SGS v Philippines*, para. 166; Wälde (n 18) 107-108.

[242] Lowe (n 14) 455; Schreuer (n 221) 2; Kläger (n 12) 45; Orakhelashvili (n 24) 564.

[243] McLachlan (n 165) 371.

[244] Schreuer (n 221) 2; Kläger (n 12) 45; *Saluka Investments BV v The Czech Republic*, UNCITRAL, Partial Award of 17 March 2006, paras. 299-300.

[245] Stern (n 43) 192; Roberts (n 18) 50-51.

[246] *Saluka,* para. 300.

[247] *Asian Agricultural Products Ltd. (AAPL) v Sri Lanka*, ICSID Case No. ARB/87/3, Final Award of 27 June 1990 [*AAPL*]. At the end of 1990s commentators often noted absence of disputes and decisions in the area. (see e.g. ILC, *The Legal Conditions of Capital Investment and Agreements Pertaining Thereto by Mr. Mohamed Bennouna*, *Outlines Prepared by Members of the Commission on Selected Topics of Intenational Law, Yearbook of the International Law Commission* (1993) U.N.Y.B.I.L.C. Vol. II(1) pp. 209, 211; Thomas Wälde, 'International Law of Foreign Investment: Towards Regulation by Multilateral Treaties' (1999) Bus Law Int'l 50, 52; Vasciannie (n 12) 163; UNCTAD (n 156) 47.

[248] UNCTAD (n 160) 110.

[249] J Romesh Weeramantry, 'The Future Role of Past Awards in Investment Arbitration' (2010) 25 ICSID Rev. 111, 115; Ole Kristian Fauchald, 'The Legal Reasoning of ICSID Tribunals - An Empirical Analysis' (2008) 19 EJIL 301.

[250] Newcombe & Paradell (n 1) 58-59, 102-105; Kaufmann-Kohler (n 46) 357; Bjorklund (n 148) 277; Landau (n 168) 199; Roberts (n 18) 53, 62; Wälde (n 18) 54; Dolzer, 'FET: A

reflect the inevitability of using analogies in a situation, described above, in which tribunals as decision-makers find themselves.[251] These references contribute to the creation of a body of rules more coherent than would have otherwise existed given the atomised and *ad hoc* nature of the regime.

However, the results of employing these two methods are not free from controversy. The main complaints address inconsistency and quality of tribunals' decisions.

Awards of investment tribunals attract considerable criticism for being inconsistent. This concerns situations when in largely the same factual circumstances various tribunals arrive at diametrically opposite results with regard to important substantive or procedural issues.[252]

Inconsistency is often justified. A decision in every dispute depends on a number of factors, namely: the facts of the case, the evidence provided, the wording of a given IIA, the arguments presented by the parties, and the particular constellation of arbitrators in a tribunal.[253] Given the scope for variations, to paraphrase Muchlinski, if the tribunals were speaking with one voice, they would be doing administration, not law.[254] The key to resolving the problem of inconsistent decisions is a persuasive justification of a divergent approach based on critical evaluation of previous decisions.[255]

The requirements of consistency, coherence and clarity attach predominantly to the tribunals' methodology, i.e. the process by which they reach decisions in individual cases.[256] To strengthen their authority and enhance legitimacy of the developing legal order, the tribunals must 'function in accordance with ascertainable principles of

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Key Standard' (n 5) 92; Vadi (n 56) 88. Specifically on the issue of precedent in ITL see e.g. Paulsson (n 77); Kaufmann-Kohler (n 46); Bjorklund (n 148); Weeramantry (n 249); Christoph Schreuer, Matthew Weiniger, 'Conversations Across Cases – Is There a Doctrine of Precedent in Investment Arbitration?' in Muchlinski P, Ortino F, Schreuer C (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008).

[251] Lowe (n 23) 214; Roberts (n 18) 50.

[252] van Harten (n 44) 7-8; Wälde (n 18) 115; Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing International Law through Inconsistent Decisions' (2005) 73 Fordham L Rev 1521.

[253] Paulsson (n 212) 701; Weeramantry (n 249) 120-121.

[254] Muchlinski (n 208) 566.

[255] Newcombe & Paradell (n 1) 59-60, 106; Landau (n 168) 198. But see Kaufmann-Kohler (n 190) 376-377.

[256] Kaufmann-Kohler (n 46) 376; Franck (n 193) 61.

right process' that are common to all participants of the regime.[257] Such legitimate methodology cannot be 'discovered' but develops on a case-by-case basis.

Consistent methodology helps to secure a more predictable operation of the legal order. This predictability contributes to the order's credibility and strengthens the confidence of its users.[258] Clarification of investment treaty standards by way of well-reasoned awards arrived at through consistent and acceptable methodology is most likely to have a 'powerful pull to compliance'.[259]

This takes us to the quality of tribunals' reasoning, which is the second point of critique of the regime's development. The quality of awards is considered insufficient for the purposes of the regime.[260] The role of tribunals as law-developers requires that their awards create, as well as respect, an 'authoritative and persuasive precedent'.[261] However, they do not disclose the reasons that led them to decide the dispute in a particular way.[262]Tribunals rely on previous awards uncritically[263] and reveal very little of the thinking behind their decisions.[264] This is perceived as a prerequisite for the regime's evolution in a wrong direction.[265]

Tribunals must issue well-reasoned awards to avoid perceptions negatively impacting on their authority and enhance the convergence of ITL. A four-point methodology may be of assistance in this respect. First, tribunals need to explain why they relied on certain awards, distinguished others and found yet others unconvincing.[266] Secondly, they must carefully and fully explain how they took into account the legal and factual positions presented by the parties and why they arrived at a particular resolution of their dispute.[267] Thirdly, tribunals should adequately

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[257] Franck (n 193) 64-65; Muchlinski (n 208) 566.

[258] Kaufmann-Kohler (n 46) 378.

[259] Franck (n 193) 64.

[260] Landau (n 168) 188, 196-197.

[261] Wälde (n 18) 116.

[262] On this issue see e.g. Lord Bingham, 'Reasons and Reasons for Reasons: Differences Between a Court Judgement and an Arbitral Award' (1988) 4 Arb Intl 141; Landau (n 168); Pierre Lalive, 'On the Reasoning of International Arbitral Awards' (2010) 1 JIDS 55.

[263] Newcombe & Paradell (n 1) 104-105.

[264] Landau (n 168) 202-203; Lalive (n 262) 57.

[265] Newcombe & Paradell (n 1) 104-105; Bjorklund (n 148) 277.

[266] Paulsson (n 212) 700; Bjorklund (n 148) 273, 277; Landau (n 168) 200.

[267] Landau (n 168) 197; Lalive (n 262) 57, 64; *Industria Nacional de Alimentos, S.A. and Indalsa Peru, S.A. v The Republic of Peru,* ICSID Case No. ARB/03/4, Decision on

explain what they were doing in the interpretative process.[268] This must include the whole series of steps in the logical chain that led the tribunal to apply the treaty in the circumstances of a particular case, showing its diligent and systematic application of the VCLT.[269] Lastly, the tribunals must remember that their reasoning is taken into account in future disputes and future scholarly critique. The reasoning should thus be 'clear and straightforward' and avoid unnecessary *obiter* comments.[270]

How far can the tribunals go in exercising their broad powers? Their discretion is not delineated by bright lines. However, there are important guideposts the tribunals must be mindful of.

First, tribunals are not law-makers but decision-makers, even though, when understood literally, such a division is a fiction.[271] The traditional view of international law is that only States can *create* international law, while courts and tribunals only *interpret* and *apply* it.[272] Investment tribunals' quasi-legislative function is a functional necessity.[273] ITA awards, even without the system of precedent, are perceived as evidence of the content of ITL.[274] However, tribunals need to operate within the confines of a given treaty and avoid a *perception* that they create the law rather than apply it. They cannot abuse their powers e.g. by deliberately or drastically misreading the intention of the treaty parties.[275] As observed by Lauterpacht:

> The law-creating autonomy and independence of judicial activity may be an unavoidable and beneficent necessity. But they are so only on condition that the judge does not consciously and deliberately usurp the function of legislation.[276]

Secondly, tribunals operate within the rules of treaty interpretation. The VCLT does not provide a mechanical test that could allow them to arrive at a 'correct'

Annulment of 5 September 2007, Dissenting Opinion of Sir Franklin Berman, paras. 14-15.

[268] *Industria Nacional*, paras. 6.

[269] *Industria Nacional*, paras. 12, 14.

[270] Landau (n 168) 200; Lalive (n 262) 64; Wälde (n 18) 114.

[271] Roberts (n 167) 188; Lauterpacht (n 221) 80; Paulsson (n 192) 881.

[272] Lauterpacht (n 221) 73-74; Roberts (n 167) 188.

[273] Douglas (n 234) 99.

[274] Roberts (n 167) 188; Roberts (n 18) 62; Frank Berman, 'Evolution or Revolution?' in Brown C, Miles K (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press 2011) 658, 662-663; Paulsson (n 212) 703; Paulsson (n 192) 881.

[275] Lauterpacht (n 221) 74, 80; Falk (n 221) 351.

[276] Lauterpacht (n 221) 83.

interpretation.[277] These are only basic[278] or guiding[279] rules, leaving considerable scope for flexibility.[280] Although in interpreting and applying the IIAs investment tribunals engage in a creative, or even experimental, activity[281], their freedom is checked by the rules of interpretation.

The preferred approach of the tribunals has been labelled as 'professional'[282], that of 'self-restraint'[283] and, perhaps most aptly, as a requirement

> to adopt such objectively justifiable and explainable decisions as would be based on legal rules and principles accepted by all parties to the legal dispute[284]

and, one should add, the parties to the IIA.[285] Quality of reasoning therefore plays a key role in explaining what the tribunals are doing and why, and why this stays within the confines of their function. The requirements with regard to such reasoning also shape the tribunals' discretion.

The architecture of the investment treaty regime *authorises* tribunals to develop this legal order and gives them a broad discretion to do so. However, it does not endow them with the *authority recognised as legitimate* by the participants of the system.[286] A well-reasoned award contributes to the persuasive application of vague treaty standards.[287] A line of such awards forms a persuasive *jurisprudence constante.*[288] The validation process influences the tribunals' authority.[289] This process is

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[277] Schreuer (n 221) 1.

[278] Duncan French, 'Treaty Interpretation and the Incorporation of Extraneous Legal Rules' (2006) 55 ICLQ 281.

[279] McLachlan (n 165) 385.

[280] Roberts (n 18) 50-51.

[281] Wälde (n 18) 46.

[282] Wälde (n 221) 745; Berman (n 313) 672.

[283] French (n 278) 283.

[284] Orakhelashvili (n 24) 196.

[285] See generally on the importantce of treaty parties in ITA: Roberts (n 167).

[286] Wälde (n 221).

[287] Bjorklund (n 148) 272, 277.

[288] Bjorklund (n 148); Kaufmann-Kohler (n 46); Landau (n 168) 200; Paulsson (n 212) 712; Wälde (n 18) 47.

[289] Franck (n 193) 61; Zachary Douglas, 'Nothing If Not Critical for Investmnt Treaty Arbitration: Occidental, Eureko and Methanex' (2006) 22 Arb. Int'l 27, 38; Bjorklund (n 148) 277.

particularly visible with regard to the concept of legitimate expectations, to which we now turn.

D. Legitimate Expectations in the Process of Development of ITL

References to legitimate expectations are an 'arbitral innovation'.[290] They developed as 'an operational method' of applying indeterminate treaty standards, in particular the FET standard.[291] Tribunals developed tools necessary to avoid the embarrassment of *non liquet* and the need to declare the FET standard 'void for vagueness'.[292]

Legitimate expectations are not referred to in investment treaties.[293] Arbitral tribunals spun the practice of referring to legitimate expectations from the *Tecmed* award. That award is an example of an early practice of operationalizing the vague treaty standards through abstract 'definitions'.[294] References to expectations were often used in such 'definitions'. In *AAPL v Sri Lanka,* the standard of full protection and security was found to include 'what should be legitimately expected to be secured for foreign investors by a reasonably well organised modern State'.[295] In *Metalclad*, deprivation of 'reasonably-to-be expected economic benefit of property' was referred to as an important element of expropriation.[296] Finally, in *Tecmed*, the tribunal pronounced that the FET standard:

> requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know

[290] UNCTAD (n 12) 9.

[291] *Suez, Sociedad General de Aguas de Barcelona S.A. and InterAgua Servicios Integrales del Agua S.A. v Argentina*, ICSID Case No. ARB/03/17, Decision on Liability of 30 July 2010 [*Suez/InterAgua*] para. 203; *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A. v Argentina*, ICSID Case No. ARB/03/19 and *AWG Group v Argentina*, UNCITRAL, Decision on Liability of 30 July 2010, para. 222.

[292] Franck (n 193) 56; Jean d'Aspremont, 'International Customary Investment Law: Story of a Paradox' in Gazzini T, De Brabandere E (eds), *International Investment Law: The Sources of Rights and Obligations* (Martinus Nijhoff Publishers 2012) 34.

[293] But see recent draft of the Comprehensive Economic and Trade Agreement between Canada and the EU (CETA), discussed in Chapter 9, Section D.

[294] Dolzer, 'FET: A Key Standard' (n 5) 93; Douglas (n 289) 27 (disapprovingly).

[295] *AAPL*, para. 77.

[296] *Metalclad Corporation v United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of 30 August 2000 [*Metalclad*], para. 103.

> beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor's ability to measure the treatment and protection awarded by the host State and to determine whether the actions of the host State conform to the fair and equitable treatment principle.[297]

Some commentators welcomed *Tecmed's* 'lengthy list of desiderata'[298] as the 'most comprehensive definition' of the standard'.[299] However, other reactions suggested that the *Tecmed* tribunal might have overstepped the mark of acceptable creativity.[300] Subsequent tribunals were more wary of using sweeping statements to define the FET standard, but were not discouraged from referring to legitimate expectations.[301]

Despite this criticism, the above passage became the centre of the web of ideas of what legitimate expectations are or should be. The critique truncated the mantra of the *Tecmed* definition to a more general reference that the FET standard requires 'treatment that does not affect the basic expectations that were taken

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[297] *Técnicas Medioambientales Tecmed, S.A. v United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award of 29 May 2003, para. 154.

[298] McLachlan (n 165) 376.

[299] Dolzer, 'FET: A Key Standard' (n 5) 95; Dolzer & Schreuer (n 13) 130.

[300] Douglas (n 289); Orakhelashvili (n 24) 261, 567-569; *MTD Equity Sdn. Bhd. & MTD Chile S.A. v The Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment of 21 March 2007 [*MTD Annulment*], para. 71.

[301] See e.g. *OKO Pankki Oyj, VTB Bank (Deutschland) AG, Sampo Bank PLC v The Republic of Estonia*, ICSID Case No. ARB/04/6, Award of 19 November 2007 [*OKO*], para. 243; *Plama Consortium Limited v Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008 [*Plama*], para. 175; *Suez/Vivendi*, para. 224; *Suez/InterAgua,* para. 205.

into account by the foreign investor to make the investment'.[302] However, this means different things to different tribunals.[303] Some require a 'conduct' that creates expectations, in particular specific representations[304], others find it sufficient that an investor had some pre-existing set of expectations formed at the time he decided to invest.[305] Some tribunals accept, or even require, the legitimate expectations to be created by contractual relations between the investor and the host State[306], while others stress that contractual expectations cannot be equated with the concept of legitimate expectations.[307]

A number of awards cultivate the broad concept of legitimate expectations from the 'definitional' approach of *Tecmed*.[308] They view legitimate expectations as covering 'such well-established fundamental standards as good faith, due process, and non-discrimination'. [309] This approach allows tribunals to subsume under the FET standard a number of different sub-standards such as non-arbitrariness,

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[302] See e.g. *Parkerings-Compagniet AS v Lithuania*, ICSID Case No. ARB/05/8, Award of 11 September 2007 [*Parkerings*], para. 330; *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Şikreti v Republic of Turkey*, ICSID Case No. ARB/02/5, Award of 19 January 2007 [*PSEG*], para. 240; *Jan de Nul N.V., Dredging International N.V. v Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Award of 6 November 2008 [*Jan de Nul*], para. 186; *Alpha Projektholding GmbH v Ukraine*, ICSID Case no. ARB/07/16, Award of 8 November 2010 [*Alpha*], para. 420; *Spyridion Roussalis v Romania*, ICSID Case No. ARB/06/1, Award of 7 December 2011 [*Roussalis*], para. 316.

[303] von Walter (n 103).

[304] *PSEG*, para. 241; *Plama,* para. 219; *EDF (Services) Limited v Romania*, ICSID Case No. ARB/05/13, Award and Dissenting Opinion of 8 October 2009 [*EDF v Romania*], para. 216; *AES Summit Generation Limited AES-Tisza Erömü Kft v The Republic of Hungary*, ICSID Case No. ARB/07/22, Award of 23 September 2010 [*AES Summit*], para. 9.3.18.

[305] See e.g. *OKO*, *Parkerings*, para. 331; *Al-Bahloul v Republic of Tajikistan*, SCC Case No. V (064/2008), Partial Award on Jurisdiction and Liability of 2 September 2009 [*Al-Bahloul*], paras. 200-202; *Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability of 14 January 2010 [*Lemire*], para. 267; *Electrabel S.A. v The Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, applicable law and liability of 30 November 2012 [*Electrabel*], paras. 7.76-78.

[306] *Metalpar S.A. and Buen Aire S.A. v Argentina*, ICSID Case No. ARB/03/5, Award on the Merits of 6 June 2008 [*Metalpar*], para. 185; *Walter Bau AG (in liquidation) v The Kingdom of Thailand*, UNCITRAL, Award of 1 July 2009, para. 12.1.

[307] *Parkerings,* para. 344; *Gustaw F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No. ARB/07/24, Award of 18 June 2010, paras. 335, 357.

[308] *Tecmed,* para. 154; *Saluka*, para.307; *Plama*, para. 176; *Kardassopoulos and Fuchs v The Republic of Georgia*, ICSID Case Nos. ARB/05/18 and ARB/07/15, Award of 3 March 2010 [*Kardassopoulos*], para. 438; *Lemire*, para. 267; *Electrabel*, para. 7.77; *Oostergetel, Laurentius v The Slovak Republic*, UNCITRAL, Final award of 23 April 2013 [*Oostergetel*], para. 222.

[309] Saluka, para. 303.

transparency, consistency, non-discrimination or stability, regardless whether they are expressly referred to in a given IIA.[310]

Similar collection of divergent ideas emerges from scholarly writings. Many commentators are descriptive rather than critical in their writings. Legitimate expectations are viewed as closely related to the requirement of transparency of the host State's legal framework[311], its stability and predictability[312], and to due process in administrative decision-making.[313] Some commentators argue that expectations may be derived from 'any form of state conduct'[314], or from broadly understood 'legal framework', representing the whole legal universe relevant to the investment.[315] Others argue that expectations only arise from specific representations made by the State to the investor.[316] Yet others suggest that legitimate expectations arise directly from investor's reliance on an IIA.[317] Some commentators state that legitimate expectations cannot be equated with vested property rights[318], while others make the opposite argument.[319] Some commentators pair legitimate expectations with the need of balancing investors' interests with the host State's regulatory flexibility[320], while others exclude such balancing from the concept.[321]

Two observations immediately spring to mind here. First, legitimate expectations are a central element of the FET standard and are habitually referred to by parties and tribunals.[322] Secondly, the concept is incoherent. Despite the fact that legitimate

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[310] Landau (n 168).

[311] Dolzer & Schreuer (n 13) 133-134.

[312] Newcombe & Paradell (n 1) 279-280.

[313] McLachlan, Shore & Weiniger (n 12) 239, 261; McLachlan (n 165) 377.

[314] Newcombe & Paradell (n 1) 280.

[315] Dolzer & Schreuer (n 13) 133.

[316] McLachlan (n 165) 377.

[317] Todd J Grierson-Weiler, Ian A Laird, 'Standards of Treatment' in Muchlinski P, Ortino, Schreuer C (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008) 275-283

[318] McLachlan, Shore, Weiniger (n 12) 239, 261; McLachlan (n 165) 377.

[319] Newcombe & Paradell (n 1) 255, 278, 280, 283.

[320] McLachlan, Shore, Weiniger (n 12) 239; UNCTAD (n 12) 77.

[321] Dolzer, 'FET: A Key Standard' (n 5) 106.

[322] Kaufmann-Kohler (n 46) 372-373; Fietta (n 2) 378, 385; *Electrabel*, para. 7.75; von Walter (n 103) 173 (frequency of references suggests that it is treated as a 'panacea for the resolution of all unresolved questions').

expectations have been invoked in virtually every FET claim after *Tecmed*, references to expectations did not reach satisfactory coherence. Reference to legitimate expectations as a 'concept', let alone a 'doctrine' or 'principle', may therefore be a *misnomer*.

References to legitimate expectations are not free from criticism. Three points of critique are highlighted below: low quality of reasoning, string citations[323] as the main engine of perpetuation and an unrealistic and all-encompassing nature of the concept.

Quality of reasoning is a perpetual problem. *Tecmed* and subsequent tribunals did not invoke any authority to support their concept of legitimate expectations.[324] Even when relying on previous awards tribunals often do not explain how and why they approached the concept of legitimate expectations. As a result, although certain more specific elements are recurring in practice, there is little explanation why they are being used and little critical evaluation of such practice. A good example is the rule that legitimate expectations must exist at the time when investment is made. It is commonly repeated by tribunals and traced back to *Tecmed*.[325] Some tribunals reject claims based on legitimate expectations based on this time element[326], and only a few were not comfortable with the rule's strictness.[327] The explanation offered for this rule is that the time of making the investment marks the point at which the investor assesses the legal and factual background for investment.[328] This argument is insufficient to explain why upsetting such expectations should be regarded as unfair and inequitable.

Similar criticism applies to many scholarly writings. As shown above, the bundle of ideas emerging from commentaries is often contradictory. It is often also

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[323] Landau (n 168) 204.

[324] Douglas (n 289) 28; Dolzer, 'FET: A Key Standard' (n 5) 96; *El Paso Energy International Company v Argentina*, ICSID Case No. ARB/03/15, Legal Opinion of M. Sornarajah [*El Paso*/Sornarajah], para. 80.

[325] See e.g. *Jan de Nul*, para. 265; *Plama*, para. 176; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Award of 27 August 2009 [*Bayindir*], para. 190; *AES Summit*, para. 9.3.8; *Frontier Petroleum Services Ltd. v The Czech Republic*, UNCITRAL, Award of 12 November 2010 [*Frontier Petroleum*], paras. 287-288; *Lemire*, para. 285; *Electrabel*, para. 7.76; *Oostergetel*, para. 209.

[326] *International Thunderbird Gaming Corporation v The United Mexican States*, UNCITRAL (NAFTA), Arbitral Award of 26 January 2006 [*Thunderbird*], para. 165.

[327] *AES Summit*, paras. 9.3.12-13; *Kardassopoulos*, paras. 439-441.

[328] *Frontier Petroleum*, para. 287; Dolzer & Schreuer (n 13) 134-135.

unsupported by detailed arguments and references to authorities. Rather, it represents a collection of arguments, competing for persuasiveness and authority.[329]

Low quality of reasoning is also related to the tribunals' use of the general rule of interpretation. The approach taken by the *Tecmed* tribunal was criticised as an abuse of this rule. The tribunal invented the intention of the treaty parties rather than read it out of the treaty. [330] That intention was effectively derived from the expectations of the foreign investor.[331] The tribunal's reference to Article 31(1) of the VCLT was therefore a fiction. [332]

Tribunals often skip this part of the interpretative process, relying instead on what has been pronounced by earlier tribunals. [333] This may suggest that by operationalizing the FET standard though legitimate expectations investment tribunals mentally eject themselves from the process of treaty interpretation and simply declare the standard in one guise or another.[334] This would remove the important barrier separating the use of creativity from its abuse. Since previous tribunals often did not base their interpretation on anything other than dictionary definitions or previous awards, this may lead to nothing more than a mechanical string citation, which is the next point we will discuss.

Investment tribunals referring to legitimate expectations have been harshly criticised for their reference to past awards. Such awards are often the only 'authority' for referring to legitimate expectations. The past awards, however, also provide no explanation of their approach. These references are therefore often little more than mechanical.[335] This practice of string citations has been criticised as an abuse of

[329] The process of drawing out of interstitial tools has been described by Lowe ((n 23) 219).

[330] Orakhelashvili (n 24) 570.

[331] *MTD Annulment*, para. 67.

[332] Wälde (n 18) 107.

[333] See e.g. *The Rompetrol Group N.V. v Romania*, ICSID Case No. ARB/06/3, Award of 6 May 2013 [*Rompetrol*], para. 197; *Oostergetel*, para. 221; *GEA Group Aktiengesellschaft v Ukraine*, ICSID Case No. ARB/08/16, Award of 31 March 2011 [*GEA*], paras. 268, 272-305; *Arif v Republic of Moldova*, ICSID Case No. ARB/11/23, Award of 8 April 2013 [*Arif*], paras. 531-539; *Parkerings,* paras. 330-333.

[334] Vandevelde (n 165) 68; Snodgrass (n 2) 58; von Walter (n 103) 199.

[335] Douglas (n 289) 28; *El Paso*/Sornarajah, para. 80; Orakhelashvili (n 24) 265.

precedent[336], 'a thoughtless application'[337], 'the magic incantation of the formula'[338] and a building of a 'house of cards'.[339]

Tribunals do not clarify the different approaches to legitimate expectations, their normative scope, character or weight.[340] They neither explain the analysis that underpins their application of the concept of legitimate expectations[341], nor provide any authority for the approach taken.[342] Tribunals often refer to previous awards representing diametrically different views of legitimate expectations, without explaining which one in particular they are relying on in their own approach.[343] Some tribunals take even more minimalist approach, supporting their pronouncements on legitimate expectations with no references at all[344] or providing no reasoning for their finding that the host State 'did not respect investor's reasonable and legitimate expectations'.[345]

The third point of criticism is that references to legitimate expectations expand the intended scope of an IIA and support an all-encompassing standard that favours interests of investors. The *Tecmed* 'definition' was criticised for providing no outer limit to the obligation of FET.[346] Such standard would require perfection 'to which all states should aspire but very few (if any) will ever attain'.[347] As such, it is unrealistic and obviously beyond the scope of what could have been

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[336] Douglas (n 289) 28.

[337] UNCTAD (n 12) 9.

[338] *El Paso*/Sornarajah, para. 80.

[339] Potestà (n 2) 90; Zeyl (n 48) 224; Christopher Campbell, 'House of Cards: The Relevance of Legitimate Expectations under Fair and Equitable Treatment Provisions in Investment Treaty Law' (2013) 30 Journal of Int'l Arb'n 361, 366-367, all referring to Roberts' (n 193) use of the phrase to generally describe the methodology use of investment tribunals.

[340] Orakhelashvili (n 24) 282; Dolzer, 'FET: A Key Standard' (n 5) 106; Snodgrass (n 2) 10, 58; Potesta (n 2) 98-90.

[341] Fietta (n 2) 375.

[342] Snodgrass (n 2) 10.

[343] See e.g. *Jan de Nul,* para. 186; *Al Bahloul*, paras. 201-202.

[344] *Rumeli Telekom A.S. and Telsim Mobil Telekomikasyon Hizmetleri A.S. v Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award of 29 July 2008 [*Rumeli*], para. 609. See also *Electrabel*, paras. 7.75-7.76.

[345] *Rumeli*, para. 615.

[346] Orakhelashvili (n 24) 570; *Suez/InterAgua/*Nikken and *Suez/Vivendi/*Nikken, paras. 2-3 (referring generally to the practice of investment tribunals since *Tecmed*).

[347] Douglas (n 289) 28; see also UNCTAD (n 12) 64-65.

intended by the treaty parties. Subsequent tribunals has been criticised for unduly favouring investors' concerns in applying the vague treaty standards.[348]

The problems troubling the development of ITL through the concept of legitimate expectations show that there are no firm guiding principles as to how references to expectations should be used in an investment treaty claim.[349] Tribunals appear to pick and choose from the uncoordinated mass of ideas in a way that most suits the case before them.[350] The choice of a convenient articulation of the concept is often made by the parties and tribunals usually uncritically follow these conceptual 'tunnels'.[351]

On a 'macro' level the aspects of awards concerning legitimate expectations often display 'a marked lack of consistency of legal analysis'.[352] Tribunals do not try to bring those ideas into a consistent and coherent whole.[353] The variety of inconsistent approaches is not converging into a specific principle, rule or doctrine. The concept is applied in a way that suggests is limitless character and applicability to any situation that the investor considers disadvantageous.[354]

The origins and operation of the various approaches to legitimate expectations are left unexplained and way in which they are used lacks consistency. As a result, decisions based on references to legitimate expectations are not convincing[355] and seen as an overstepping of the bounds of accepted creativity. This undermines the authority of investment tribunals as well as legitimacy of the developing regime as a whole.[356] The persuasiveness of what the tribunals are doing is weakened.

Tribunals are obviously not required to lay out a complete theory or doctrine of legitimate expectations. Yet the interest of the regime as a whole demands their responsibility for the precedential value of their awards and for the systemic

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[348] UNCTAD (n 12) 9, 11.

[349] Fietta (n 2) 375.

[350] See e.g. *Ulysseas, Inc. v Ecuador*, UNCITRAL, Final Award of 12 June 2012 [*Ulysseas*], para. 249.

[351] Wälde (n 18) 52-53; see e.g. *Al Bahloul*, para. 203, *Roussalis*, paras. 316-317; *GEA,* paras. 268, 271-305.

[352] Fietta (n 2) 390.

[353] ibid 375; Snodgrass (n 2) 2, 17; Pandya & Moody (n 2) 1; Potesta (n 2) 89.

[354] Orakhelashvili (n 24) 282; Snodgrass (n 20) 10; UNCTAD (n 12) 67.

[355] Orakhelashvili (n 24) 282.

[356] French ((n 278) 283) observed that improper exercise of the judicial function may 'undermin[e] the confidence of States in international justice itself.'

consistency of their methodology.[357] Application of the concept of legitimate expectations needs to provide commentators with sufficient material to analyse the tribunals' approach and develop a more coherent and complete conceptualisation of the concept.[358] The awards and scholarly writings so far do not support its consistency and predictability.

This is not to say that the disorganised patchwork of ideas on legitimate expectations is happily perpetuated. Some tribunals realise their authority is at stake when faced with claims suggesting that the claimant hoped his reference to legitimate expectations could convert a weak, or even frivolous, claim into a success.[359] They realise that if the concept is not tackled, it may allow for endless reconceptualisation of the claim, creating 'a "moving target" for a respondent' and undermine due process.[360] Tribunals are becoming more assertive in setting boundaries of what is a reflection of the concept.[361]

Resort to analogies is justified to help to address the problems that limit the development of legitimate expectations as a consistent, predictable and legitimate tool operationalizing the vague treaty standards. These analogies may be inductive[362], turning to the general international law or other branches of international law, or deductive, turning to national legal systems. Comparisons and analogies are a normal way of searching for answers to novel problems. In case of nascent legal regimes such ITL, the recourse to more established legal systems dealing with similar issues is a logical approach to problem-solving and clarification.[363] They are

[357] Wälde (n 18) 53.

[358] Lowe (n 213) 73.

[359] See e.g. *Oostergetel*, paras. 174-177; *Unglaube Marion, Unglaube Reinhart v Republic of Costa Rica*, ICSID Case Nos. ARB/08/1 and ARB/09/20, Award of 16 May 2012 [*Unglaube*], para. 250.

[360] *Arif*, para. 543.

[361] In a series of awards tribunals rejected an argument that legitimate expectations are expectations of stability: *Mobil Investments Canada Inc. & Murphy Oil Corporation v Canada*, ICSID Case No. ARB(AF)/07/4, Decision on Liability and on Principles of Quantum of 22 May 2012 [*Mobil*], para. 153; *Continental Casualty Company v Argentina*, ICSID Case No. ARB/03/9, Award of 5 September 2008 [*Continental*], para. 258; *El Paso Energy International Company v Argentina*, ICSID Case No. ARB/03/15, Award of 31 October 2011 [*El Paso*], paras. 350-352; *Metalpar,* para. 187; *Impregilo,* paras. 290-291; *Total,* paras. 115-117.

[362] On inductive and deductive reasoning in international law see: Schwarzenberger (n 58).

[363] Roberts (n 18) 46; Lowe (n 23) 214; Wälde (n 18) 109; Vadi (n 56) 77.

also an established method of developing international law.[364] Use of analogies is subject to the usual limits of the function of courts and tribunals in international law.

Investment tribunals have been referring to other legal regimes to develop ITL[365] although they are wary of using analogies openly in relation to legitimate expectations.[366] However, comparative arguments are an important element of the scholarly critique of the concept.[367] Perceptions of legitimacy depend on 'the plausibility of analogical reasoning and the persuasiveness of topical, rhetorical argument'.[368] Yet, analogical references to legitimate expectations are often insufficiently detailed or too narrow to strengthen such perceptions. As explained in chapter 1, an in-depth exploration of selected legal systems, a task undertaken in this thesis, has a greater chance of succeeding in this respect.

E. Conclusions

ITL, as a nascent legal regime, develops mainly through investment awards. Yet, the quality of awards, in particular with regard to the concept of legitimate expectations, has been criticised. Approaches suggested by investment tribunals are only to some extent converging into a coherent practice. They are viewed as not authoritative by commentators, treated as a broad and varied catalogue of available approaches by claimants, and are not followed pursuant to a predictable pattern by tribunals. A comparative approach in addressing these issues has been either shallow or limited. A more in-depth analysis may support more persuasive approaches and create solid points of reference that could propel the concept towards greater coherence.

[364] Snodgrass (n 2) 18; Silia Vöneky, 'Analogy in International Law' in Wolfrum R (ed), *Max Planck Encyclopedia of International Law* (internet ed).

[365] Vadi (n 56) 89-94; Roberts (n 18) 51-52.

[366] But see *Thunderbird/W*älde, paras. 27-29; *Total,* paras. 128-134; *Sempra Energy International v Argentine Republic*, ICSID Case No. ARB/02/16, Award of 28 September 2007 [*Sempra*]*,* para. 298.

[367] See Chapter 1, Section D.

[368] Lowe (n 23) 221.

Chapter 3 The Origins and Development of Legitimate Expectations Doctrine in Anglo-American Municipal Law

A. Introduction

This chapter looks into references to expectations in Anglo-American national legal systems. It focuses on two concepts used in the laws of the United States of America ('USA'), England and Australia that are of particular relevance to ITL. Section B looks at the US law concept of 'reasonable investment-backed expectations' ('RIBE'). This concept is used to analyse whether an impact of a regulation on private property constitutes expropriation (regulatory taking). Section C focuses on the concept of 'legitimate expectations' used in England and Australia. The concept is used there in a judicial review inquiry into whether an individual should be granted a fair hearing before his interests ('legitimate expectations') are affected by exercise of State discretion. English law extends this concept to substantive fairness, allowing the courts to find that administrative bodies should fulfil an individual's legitimate expectations in substance.

The English law concept of 'legitimate expectations' attracts greater attention than the US law concept of 'RIBE' in ITL discussions on legitimate expectations. This lesser attention is undeserved and this chapter attempts to fill this gap. Facial references to the US concept have been present in ITA/ITL from its early stages[369] and continue to this day.[370] IIAs expressly refer to RIBE and to the *Penn Central* test of which RIBE are one of the factors.[371] This chapter will also show that the relevance of RIBE for elucidation of the concept of legitimate expectations goes beyond such labelling.

[369] See e.g. Jan Paulsson, 'Investment Protection Provisions in Treaties' (2000) 19 ICC Investment Protection: La protection de l'investissement 1, 7 (suggesting that assessment of State actions under the FET standard may include 'the impact of the measure on the reasonable investment-backed expectations of the investor').

[370] See Chapter 1, Section B.

[371] See Chapter 6, Section C.

B. The US Regulatory Takings and 'Reasonable Investment-Backed Expectations' ('RIBE')

1. The Origins and Rationale of RIBE

a. Origins

The concept of RIBE is used in US federal constitutional law in the context of regulatory expropriation. According to the US Constitution:

> private property [shall not] be taken for public use without just compensation.[372]

This phrase, known as the 'Takings Clause', was initially applied only to physical takings of property.[373] This changed with the 1922 *Pennsylvania Coal* case in which the US Supreme Court ('USSC') recognised that:

> while property may be regulated to a certain extent, if regulation goes too far it will be recognised as a taking.[374]

Since then courts and commentators have been struggling to make clear when regulation 'goes too far' and constitutes a taking.[375] The initial approach focused on

[372] Part of the Fifth Amendment of the Constitution of the United States of America (the US Constitution).

[373] Thomas Ruppert, 'Reasonable Investment-Backed Expectations: Should Notice of Rising Seas Lead to Falling Expectations for Coastal Property Purchases?' (2011) 26 J.Land Use & Envtl.L. 239, 244-245; Pamela O'Connor, 'The Changing Paradigm of Property and the Framing of Regulation as a "Taking"' (2010) 36 Mon LR 50, 56; *Lucas v South Carolina Coastal Council*, 505 U.S. 1003, 1014 (1992).

[374] *Pennsylvania Coal Company v Mahon et al.,* 260 U.S. 393, 415 (1922). Jeffrey M Gaba, 'Taking 'Justice and Fairness' Seriously: Distributive Justice and the Takings Clause' (2007) 40 Creighton L.Rev. 569, 571, 573-574.

[375] *Tahoe-Sierra Preservation Council, Inc., et al. v Tahoe Regional Planning Agency* et al., 535 U.S. 302, 330 (2002); *Penn Central Transportation Co. et al. v New York City et at.,* 438 U.S. 104 (1978) at 123; *Palazzolo v Rhode Island et al.*, 533 U.S. 606, 617 (2001); Gaba (n 374) 569; Lynda J Oswald, 'Cornering the Quark: Investment-Backed Expectations and Economically Viable Uses in Takings Analysis' (1995) 70 Wash.L.Rev. 91, 96-97; David Crump, 'Takings by Regulation: How Should Courts Weigh the Balancing Factors?' (2012) 52 Santa Clara L.Rev. 1, 3; John A Kupiec, 'Returning to Principles of "Fairness and Justice": The Role of Investment-Backed Expectations in Total Regulatory Taking Claims' (2008) 49 B.C.L.Rev. 865, 870; David J Breemer, RS Radford, 'Great Expectations: Will Pallazzolo v Rhode Island Clairfy Doctrine of Investment-Backed Expectations in Regulatory Takings Law?' (2001) 9 N.Y.U.Envtl.L.J. 449, 477.

the diminution of value.[376] Another approach, suggested by Michelman[377], was to ask not 'how much' property had been taken but:

> whether or not the measure in question can easily be seen to have practically deprived the claimant of some distinctly perceived, sharply crystallized, investment-backed expectations.[378]

Michelman argued that those 'distinctly perceived, sharply crystallized, investment-backed expectations' represent 'mentally circumscribed things' which the property owner thinks he controls. Frustration of expectations by regulation inflicts on him a 'pain of acute or demoralizing kind'.[379] This, in turn, brings about 'demoralization costs'.[380]

The USSC adopted Michelman's idea of investment-backed expectations in its 1978 *Penn Central* case.[381] The USSC's takings practice is based on an *ad hoc* case-by-case approach involving various factors but lacking a coherent unifying theory.[382] The USSC eschews mechanical tests. Its approach depends on the circumstances of a particular case[383] and requires their 'careful examination and weighing'.[384] As stated in one recent case:

> we still resist the temptation to adopt per se rules in our cases involving partial regulatory takings, preferring to examine a 'number of factors' rather than a simple 'mathematically precise' formula.[385]

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[376] Leif Wenar, 'The Concept of Property and the Takings Clause' (1997) 97 Colum.L.Rev. 1923, 1929.

[377] Frank I Michelman, 'Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law' (1967) 80 Harv.L.Rev. 1165, 1165-1258. Michelman's article is regarded as a 'single most significant article on the subject' of RIBE (Joshua P Borden, 'Derailing Penn Central: A Post-Lingle, Cost-Basis Approach to Regulatory Takings' (2010) 78 Geo.Wash.L.Rev. 870, 894) and 'the cornerstone of investment-backed expectations as a legal concept' (Kupiec (n 375) 870, 878-879).

[378] Michelman (n 377) 1233.

[379] ibid 1233-1234.

[380] ibid 1214.

[381] *Penn Central,* 438 U.S. at 124. Kupiec (n 375)Radford (n 375)

[382] Gaba (n 374) 574; Crump (n 375) 21; *Penn Central,* 438 U.S. at 124.

[383] *Penn Central* 438 U.S. at 124; *Pennsylvania Coal* (260 U.S. at 416.

[384] *Palazzolo*, 533 U.S. at 636 (O'Connor J, concurring).

[385] *Tahoe-Sierra* 535 U.S. at 326. See also *Penn Central,* 438 U.S. at 124 (Brennan J) ('this Court, quite simply, has been unable to develop any "set formula"' and engaged in 'essentially ad hoc, factual inquiries') or *Lucas,* 505 U.S. 1003, 1015 (1992) ('we have generally eschewed and "set formula" for determining how far is too far').

The USSC uses a 'polestar'[386] of three factors of 'particular significance'[387] which it set out in the *Penn Central* case. This 'Penn Central test'[388] consists of: first, the economic impact of the regulation on the claimant; secondly, the extent to which the regulation has interfered with *distinct investment-backed expectations*, i.e. RIBE, inspired by Michelman's idea of expectations; and, thirdly, the character of the government action.[389]

b. Rationale

RIBE are derived from the utilitarian concept of property.[390] According to Bentham, utilitarianism's most influential contributor, property is 'nothing but a basis of expectation'.[391] An individual expects future enjoyment of the fruit of his property resulting from his investment in it. The State's role is to provide security of these expectations because absence of security discourages property owners from using their property productively.[392] This role of the State reflects the ultimate goal of utilitarianism, namely the maximisation of aggregate welfare.[393] However, the classic utilitarian theory opposed redistribution affecting security of expectations.[394] Michelman, however, accepts that redistributions are acceptable, even if they frustrate expectations. He argues that regulatory impact on property owner's expectations should be compensated only when disappointment of expectations would be 'critically demoralizing'.[395]

The above reflects the on-going US constitutional debate that informs the Takings Clause and RIBE, and concerns relations between private property and the State[396].

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[386] *Palazzollo,* 533 U.S. at 633.

[387] *Penn Central*, 438 U.S. at 124.

[388] Mark W Cordes, 'The Fairness Dimension in Takings Jurisprudence' (2010) 20 Kan.J.L.& Pub.Pol'y 1, 2. Similar names are used that suggest its 'polestar' character: 'Penn Central factors' (*Lingle, Governor of Hawaii, et al. v Chevron U.S.A. Inc.*, 544 U.S. 528, 539 (2005)), 'Penn Central analysis' (*Tahoe-Sierra,* 535 U.S. at 334; *Palazzolo,* 533 U.S. at 633 (O'Connor J, concurring)) or 'Penn Central approach' (Crump (n 375) 3).

[389] *Penn Central*, 438 U.S. at 124.

[390] Michelman (n 377) 1211-1212.

[391] Jeremy Bentham, *The Theory of Legislation* (Routledge & Kegan Paul 1950) 111-112.

[392] Michelman (n 377) 1212.

[393] ibid 1182.

[394] ibid 1212-1213.

[395] ibid 1213 (arguing that '[s]ecurity of expectations is cherished not for its own sake but only as a shield for morale.')

[396] Ruppert (n 373) 244-245.

The federalist-natural law tradition argues that 'property rights generate firm expectations entitled to judicial protection from excessive government regulation'.[397] It assumes that the main purpose of the Takings Clause is protection of property.[398] On the other hand, the republican-positivist tradition argues that property rights are inherently limited by public interest.[399] Following the former, RIBE reflect a view that the State will not interfere with proprietary expectations and will protect property rights from interference. Alternatively, RIBE may be seen as reflecting a dynamic understanding of property rights, changing over time and reflecting social concerns and values allowing for certain uses of property but prohibiting others.[400]

2. RIBE Based on Property Rules at the Time Property Is Purchased or Invested In

The concept of RIBE focuses on 'investment' as a basis of 'reasonable' expectations of a property owner.[401] Expectation has to be 'investment-backed', meaning a 'financial venture with a view of specific future use'.[402] However, the fact that an expectation is investment-backed is not sufficient to establish RIBE.[403] This requires establishing objectively what 'bundle of rights' constitutes the property in question and what expectations are linked with that property.[404] This enquiry into the relevant circumstances resembles the investigation of the 'sources' of legitimate expectations in the other legal systems analysed here. The main difference is that RIBE are expectations of property while in the other systems they usually focus on State conduct.

The 'sources' of RIBE are rooted in the law shaping the property owner's expectations concerning his property.[405] That law consists of various rules in force

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[397] Daniel R Mandelker, 'Investment-Backed Expectations in Taking Law' (1995) 27 Urb.Law. 215, 227.

[398] ibid 227-228.

[399] ibid 227.

[400] Gaba (n 374) 569.

[401] Cordes (n 388) 34; Breemer & Radford (n 375) 451.

[402] Robert M Washburn, '"Reasonable Investment-Backed Expectations" as a Factor in Defining Property Interest' (1996) 49 Wash.U.J.Urb.& Contemp.L. 63, 67.

[403] Oswald (n 375) 115.

[404] Washburn (n 402) 68; Kupiec (n 375) 883-884; Daniel R Mandelker, 'Investment-Backed Expectations: Is There a Taking?' (1987) 31 Wash.U.J.Urb.& Contemp.L. 3, 6-7.

[405] *Palazzolo,* 533 U.S. at 633 (O'Connor J (concurring).

when the owner purchases his property or invests in it.[406] It shapes the content of property rights, the permissible and protected uses of the property, as well as restrictions of those uses. It informs expectations about future benefits of the owner's investment.[407]

The USSC's description of 'property interests' in *Roth*[408] is often referred to[409] in discussions about the 'sources' of RIBE:

> Property interests … are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law – rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.[410]

However, RIBE represent a concept broader than 'property interests'.[411] They include the property owners' understandings of the State powers over his property.[412] The 'background principles'[413] shaping reasonable property expectations are rooted in statutory and common law[414], but also in other 'objective rules and customs that can be understood as reasonable by all parties involved'.[415] Equating RIBE and property interests would create circularity: an expectation would be reasonable only conforming to what the law says property is. This would enable the authorities or the courts to create or extinguish expectations at their will.[416]

The sources of RIBE thus go beyond a property interests and 'black letter' rules. RIBE are determined 'in light of the whole of our legal tradition' and set within a

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[406] Washburn (n 402) 69; Cordes (n 388) 34; *Lucas,* 505 U.S. at 1027.

[407] Cordes (n 388) 34; Washburn (n 402) 70; *Lucas*, 505 U.S. at 1017; Breemer & Radford (n 375) 480.

[408] *Board of Regents of State Colleges et al. v Roth,* 408 U.S. 564 (1972) [*Roth*].

[409] John J Delaney, Emily J Vaias, 'Recognizing Vested Development Rights as Protected Property in Fifth Amendment Due Process and Takings Claims' (1996) 49 Wash.U.J.Urb.& Contemp.L. 27, 29; *Lucas,* 505 U.S. at 1030.

[410] *Roth*, 408 U.S. at 577 (such approach is common even though *Roth* concerned 14th Amendment).

[411] Mandelker (n 397) 226.

[412] *Lucas*, 505 U.S. at 1027.

[413] ibid at 1029.

[414] ibid at 1017.

[415] ibid at 1030 (Scalia J) and 1035 (Kennedy J, concurring); Washburn (n 402) 70 (referring generally to laws, rules and regulations); Breemer & Radford (n 375) 454, 480-482 (criticising).

[416] Oswald (n 375) 108-109; Kupiec (n 375) 884; *Lucas*, 505 U.S. at 1034 (Kennedy J, concurring).

dynamic concept of property that balances private expectations to secure private investment with the State's entitlement to enact new regulation in response to changing conditions.[417] Such approach takes account of the market conditions at the time of investment and social preferences as to desirability of protection or restriction of certain uses of property.[418]

RIBE may reflect situations traditionally allowing for more State interference[419] or 'unique concerns' justifying expansion of traditional limits of State power. The specific content of proprietary expectations depends on the purpose of the relevant regulation and the subject-matter of the expectations.[420] Limitations in the use of property based on existing regulations are not regulatory takings.[421] The property owner cannot complain that existing rules are applied to him.

RIBE reflect the tension between protection of expectations of private property owners and the State's right to regulate.[422] This tension arises from uncertainty about future government regulations.[423] This is the problem of 'legal transitions', namely situations when new regulation changes the existing regulatory framework in a way negatively affecting the value of certain property.[424] Such regulatory uncertainty cannot be entirely eliminated and regulatory takings aim at allocating the risk of such uncertainty between property owners and the rest of society.[425] RIBE hold a key role in this allocation. Their mechanism rests on two opposing arguments. First, that the property owner relies on the state of the law at the time he makes his investment and, secondly, that he has the ability to foresee the regulation negatively impacting on his expectations.[426] To these arguments we now turn.

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[417] *Lucas*, 505 U.S. at 1035 (Kennedy J, concurring).

[418] Mandelker (n 397) 235-236, 230-231.

[419] *Kaiser Aetna et al. v United States,* 444 U.S. 164 (1979) (federal navigational servitude over interstate waters is traditionally viewed as not requiring compensation); Mandelker (n 397) 226 (historical governmental powers over common resources).

[420] *Lucas,* 505 U.S. at 1035 (Kennedy J, concurring) (e.g. protection of coastal areas from erosion).

[421] ibid at 1030; Washburn (n 402) 69-70.

[422] See Breemer & Radford (n 375) 519-520 (and references) for criticism of such approach.

[423] Louis Kaplow, 'An Economic Analysis of Legal Transitions' (1986) 99 Harv.L.Rev. 509, 512.

[424] Kaplow (n 423) 511-512; Mandelker (n 397) 228.

[425] Kaplow (n 423) 513.

[426] ibid 513, 520, 522; Cordes (n 388) 35; Mandelker (n 397) 232.

3. Reliance on the Law as an Argument in Favour of Protecting RIBE

a. Reasonable Reliance on Law as a Shield against Subsequent Regulatory Change

RIBE represent expectations that are more than the property owner's unilateral hope, his abstract need or belief.[427] It is argued that such expectations should be protected from subsequent regulatory changes because, when the owner invested in his property, he reasonably relied on the norms and rules shaping the allowed uses of property at that time.[428] Consequently, it would be unfair to 'change the rules of the game mid-stream'[429] in a way negatively affecting the value of his property.[430]

Certain circumstances may strengthen the above argument beyond simple reliance and increase the weight of the property owner's interests in the *Penn Central* balancing exercise. This happens when the property owner 'substantially proceeds in good faith after governmental approval of his development'.[431] In such case the subsequent regulation affects an established use of property rather than its future or potential use.[432] The next section illustrates this point with four examples.

b. Substantial Reliance: Factors Strengthening the Reliance on Law Argument

First, acquisition of property may be based on governmental assurances that the land will be available for certain development. Subsequent government conduct disregarding such assurances may constitute a taking if it is coupled with substantial economic loss for the property owner.[433]

Secondly, the property owner may have relied on specific statutory provisions allowing for certain use of property or establishing its protection. Here, expectation follows from the explicit text of the relevant law in force at the time of the property's purchase. The law may indicate that certain uses of property are approved and that it is reasonable for the property owner to rely on them to pursue his investment.[434] In

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[427] *Penn Central*, 438 U.S. at 130; Oswald (n 375) 115-116.

[428] Cordes (n 388) 34; Gaba (n 374) 589; Kaplow (n 423) 522; Mandelker (n 397) 232.

[429] Cordes (n 388) 34.

[430] ibid 34, 35; Washburn (n 402) 81.

[431] Mandelker (n 397) 237-238.

[432] ibid 232-233; Cordes (n 388) 35-36; Michelman (n 377) 1233.

[433] Cordes (n 388) 39.

[434] Washburn (n 402) 76-79.

Monsanto the relevant statute concerning submission of trade secrets in the process of registration of toxic products provided that such trade secrets will be kept confidential. Subsequent disclosure of those secrets by the authorities violated these provisions and frustrated claimant's RIBE. Given importance of the right to exclude others in protecting trade secrets, the Court found that the impact on the property required just compensation.[435]

Thirdly, the property owner might have 'sunk a lot of irretrievable investment in the project' [436] after purchasing the property and before the regulatory change. Michelman recognised such situation as a 'distinctly crystallized expectation'.[437] If a property owner already developed his land and put it to use, it means that he substantially relied on the previously existing rules. He should be protected from subsequent interference, unless his activity constitutes a nuisance.[438]

Fourthly, such substantial expenditures may be based on the property owner's good faith reliance on a formal approval of certain land development, such as a building permit. [439] In such situations the owner obtains a vested right protected from subsequent regulatory changes. Mandelker argues that the mechanism of vested rights or estoppel should be available in takings cases.[440] The law of vested rights clearly protects from subsequent regulatory changes those owners who already applied for a building permit or started a construction.[441] However, others point out that RIBE represent a broader concept than vested rights because they do not require financial investment for a finding of a regulatory taking.[442]

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[435] *Ruckelshaus, Administrator, United States Environmental Protection Agency v Monsanto Co.,* 467 U.S. 986, 1011-1013 (1984) [*Monsanto*]; Washburn (n 402) 78-79.

[436] William A Fischel, *Regulatory Takings: Law, Economics, and Politics* (Harvard University Press 1995) 50. See also Cordes (n 388) 35; Washburn (n 402) 91.

[437] Michelman (n 377) 1233; Cordes (n 388) 35.

[438] Cordes (n 388) 35.

[439] Mandelker (n 397) 236 and (n 442) 5.

[440] Mandelker (n 397) 236-237. See also Delaney & Vaias (n 409); Washburn (n 402) 90-91. The *Penn Central* test would involve a greater number of factors, including balancing with public interest.

[441] Washburn (n 402) 90-91; Mandelker (n 404) 5.

[442] Washburn (n 402) 91; *Palazzolo*, 533 U.S. at 635 (O'Connor J, concurring).

A less formal government approval may also trigger relevant substantial reliance.[443] Such expectations arose in *Kaiser Aetna*, where a developer invested to build a private marina. He was advised by relevant authorities that he did not require any permits for its development and operations. His expectations were dashed in breach of the Takings Clause when the authorities later required free public access to the marina.[444]

c. Reasonable Reliance on Law as a Regulatory Freeze

Commentators often categorically state that property owners *should* be protected from changes of the law on which they reasonably relied.[445] Such argument favours interests of property owners and 'proves too much'.[446] Taken literally, it is circular by implying that the laws, once relied upon, should never change.[447] This resonates with the classic utilitarian concept of property demanding perfect security for expectations.[448] Such suggestion of immunity from regulatory change is 'particularly perverse' because laws change frequently and such changes are often predictable.[449]

The approach attaching too much weight to the reliance argument has not been endorsed by the USSC.[450] Anyone has to accept that regulations will change, as they change all the time.[451] The question is *when* such change is unfair.[452] State of the law at the time the property was acquired is only one side of the risk allocation exercise. The other one, foreseeability of regulatory change, will be analysed now.

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[443] Michael M Berger, 'Happy Birthday, Constitution: The Supreme Court Establishes New Ground Rules for Land-Use Planning' (1988) 20 Urb.Law. 735, 766-767; Mandelker (n 397) 218.

[444] *Kaiser Aetna*, 444 U.S. at 167, 179-180; Mandelker (n 397) 218; Crump (n 375) 31.

[445] ibid 81.

[446] Cordes (n 388) 34, 35.

[447] Kaplow (n 423) 522, 524; Mandelker (n 397) 228.

[448] See Section B.1.a.

[449] Kaplow (n 423) 522.

[450] Ruppert (n 373) 255.

[451] Cordes (n 388) 35.

[452] ibid 35.

4. Foreseeability of Regulatory Change as a Factor in Establishing RIBE

a. Recognition of General Regulatory Powers of the Authorities

Reliance on the rules shaping property owner's expectations does not make him completely immune from a negative impact of future regulation.[453] Proper functioning of the State requires for such regulation.[454] If governments were required to pay for every diminution of property value caused by regulation they could hardly go on[455] and would be compelled to '*regulate by purchase.*'[456] Every regulation involves 'adjusting the benefits and burdens of economic life to promote the common good'[457] and usually burdens some persons more than others.[458] This does not mean, however, that those burdened more are to be automatically compensated.

The assessment whether regulation 'goes too far' needs to consider regulatory risk implied in property ownership.[459] Legal rules change all the time and it is a normal element of an economic life.[460] Property owner necessarily expects regulatory restrictions on his property.[461] This implied risk differs between ownership of real property and personal property. In US constitutional law land ownership has a special status. The Takings Clause reflects the 'historical compact' prohibiting the State from eliminating all economically valuable use of land. On the other hand, no such implied limitation exists with regard to personal property.[462] As a result, regulatory interference, especially with business activities, is allowed to a much greater extent with regard to personal property than with regard to land ownership.[463] Economic loss caused by regulatory changes is part of the business risk[464] and is a

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[453] ibid at 627; *Armstrong*, 364 U.S. at 48; *Penn Central,* 438 U.S. at 124-125; Cordes (n 388) 38.

[454] *Andrus, Secretary of the Interior, et al. v Allard et al.,* 444 U.S. 51, 65 (1979).

[455] *Pennsylvania Coal*, 260 U.S. at 413.

[456] *Andrus*, 444 U.S. at 65. See also *Tahoe-Sierra,* 535 U.S. at 324; *Penn Central*, 438 U.S. at 131; *Pennsylvania Coal*, 260 U.S. at 413.

[457] *Penn Central*, 438 U.S. at 124.

[458] ibid at 133-134; *Andrus*, 444 U.S. at 65.

[459] Cordes (n 388) 38.

[460] ibid 34.

[461] *Lucas*, 505 U.S. at 1027; *Pennsylvania Coal*, 260 U.S. at 413.

[462] *Lucas*, 505 U.S. at 1028.

[463] Ruppert (n 373) 257-258.

[464] *Concrete Pipe & Products of California, Inc. v Construction Laborers Pension Trust for Southern California*, 508 U.S. 602, 645 (1993); *Connolly et al., Trustees of the*

cost of 'the advantage of living and doing business in a civilized community'.[465] The State has a 'traditionally high degree of control over commercial dealings' and a business person 'ought to be aware that new regulation might even render his property economically worthless'.[466]

The above does not mean that a regulatory change can never constitute a taking. Immunity from future regulatory change is linked with its foreseeability by the property owner. Foreseeability will depend on the circumstances of a particular case, as they reflect a level of implied regulatory risk. Next sub-section discusses factors relevant for assessing foreseeability. However, none of them is generally dispositive of the *Penn Central* enquiry.

b. Examples of Situations Related to State's Regulatory Powers That May Impact on Reasonableness of RIBE

First, such implied regulatory risk may be linked with legitimate exercise of State's police powers.[467] Traditionally, police powers include regulation to protect 'health, safety, morals or general welfare'.[468] This may cover zoning laws, defining what type of development is allowed on certain land[469], or rules on preventing 'harmful or noxious uses' of property.[470] Expectations that such regulatory powers will not be used are unreasonable.[471]

Secondly, regulatory powers foreseeable by the property owner may be rooted in the 'background principles' which are the source of RIBE. Rules and regulations set out discretionary powers of the State, reaching beyond police powers or nuisance. Expectation that those discretionary powers will not be exercised, or will be exercised only in a way favourable to the property owner, is often unsupported by those background principles and therefore unreasonable.[472]

Operating Engineers Pension Trust v Pension Benefit Guaranty Corporation et al., 475 U.S. 211, 227 (1986).

[465] *Pennsylvania Coal*, 260 U.S. at 422 (Brandeis J dissenting); *Andrus*, 444 U.S. at 67.

[466] *Lucas*, 505 U.S. at 1027-1028.

[467] ibid at 1027; *Pennsylvania Coal*, 260 U.S. at 413; Oswald (n 375) 114; but see Berger (n 443) 745.

[468] *Penn Central*, 438 U.S. at 125.

[469] ibid at 125.

[470] *Lucas*, 505 U.S. at 1022; Crump (n 375) 14-15.

[471] *Pennsylvania Coal,* 260 U.S. at 413.

[472] Washburn (n 402) 85; *Monsanto*, 467 U.S. at 1006.

Thirdly, a statute in force at the time when the property was acquired may put the property owner on notice that new regulation may be passed in the future to further legislative ends of that statute.[473]

Fourthly, since regulation is introduced to advance common good, in certain circumstances the society makes known its disapproval of continuing enjoyment of certain expectations.[474] Here, circumstances of a particular case may reveal impending restrictions on property use, such as: conversions of farmland into a residential area[475]; regulation preserving buildings of historical importance[476]; restrictions on residential development in coastal area in light of rising sea levels[477] or due to increased environmental impact of the existing human settlements.[478] A sudden discovery of a product's harmfulness may trigger preventive regulation that will not be linked with expectations of compensation.[479]

Fifthly, it may be relevant whether the activity in which the property owner is engaged is already highly regulated.[480] If it is, new regulation may hardly come as a surprise and can usually be easily anticipated.[481]

Lastly, subsequent change of regulation may not constitute a taking if restrictions on property rights are imposed in return for the benefit of participating in a regulated market.[482] This factor is limited to personal property. Use of one's real property, e.g. a right to build on one's land, is not viewed as a government benefit.[483] A landowner cannot be required to give up a property interest in return for a right to build on his property.[484]

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[473] Washburn (n 402) 80; *Connolly*, 475 U.S. at 227.

[474] Michelman (n 426) 1241.

[475] Cordes (n 388) 39.

[476] *Penn Central*, 438 U.S. at 107.

[477] Ruppert (n 373).

[478] *Tahoe-Sierra,* 535 U.S. at 307-312.

[479] Kaplow (n 423) 524.

[480] Cordes (n 388) 39; Berger (n 443) 765-767; *Tahoe-Sierra,* 535 U.S. at 257.

[481] Cordes (n 388) 39.

[482] *Monsanto*, 467 U.S. at 1007.

[483] *Nollan et ux. v California Coastal Commission*, 483 U.S. 825, 833 (1987); Berger (n 443) 746-747.

[484] Mandelker (n 397) 222. Despite this limitation in *Nollan* federal courts applied the *Monsanto* notice rule to land ownership cases (Breemer & Radford (n 375) 469-470, 485-486).

All, or some, of the above factors may be relevant in the assessment of reasonableness of investment-backed expectations.[485] These factors may trigger the so-called 'notice rule', i.e. a situation when the property owner's expectations are unreasonable because he could have predicted the regulation and its impact on his investment-backed expectations.[486]

The notice rule was introduced in *Monsanto*[487], a case concerning registration of pesticides. In the process of registration producers submitted data about their products, including trade secrets. A new regulation gave the regulator discretion to publish such data prospectively. The data was confidential before. The court found that the producer did not have RIBE that his data will not be publicised in the future. He could have foreseen the regulatory change because he operated on a market that has already been regulated for a long time and pesticides have been subject of public concern for a long time.[488] It was important that: the regulation addressed legitimate government interest; the participation in the regulatory scheme was voluntary; and that the risk of having the data published was balanced with the producer's ability to market his products and gain economic advantages from its sales.[489] The fact that data disclosure was not regulated previously did not support, absent any express promise to the contrary, RIBE that such disclosure will not be allowed in the future. In the circumstances of the case it was part of the producers' risk that, once the government focuses on the issue to regulate it, that regulation will not be to their advantage.[490]

c. The Notice Rule Cannot Mean That All Regulation Is Foreseeable

The US federal courts extended the *Monsanto* notice rule and the concept of 'background principles' to untenable proportions.[491] They were finding that a mere existence of a general regulation excludes any reasonable expectation that a subsequent regulation will not be enacted.[492] The courts were also finding that the

[485] Cordes (n 388) 39-40.

[486] ibid 34.

[487] 467 U.S. 986 (1984).

[488] *Monsanto*, 467 U.S. at 1007-1008.

[489] ibid at 1007.

[490] ibid at 1008-1009.

[491] Breemer & Radford (n 375) 463; Mandelker (n 397) 219; Cordes (n 388) 41; Washburn (n 402) 80; *Palazzolo*, U.S. 533 at 626 and 629.

[492] Kupiec (n 375) 877, 886.

'regulatory climate' of a given area of activity automatically puts the property owner on notice of further more restrictive regulation. Some courts concluded that existence of a regulation eliminates completely expectations of potential future uses of property. This led to routine rejections of regulatory takings claims[493] and even to findings that lack of RIBE *precluded* the property owners from bringing regulatory takings claims altogether.[494]

Such an extreme approach has been criticised. Commentators observe that it views all regulation as reasonably foreseeable and thus exempts even the harshest one from inflicting a taking.[495] Regulatory changes should be anticipated by property owners.[496] However, such implied foreseeability cannot be converted into a rule that regulatory changes should always be anticipated.[497] In such case the concept of RIBE would not serve fairness and justice in relations between the State and property owners[498] but would turn into a defence against regulatory takings claims.[499]

Such a position is untenable, just as the assumption that reliance on existing rules and regulations immunises the property owner from all future regulation.[500] The federal courts' approach illustrates the tendency of RIBE to move towards circularities.[501] It may be used to show that every regulatory change constitutes a taking because an expropriatory interference is what the court said it is. On the other hand, it may be used to show that no regulatory change may ever constitute a taking because there is usually some information allowing for a conclusion that the property owner could have anticipated the regulatory change.

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[493] Breemer & Radford (n 375) 484.

[494] Cordes (n 388) 40; Washburn (n 402) 86; Breemer & Radford (n 375) 518; *Palazzolo,* 533 U.S. at 626.

[495] Oswald (n 375) 114; Richard A Epstein, 'Lucas v South Carolina Coastal Council: A Tangled Web of Expectations' (1993) 45 Stan.L.Rev. 1369, 1371; Cordes (n 388) 38; Kaplow (n 423) 524; Mandelker (n 397) 228.

[496] Cordes (n 388) 34.

[497] Kaplow (n 423) 524; Mandelker (n 397) 228.

[498] Cordes (n 388) 38; Kupiec (n 375) 886; Breemer & Radford (n 375) 517.

[499] Breemer & Radford (n 375) 517; Epstein (n 495) 1372.

[500] Oswald (n 375) 114; Kaplow (n 423) 525.

[501] Epstein (n 495) 1371.

The USSC criticised and rejected the latter 'sweeping rule' in *Palazzolo*.[502] It observed that in balancing between the private right to use one's property and the State's right to regulate the court may take into account whether the exercise of State authority was reasonable. Regulation may be 'so unreasonable or onerous' that it will call for compensation. The notice rule cannot preclude the court from analysing the regulation from this perspective.[503] It analyses the purposes and effects of a particular regulation.[504] The assessment whether a regulation unjustly burdened private property must turn on objective factors.[505]

5. Balancing Reasonable Reliance and Foreseeability of Change: Regulatory Risk Allocation

a. Balancing Between Reasonable Reliance and Foreseeability Is a Matter of Degree

Neither reliance on the law at the time of the property acquisition, nor the foreseeability of future regulation can unlock the concept of RIBE on their own. The former favours property owners and implies regulatory freeze.[506] The latter favours the State and implies that no compensation should be paid for a regulatory impact on property.[507] Insisting on either the one or the other represents an 'all-or-nothing approach'[508] which provides no satisfactory answer to the question when regulation 'goes too far' in affecting property owner's RIBE.

The answer to what constitutes RIBE lies between these two extremes. It is a matter of degree[509] and of striking a balance between them.[510] These two opposing positions cannot be reconciled by way of general propositions[511] as 'there is no

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[502] *Palazzolo*, 533 U.S. at 626 (Kennedy J, for the Court) and 632 (O'Connor J, concurring).

[503] ibid at 625-627.

[504] ibid at 634 (O'Connor J, concurring).

[505] ibid at 630.

[506] Cordes (n 388) 34.

[507] ibid 34.

[508] Kaplow (n 423) 525.

[509] ibid 525; *Pennsylvania Coal*, 260 U.S. at 416.

[510] Washburn (n 402) 87.

[511] *Pennsylvania Coal*, 260 U.S. at 416.

abstract or fixed point' beyond which regulation becomes expropriatory.[512] Thus, the assessment of RIBE takes into account the elements discussed in the previous sections. This assessment is not clinically isolated from the other elements of the *Penn Central* test and interacts with the other factors the USSC takes into account on a case-by-case basis.[513]

b. Balancing Directed by 'Fairness and Justice' of Regulatory Transitions

How should the two interests, i.e. protection of proprietary expectations and regulation in the public interest, be reconciled? There are no mechanical tests here that could guarantee predictable results.[514] No set formula exists to assess when the property owner's expectations are reasonable.[515]

This exercise is informed by the general direction underlying the Takings Clause, namely that of the requirement of 'just compensation' for a taking. The constitutional requirement of just compensation for a taking

> was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.[516]

The USSC therefore links protection under the Takings Clause with distributive justice.[517] The *Penn Central* test (including, but not limited to, the three 'polestar' factors) is informed by the search for fairness and justice. Its application is instrumental to the Court's finding, based on its judgement and logic[518], what is required by justice and fairness in the circumstances of a particular case.[519] However, the Court gives no indication how to apply the test other than that it is

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[512] *Andrus*, 444 U.S. at 65.

[513] Ruppert (n 373) 253; Breemer & Radford (n 375) 527-528; Mandelker (n 404) 14; Washburn (n 402) 67.

[514] *Palazzolo*, 533 U.S. at 634 (O'Connor J, concurring).

[515] Washburn (n 402) 86.

[516] *Armstrong*, 364 U.S. at 49. See also *Pennsylvania Coal*, 260 U.S. at 416.

[517] Gaba (n 374) 570.

[518] *Andrus*, 444 U.S. at 65.

[519] ibid at 65.

applied on an *ad hoc* case-by-case basis.[520] Introduction of RIBE or the *Penn Central* factors did not provide it with a golden bullet to resolve this conundrum.[521]

Scholars propose many economic, social and political theories as standards to be applied to this balancing.[522] However, none of these propositions had much influence over the USSC jurisprudence.[523] As a result, very little can be said about how the *Penn Central* test, and particularly RIBE, is in fact applied. It is even suggested that due to the multiplicity of competing values and the ideological tensions, the USSC deliberately avoids a fixed solution and rotates between alternative interpretations.[524] USSC's practice has been criticised for lack of neutrality and exposure to 'biases and prejudices of judges', who apply their own values to the constitutional interpretation.[525]

One of the factors used by the USSC directly addressing the question of balancing private and public interests is the 'average reciprocity of advantage'.[526] It is used to weigh burdens and benefits brought about by regulation and enquire whether the benefits outweigh the burdens.[527] At a 'micro' level reciprocity of advantage looks into the relationship between specific property and surrounding properties, while at a 'macro' level it evaluates the benefits of regulation for the society and for the property owner as a member of that society. The assessment is not limited to the impact of a particular regulation but may consider benefits stemming from related regulations. It is not a search for perfect reciprocity but rather a general offsetting of regulatory burdens with the benefits of regulation. Generally, broad-based

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[520] *Palazzolo*, 533 U.S. at 633 (O'Connor J, concurring); *Tahoe-Sierra,* 535 U.S. at 336; Gaba (n 374) 570, 575.

[521] Mandelker (n 397) 231.

[522] E.g. Cordes (n 388) 34 ('sharp and unanticipated change'); Mandelker (n 397) 228-229 (mentions proposition focusing on 'abrupt and arbitrary change', 'efficiency values'); Kaplow (n 423) ('economic approach'); Kupiec (n 375) ('public choice theory'); Gaba (n 374) ('principle of distributive justice').

[523] Gaba (n 374) 590; Borden (n 377) 870-871. The federal courts are less confused here and pay particular attention to the foreseeability of regulation. (Ruppert (n 373) 254)

[524] Mandelker (n 397) 231, referring to Richard H Plides and Elizabeth S Anderson, 'Slinging Arrows at Democracy: Social Choice Theory, Value Pluralism, and Democratic Politics' (1990) 90 Colum.L.Rev. 2121, 2171-2172.

[525] Gaba (n 374) 592.

[526] *Pennsylvania Coal,* 260 U.S. at 415; *Penn Central,* 438 U.S. at 123; *Agins et ux. v City of Tiburon*, 447 U.S. 255, 263 (1980); *Lucas,* 505 U.S. at 1017-1018; *Tahoe-Sierra,* 535 U.S. at 341.

[527] ibid 586.

regulations are more likely to create reciprocal benefits and spread the burdens over a large number of parties.[528]

c. Concept of RIBE Is Unclear and RIBE-Based Claims Rarely Successful

The *Penn Central* test and the USSC's *ad hoc* approach do not operate in a predictable and mechanical way. The US regulatory takings law is universally criticised for its lack of clarity.[529] Just like the other concepts analysed here, RIBE are not a beacon of clarity. The courts have never explained its meaning[530] and they struggle to apply it.[531] It is not supported by any 'monolithic unitary theory'.[532] Some commentators see it as suspicious[533] or even 'dysfunctional'[534] and its effectiveness as questionable.[535]

RIBE require a factual enquiry into the scope of proprietary protection against regulation.[536] At the minimum, they may be treated as an analytical tool for 'evidentiary description of the property interest alleged to have been taken'.[537] To avoid veering into circularities, RIBE call for a balance between the need for stability of proprietary expectations and the need for the concept of property to evolve according to social needs.[538] Thus, facially, RIBE represent an evidentiary factual enquiry. The USSC practice, however, shows that it reflects the dynamic concept of property that

> reflects a pragmatic judgement about the property interests that courts decide are worth protecting under the Taking Clause. Nothing else is possible.[539]

RIBE appear to focus attention on the private interest in security against regulatory changes.[540] However, the USSC rarely finds that a regulatory change is a taking.[541]

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[528] Cordes (n 388) 20-21, 50.

[529] Crump (n 375) 2.

[530] Mandelker (n 397) 249; Oswald (n 375) 106; Gaba (n 374) 588-589; Breemer & Radford (n 375) 449-450 (and references).

[531] Mandelker (n 397) 249; Berger (n 443) 758.

[532] Mandelker (n 397) 249; Kupiec (n 375) 867, 911.

[533] Epstein (n 495) 1370.

[534] Breemer & Radford (n 375) 517.

[535] Oswald (n 375) 107, 151; Borden (n 377) 873.

[536] Berger (n 443) 759; Breemer & Radford (n 375) 517, 527-528.

[537] Breemer & Radford (n 375) 517.

[538] Ruppert (n 373) 255; Cordes (n 388) 26.

[539] Mandelker (n 397) 249.

Despite initial fears, introduction of RIBE did not tilt the takings analysis in favour of the property owner.[542] Alleged expectations are usually found to be unreasonable in the circumstances[543] and commentators observed that even in the land ownership cases, RIBE 'generally support a balance in which the vast majority of costs [of regulation] must be borne by landowners'.[544]

6. Conclusions

RIBE are a flexible and amorphous concept. They refer to property interests affected by regulation. US courts use RIBE among multiple factors to establish whether regulation went too far and constituted expropriation. In the narrow sense RIBE focus on the state of the law and other circumstances at the time when the owner acquires his property. They ask what crystallised expectations about the future use of that property arise from those circumstances and influenced his understanding of his property rights. In a broader sense RIBE embody the balancing between the owner's need for stability of his property expectations and the State's need for flexibility to regulate in the public interest. However, they provide little general guidance as to how this balancing should occur. RIBE also reflect the dynamic understanding of property, reflecting changing social attitudes to property. They are an important tool of regulatory risk allocation between the property owners and society. It reflects special protection of land ownership in US law and shows that regulatory risk is higher for business entities. Like in English law, to which we now turn, RIBE-based claims are rarely successful.

C. Legitimate Expectations in English and Australian Law

1. Origins and Rationale

In England and Australia courts developed[545] the concept of protection of legitimate expectations to extend procedural fairness to situations falling short of rights.[546] The

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[540] Mandelker (n 404) 6; Washburn (n 402) 67, 71.

[541] Washburn (n 402) 67, 71.

[542] ibid 71.

[543] Washburn (n 402) 71; Mandelker (n 397) 244.

[544] Cordes (n 388) 18.

[545] The phrase was first used in 1969 by Lord Denning in in *Schmidt v Secretary of State for Home Affairs* [1969] 2 Ch 149, 170.

[546] Philip Sales, Karen Steyn, 'Legitimate Expectations in English Public Law: An Analysis' (2004) PL 564, 567; Lord Woolf, Jeffrey Jowell, Andrew Le Sueur, *De Smith's*

concept of an 'expectation' refers to a legally relevant situation that would not be protected by law but for the intervention of the court.[547] The need to develop this special category arose during the progressive development of judicial review in the 1960's. The courts were erasing the historically rigid conceptual divisions, including a distinction between 'rights' (a protected category of legal situations) and 'privileges' (situations arising from State discretion that were unprotected).[548] The courts' targeted the growing administrative 'largesse', i.e. beneficial legal situations created by administrative discretion. Its growth required strengthening of protections against the capricious exercise of administrative discretion.[549]

Legitimate expectations arise when a decision-maker creates an expectation on the part of an individual about the way in which its administrative discretion will be exercised. Expectation may be later negatively affected by the unexpected exercise of such powers and may require protection.[550] The concept of legitimate expectations elevates certain expectations to legal protection.[551] The protection arises when it would be unfair to leave the expectations-holder without legal protection, if the administration were to exercise its discretion in a way negatively affecting his position.

Despite its frequent use before English courts[552] and in many scholarly writings, the concept of legitimate expectations is far for settled, specifically with regard to substantive protection. In fact, it creates 'so much uncertainty that there is a real danger that [it] will collapse into an inchoate justification for judicial intervention'.[553]

Judicial Review (Sweet & Maxwell 2007) 609; Jack Watson, 'Clarity and Ambiguity: A New Approach to the Test of Legitimacy in the Law of Legitimate Expectations' (2010) 30 LS 633, 633; Reynolds, Paul, 'Legitimate Expectations and the Protection of Trust in Public Officials' (2011) 2 P.L. 330, 333-334; *A-G of Hong Kong v Ng Yuen Shiu* [1983] 2 AC 629, 636 (*Ng Yuen Shiu*) (Lord Fraser).

[547] Woolf, Jowell & Le Sueur (n 546) 358.

[548] This is associated with *Ridge v Baldwin* [1964] AC 40.

[549] This new development was referred to as 'new property' (see: Charles A Reich, 'The New Property' (1964) 73 Yale L.J. 733; Robert Baldwin, David Horne, 'Expectations in a Joyless Landscape' (1986) 49 MLR. 685).

[550] Sales & Steyn (n 546) 565.

[551] Reynolds (n 546) 330; Watson (n 546) 634.

[552] A BAILII search on 8 April 2014 returned over 1600 cases.

[553] Christopher Forsyth, 'Legitimate Expectations Revisited' (2011) JR 429, 429. See also Watson (n 546) 651; Reynolds (n 546) 331.

Moreover, similarly to the US concept of RIBE, cases based on substantive protection of expectations are rarely successful.[554]

The concept of legitimate expectations developed from a single phrase used by Lord Denning[555], who famously said that it 'came out of my own head and not from any continental or other source'.[556] However, it is accepted that its development has been influenced by, if not borrowed from, continental Europe.[557] As it originally arose from the requirements of natural justice, the main rationale for its protection is fairness.[558] In this sense, protection of legitimate expectations is a matter of fairness in public administration.[559] This justification is related mainly to procedural protection of legitimate expectations[560] and it does not explain in what circumstances protection of expectations is fair.[561]

Much greater controversy surrounds substantive protection of legitimate expectations.[562] The rationales of this protection were proposed *ex post facto*, as the concept developed 'without any real attempt to explain its purpose and to sufficiently

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[554] Christopher Forsyth, William Wade, *Administrative Law* (Oxford University Press 2009) 446; Forsyth (n 553) 436. Both, procedural and substantive, expectations 'are concerned with exceptional situations' (*R. (on the application of Niazi) v Secretary of State for the Home Department* [2008] EWCA Civ 755 [41] (Laws LJ) (*Niazi*)).

[555] He found that an administrative body 'may give a person who is affected by their decision an opportunity of making representations. It all depends on whether he has some *right or interest, or*, I would add, *some legitimate expectation*, of which it would not be fair to deprive him without hearing what he has to say.' (*Schmidt* (n 545) 170, emphasis added).

[556] Christopher F Forsyth, 'The Provenance and Protection of Legitimate Expectations' (1988) 47 CLJ 238, 241.

[557] ibid 241-245.

[558] Forsyth & Wade (n 554) 447; *R. v Inland Revenue Commissioners Ex parte MFK Underwriting Agents Ltd.* (1990) 1 W.L.R. 1545, 1569-1570 (Bingham LJ) (*MFK Underwriting*); Sales & Steyn (n 546) 569.

[559] *R. v Ministry of Agriculture, Fisheries and Food Ex p. Hamble (Offshore) Fisheries Ltd* [1995] 2 All ER 714; [1995] 1 C.M.L.R. 533, 544 (Sedley J) (*Hamble Fisheries*); *Council of Civil Service Unions v Minister for the Civil Service* [1985] AC 374, 415 (Lord Roskill) (*GCHQ*); *Ng Yuen Shiu* (n 546) 638 (Lord Fraser); Paul Craig, *Administrative Law* (Sweet & Maxwell 2008) 650-651; Reynolds (n 546) 331.

[560] Forsyth (n 556) 240; Reynolds (n 546) 344-345.

[561] Craig (n 559) 651; Reynolds (n 546) 333.

[562] Forsyth (n 556) 240; Mark Elliott, 'Legitimate Expectations: Procedure, Substance, Policy and Proportionality' (2006) 65 CLJ 254, 255-256.

identify principles which underpin this purpose.'"[563] The three main rationales are as follows.

First, the substantive protection of legitimate expectations is a protection against abuse of power.[564] However, abuse of power is insufficient to serve as a standard of review.[565]

Secondly, substantive protection of legitimate expectations is a protection of trust that the individual has reposed in decision-maker's representations.[566] This is modelled on the German law concept of *Vertrauensschutz*, meaning protection of trust or confidence.[567] Trust between the governing and the governed underpins good administration. Without it 'government becomes a choice between chaos and coercion'.[568] It is argued that, because existence of trust is a question of fact, this rationale facilitates the finding of expectations deserving protection.[569] A related rationale for protection refers to the requirements of good government.[570]

Lastly, protection of legitimate expectations is linked with the rule of law, requiring 'regularity, predictability, and certainty in government's dealings with the public'.[571] This broad concept is linked with another rationale, namely legal certainty.[572] Legal

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[563] Reynolds (n 546) 331.

[564] *R v North and East Devon Health Authority ex parte Coughlan* [2001] QB 213, 251 (Lord Woolf MR) (*Coughlan*); Sales & Steyn (n 546) 580; Craig (n 559) 620; Forsyth & Wade (n 554) 447.

[565] *R (on the application of Nadarajah) v Secretary of State for the Home Department* [2005] EWCA Civ 1363 [2005] EWCA Civ 1363 at [67] (Laws LJ) (*Nadarajah)*; Paul Craig, Soren Schønberg, 'Substantive Legitimate Expectations After Coughlan' (2000) 4 P.L. 684, 698; Sales & Steyn (n 546) 590; Craig (n 559) 620-621, 665; Reynolds (n 546) 334. See Section C.5.

[566] Forsyth (n 556) 244 and (n 640) 431; Reynolds (n 546) 340-341; Watson (n 546) 641.

[567] Forsyth (n 556) 244. See Chapter 1, Section E.

[568] Forsyth & Wade (n 554) 447. See also Forsyth (n 553) 431; Reynolds (n 546) 343, 349-351.

[569] Forsyth & Wade (n 554) 447. However, Craig ((n 631) 651) associates trust/good government rationale with the requirement of detrimental reliance.

[570] *Nadarajah* (n 565) at [68] (Laws LJ). See also Soren Schønberg, *Legitimate Expectations in Administrative Law* (Oxford University Press 2000) 25.

[571] Woolf, Jowell & Le Sueur (n 546) 609. See also Sales & Steyn (n 546) 569-570; Craig (n 559) 652; Schønberg (n 570) 12-23.

[572] Woolf, Jowell & Le Sueur (n 546) 609-610; Craig (n 559) 652; Forsyth & Wade (n 554) 447. This is linked with an analogous approach in EU law. See Chapter 4, Section B.1.

certainty promotes certainty and consistent administration[573] and allows those who harbour legitimate expectations to plan their actions on that basis.[574] Recently, however, some commentators suggested that legitimate expectations and legal certainty are conceptually separate and play different functions.[575] The courts also criticised broad rationales such as rule of law for being too abstract to 'tell you, case by case, what is lawful and what is not'[576] and thus unhelpful in the doctrine's practical application.

2. Sources of Legitimate Expectations

a. Sources of Procedural Expectations

Procedural expectations are expectations that a certain procedure will be followed by the authorities in their exercise of administrative discretion.[577] They arise from four types of sources: the very nature of the benefit in question, an established practice, representations and published policies.

Procedural expectations arising from the very nature of the benefit that a person enjoys or hopes to enjoy[578] arises in situations when a person already enjoys some benefit as a result of administrative discretion. Legitimate expectation arises if such benefit is sufficiently important to be allowed to continue until some rational ground for withdrawal. Its continuation should not be refused without offering the beneficiary some procedural rights, such as a reasonable opportunity to comment.[579] This typically applies to renewals of licenses and permits.

In *F.A.I. Insurances*[580] the court found that a grant of a license for conducting an insurance business gave rise to a legitimate expectation that the license will be renewed unless there was a good reason not to. The 'natural expectation' in the properly conducted insurance business was that it will continue indefinitely. The

[573] Woolf, Jowell & Le Sueur (n 546) 610.

[574] Craig (n 559) 649.

[575] Reynolds (n 546) 338-340; Forsyth (n 553) 432.

[576] *Nadarajah* (n 565) at [67] (Laws LJ); similar criticism by: Watson (n 546) 633; Forsyth (n 553) 431; Reynolds (n 546) 330, 349-351.

[577] Sales & Steyn (n 546) 565; Forsyth & Wade (n 554) 453; Woolf, Jowell & Le Sueur (n 546) 371; Craig (n 559) 647.

[578] Various terms are used to refer to this situation (e.g. privilege or advantage) to reflect that the situation is less than a right.

[579] Craig (n 559) 382; *GCHQ* (n 559) 408 (Lord Diplock).

[580] *F.A.I. Insurances Ltd v Winneke* [1982] HCA 26 at [2] (Gibbs CJ).

procedural protection may also be granted if the refusal of the benefit may limit one's liberty[581] or cast a shadow on his reputation.[582]

This type of interest is protected only by way of procedural fairness. However, this situation is also regarded as being outside of the concept of legitimate expectations. It is argued that procedural protection is based on common law fairness, not on representations or practice.[583] Something more is required, e.g. a past practice or representations, to create legitimate expectations *enhancing* the inherent duty of the authorities to act fairly.[584] Moreover, this category of benefits is shrinking. It is now widely recognised that revocation, variation, suspension and refusal of licenses or similar benefits attract procedural protection without any court intervention.[585] In Australia, it's the High Court ('HCA') noted that the concept of legitimate expectations may be superfluous, since 'the rules of procedural fairness are presumptively applicable to administrative and similar decisions', and thus the question is not *whether* procedural fairness is required but '*what* does fairness require in the circumstances'.[586]

An established consistent practice may constitute an implied representation.[587] Long established practice of consultations creates legitimate expectations that the process will be followed in the future. If changes in employment conditions of civil servants have been subject to an established and invariable practice of consultations, changes introduced without it are unfair. Requirements of national security may,

[581] E.g. a refusal to grant a passport.

[582] E.g. a reputation of a professional, whose license is not renewed without reason or a reputation of anybody if a decision of his deportation is made public (*F.A.I. Insurances* (n 580) [14] (Brennan J)*; Haoucher v Minister of Immigration & Ethnic Affairs* [1990] HCA 22 at [5] (Deane J)); Woolf, Jowell & Le Sueur (n 546) 368).

[583] ibid 566-567, 588; Reynolds (n 546) 334; Woolf, Jowell & Le Sueur (n 546) 623-624; Forsyth & Wade (n 554) 447-448.

[584] Forsyth & Wade (n 554) 453-454; *R. v Devon County Council ex parte Baker* [1995] 1 All ER 73, 90-91 (Simon Brown LJ).

[585] Woolf, Jowell & Le Sueur (n 546) 366.

[586] *Minister of State for Immigration and Ethnic Affairs v Teoh* [1995] HCA 20 at [24] (McHugh J) (*Teoh*) (emphasis added). See also *Haoucher* (n 582) at [2] (Deane J); *Kioa v West* [1985] HCA 81 at [34] (Mason J); Alison Duxbury, 'The Impact and Significance of Teoh and Lam' in: Groves M, Lee HP (eds), *Australian Administrative Law, Fundamentals, Principles and Doctrines* (Cambridge University Press 2007) 311-312.

[587] Sales & Steyn (n 546) 566; Woolf, Jowell & Le Sueur (n 546) 617.

however, override the requirements of fairness and no consultation will be required.[588]

As to representations, expectations may arise from individual promises of the administration that a certain procedure will be followed. A foreigner whom the authorities promise the ability to present his case before deportation can legitimately expect this promise to be fulfilled.[589] A taxi association has a legitimate expectation of being consulted on a specific issue when the city council assured it that such consultation will take place.[590]

Representations to follow certain procedure raise the question of their 'value added', if the law already guarantees some procedural protection.[591] The dominant view is that such promise adds to the individual's situation only when it strengthens an already existing protection or offers protection that would otherwise not have existed.[592]

Published policies, viewed by some commentators as a type of representation[593], can also give rise to procedural legitimate expectations.[594] If the authorities give an individual a published circular detailing criteria for adopting a child, they cannot later depart from those criteria without affording the interested person a hearing, unless there is some overriding public interest for such departure.[595]

b. Sources of Substantive Expectations

Substantive expectations are expectations that the authorities will exercise their discretionary powers in a particular way, conferring a benefit on the person harbouring such expectation.[596] 'Procedural' and 'substantive' expectations cannot

[588] *GCHQ* (n 559) 403 (Lord Fraser), 404 (Lord Scarman), 412 (Lord Diplock), 419 (Lord Roskill), 423 (Lord Brightman).

[589] *Ng Yuen Shiu* (n 546).

[590] *R v Liverpool Corporation ex parte Liverpool Taxi Drivers Association* [1972] 2 QB 299, 306-307.

[591] Woolf, Jowell & Le Sueur (n 546) 365.

[592] Craig (n 559) 383; Woolf, Jowell & Le Sueur (n 546) 612.

[593] Woolf, Jowell & Le Sueur (n 546) 618.

[594] Craig (n 559) 384.

[595] *R. v Secretary of State for the Home Department ex parte Khan* [1984] 1 WLR 1337, 1334, 1347 (Parker LJ).

[596] Sales & Steyn (n 546) 565; Forsyth & Wade (n 554) 453; Craig (n 559) 647.

be neatly separated.[597] The same policy or assurance may be interpreted either as a promise about the procedure to be followed, or as referring to the outcome of that procedure.[598] Substantive legitimate expectations may arise from three sources, namely: representations, past practice and policies.

Representations are the main source of legitimate expectations. Some commentators argue that legitimate expectations can only be engendered by clear and unambiguous representations, especially when the protection sought is substantive.[599] Past practice and general policies as sources of substantive expectations are subject to doctrinal controversy.[600]

Finding whether an administrative conduct is a representation giving rise to legitimate expectations involves a detailed examination of its precise terms.[601] There are no strict and clearly defined requirements and 'no artificial restriction on the material' as to what could constitute a 'representation'.[602] Depending on the circumstances of a given case and their interpretation by courts, representations may arise from conduct, policy or other behaviour.[603] This may include words, conduct or combination of the two[604] and involve individual statements, circulars, reports or agreements.[605] Thus,

> the form of the express representation is unimportant as long as it appears to be a considered assurance, undertaking or promise of a benefit, advantage or course of action which the authority will follow.[606]

However, certain characteristics have been identified as necessary for the decision-maker's conduct to give rise to substantive legitimate expectations.

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[597] Forsyth & Wade (n 554) 317-318.

[598] E.g. an assurance specifying a procedure to be followed may be interpreted as an assurance that once the specified conditions are fulfilled, the outcome of the procedure will be positive (Sales & Steyn (n 546) 578).

[599] Sales & Steyn (n 546) 577.

[600] Woolf, Jowell & Le Sueur (n 546) 617 (on past practice).

[601] *Coughlan* (n 564) 241.

[602] Forsyth & Wade (n 554) 450.

[603] Watson (n 546) 639.

[604] Craig (n 559) 659.

[605] ibid 659.

[606] Woolf, Jowell & Le Sueur (n 546) 615.

First, the promise or a statement by the authorities must be clear, unequivocal and unambiguous.[607] It also cannot be subject to any relevant qualification.[608] Claims based on legitimate expectation often fail because the alleged representations were insufficiently unambiguous and clear.[609]

The more specific the representation, the easier it is to establish a legitimate expectation.[610] Representations should therefore be directed at an individual or a small group of recipients.[611] They have to be specific, or 'pressing and focussed', in nature.[612] Some commentators observe that it is relevant if the statement or representation was based on a specific consideration of the particular case. If it was not, granting protection in such situation could interfere will the discretionary powers of the authorities.[613]

The second potential source of substantive expectations, past practice, is more controversial. It does not involve clear and unambiguous statements. Commentators and courts are divided whether it falls outside the concept of substantive legitimate expectations or whether it is an exception from the general requirement of clear and unambiguous representations as a source of expectations.[614] The controversial case here is *Unilever*, where the tax authorities, after accepting for 20 years tax filings made out of time, enforced the time limit without any advance warning. The court found that this reversal of past practice was unfair.[615]

Policy statements constitute another controversial category of sources of substantive expectations. Critics point out that because general policy statements are not clear

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[607] *MFK Unterwriting* (n 645) 1570 (Bingham LCJ); Sales & Steyn (n 546) 574; Forsyth & Wade (n 554) 450; Woolf, Jowell & Le Sueur (n 546) 622; Watson (n 546) 636.

[608] *MFK Unterwriting* (n 645) 1570 (Bingham LJ); Sales & Steyn (n 546) 577; Woolf, Jowell & Le Sueur (n 546) 622.

[609] Watson (n 546) 638; Forsyth (n 553) 429.

[610] Craig (n 559) 659.

[611] Forsyth & Wade (n 554) 456; *Coughlan* (n 564) 243. But see Woolf, Jowell & Le Sueur (n 546) 616) (referring to 'individual, a number of individuals, or a class' in a catalogue which covers procedural as well as substantive expectations).

[612] *Niazi* (n 554) at [46] (Laws LJ).

[613] Sales & Steyn (n 546) 575-576.

[614] *R. (Association of the British Civilian Internees: Far East Region) v Secretary of State for Defence* [2003] QB 1397, 1423 (Dyson LJ) ('an exceptional case'); Sales & Steyn (n 546) 574-575; Craig (n 559) 659; Woolf, Jowell & Le Sueur (n 546) 617; Watson (n 546) 637.

[615] *R. v Inland Revenue Commissioners, ex parte Unilever plc* [1996] STC 681, 697 (Simon Brown LJ).

and unequivocal, they do not constrain the ability of the authorities to exercise their discretion to change their policy.[616] Since the authorities did not have knowledge about an individual's case when issuing a policy, and the policy was not directed at that individual or a narrow group of addressees, the policy statements cannot be clear and unequivocal vis-à-vis that individual.[617]

Application of an existing policy is ambivalent as to whether its addressee knows about it. The critics argue that it is inappropriate to subsume 'expectations that an existing policy will apply' under the concept of legitimate expectations, either regardless of[618] or on condition of the addressee's knowledge about such policy.[619] Such approach deprives the concept of legitimate expectations of its clear meaning and adds nothing to the general requirements of fairness.[620] Protection based on a policy should not refer to legitimate expectations but to 'a general expectation of fairness, good governance, or consistency of public administration'. [621] Some commentators argue that expectations based on general policy statements should only be protected procedurally [622] because substantive protection would be an "unacceptable fetter" of the discretionary powers.[623] However, substantive protection of expectations related to policies may be considered if the authorities made specific representations that the existing policy will not apply or that an old policy will apply to an individual in spite of its subsequent change.[624]

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[616] Sales & Steyn (n 546) 575-576; to that effect Forsyth & Wade (n 554) 450.

[617] Sales & Steyn (n 546) 575; Forsyth & Wade (n 554) 456; Watson (n 546) 643-644.

[618] *R. (on the application of Rashid) v Secretary of State for the Home Department* [2005] EWCA Civ 744 at [25] (Pill LJ) (expectation that the authorities will apply their non-deportation policy of which the claimant had no knowledge); *Teoh* (n 586) at [29] (Toohey J) (legitimate expectations arising from a signed but not ratified treaty do not require the applicant to have knowledge of that treaty); *Haoucher* (n 582) at [16] (Toohey J).

[619] *Teoh* (n 586) at [31] (McHugh J); *Re Minister for Immigration and Multicultural Affairs ex parte Lam* [2003] HCA 6 at [152] (Callinan J) (*Lam*).

[620] Forsyth & Wade (n 554) 451-452; Woolf, Jowell & Le Sueur (n 546) 626; Forsyth (n 553) 433-435; Mark Elliott, 'Legitimate Expectations and the Search for Principle: Reflections on Abdi & Nadarajah' (2006) 11 JR 281, 282-283.

[621] Woolf, Jowell & Le Sueur (n 546) 626; See also Forsyth (n 553) 433.

[622] Sales & Steyn (n 546) 588; Forsyth & Wade (n 554) 457.

[623] Sales & Steyn (n 546) 588.

[624] Forsyth (n 553) 434; Craig (n 559) 667; Reynolds (n 546) 348.

3. Legitimacy of Expectations

Legitimacy of expectations is assessed in the circumstances of a particular case. It depends on the manner in which expectations were engendered and on the reasonableness of reliance on them.[625]

Assessment of legitimacy of expectations involves an *objective* interpretation of the alleged sources of expectations in light of the surrounding circumstances.[626] There is no general test underlying such assessment, which depends on the circumstances of a particular case.[627] The context in which the representation was made is important.[628] The intention of the decision-maker and the understanding of the conduct by the representee may be relevant, but are not determinative.[629] The level of sophistication required from the addressee may be relevant for assessing how he could have understood the representation.[630] It may also be relevant that he could have foreseen that the official position is likely to change[631], or was aware that the authorities either did not intend to create an expectation[632] or made a mistake.[633] The individual's position may be strengthened if he was reassured by the authorities that the expectation will not be dashed. Legitimacy of expectations may be diminished when the addressee could have sought reassurance but failed to do so.[634]

The beneficiary of the statement or representation must deal fairly with the authorities.[635] In particular, he must make full disclosure of all relevant and

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[625] Sales & Steyn (n 546) 576.

[626] *Hamble Fisheries* (n 559) 549 (Seldey J); Sales & Steyn (n 546) 566.

[627] *R. (on the application of Bibi) v Newham London Borough Council* [2001] EWCA Civ 607 at [22] (*Bibi*) (Schiemann LJ, observing that the court will have 'to find one or more measuring rods' to construct a case-specific test).

[628] *Coughlan* (n 564) 241; Sales & Steyn (n 546) 576.

[629] Woolf, Jowell & Le Sueur (n 546) 622.

[630] *R. v Secretary of State of State for the Home Department ex parte Zeqiri* [2002] UKHL 3 at [44] (Lord Hoffmann, observing that 'Kosovar refugees cannot be expected to check the small print.'); *MFK Underwriting* (n 558) 1569 (Bingham LJ, applying a standard of 'every ordinarily sophisticated taxpayer' to dealings with the revenue); *R. v Secretary of State for Education and Employment ex parte Begbie* [2000] 1 WLR 1115, 1129 (Laws LJ) (*Begbie*) 1126-1127 (Gibson LJ); Woolf, Jowell & Le Sueur (n 546) 622.

[631] Craig (n 559) 659.

[632] Craig (n 559) 659.

[633] *Begbie* (n 630) 1127 (Gibson LJ).

[634] Woolf, Jowell & Le Sueur (n 546) 634.

[635] Forsyth & Wade (n 554) 450.

necessary information.[636] The authorities need to have full and informed opportunity to make relevant representations[637] and the applicant must put 'all his cards face up on the table'.[638]

Detrimental reliance strengthens the claim for protection of legitimate expectations. It proves existence of an expectation[639] and may add weight in the balancing of legitimate expectations with any overriding public interest.[640] Reliance is not an essential component of the concept of legitimate expectations[641], although in practice its absence is rare.[642] In some circumstances the requirement of detrimental reliance should not be imposed[643] or is impossible to fulfil.[644] Some commentators argue that *substantive* protection of legitimate expectations should be granted only in cases of significant detrimental reliance.[645]

It is also observed that pairing the concept of legitimate expectations with detrimental reliance assimilates it with the private law concept of estoppel.[646] However, in England and Australia representations about the way in which administrative discretion will be exercised cannot estop the decision-maker.[647] Analogies between

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[636] Craig (n 559) 660; Woolf, Jowell & Le Sueur (n 546) 626; Watson (n 546) 644.

[637] Sales & Steyn (n 546) 574, 576, 580; Forsyth & Wade (n 554) 450; Woolf, Jowell & Le Sueur (n 546) 626.

[638] *MFK Underwriting* (n 558) 1569 (Bingham LJ).

[639] *Bibi (n 627)* at [31] (Schiemann LJ, observing that significance of reliance is factual, not legal); Sales & Steyn (n 546) 572; Forsyth & Wade (n 554) 453; Woolf, Jowell & Le Sueur (n 546) 628.

[640] *Bibi (n 627)* at [31] (Schiemann LJ); Sales & Steyn (n 546) 580; Woolf, Jowell & Le Sueur (n 546) 628.

[641] *Hamble Fisheries* (n 559) 546 (Sedley J); *Bibi (n 627)* at [31] (Schiemann LJ); *Begbie* (n 630) 1124 (Gibson LJ); Woolf, Jowell & Le Sueur (n 546) 627-628.

[642] *Begbie* (n 630) 1124 (Gibson LJ).

[643] Woolf, Jowell & Le Sueur (n 546) 627-628; *Bibi (n 627)* at [55] (Schiemann LJ, observing that requirement of detrimental reliance would 'place the weakest in the society at a particular disadvantage').

[644] Forsyth & Wade (n 554) 453 (there is no detrimental reliance in prisoner's expectations based on the promise of home leave); Craig, (n 631) 660 ('moral' rather than economic detriment).

[645] Sales & Steyn (n 546) 580-581.

[646] Forsyth & Wade (n 554) 452. But see Michael Supperstone, James Goudie, Paul Walker, *Judicial Review* (Lexis Nexis 2010) 172-176 (arguing that *Coughlan* represents public law estoppel by representation).

[647] *Lam* (n 619) at [69] (McHugh and Gummow JJ).

estoppel and legitimate expectations are undesirable and are rejected by courts[648] because the authorities, unlike a private party, must 'weigh up the public interest against that of the individual' when making decisions.[649]

Representations must be made by a properly authorised person.[650] This raises a question whether expectations can arise from *ultra vires* representations. The rule of law requires that the authorities always act within their powers. As a result, they are prohibited from acting *ultra vires*. The scope of their duties cannot be extended or varied through their own conduct or conduct of other persons. Expectations are therefore not legitimate when the action they pertain to would be *ultra vires.*[651] Upholding an unlawful representation by allowing it to give rise to legitimate expectations would legitimise arbitrarily extensions of administrative powers in disregard of statutory limitations.[652]

After England implemented the ECHR, the English law doctrine of *ultra vires* clashed with the ECtHR's approach to legitimate expectations. The latter does not treat the doctrine of *ultra vires* as automatically disqualifying expectations from protection.[653] After *Stretch* and *Pine Valley*[654] the English courts accepted this position.[655] In certain circumstances fairness will require protection of such 'unlawful legitimate expectations' under English law.[656] Commentators argue that although unlawful expectations cannot bind the authorities, fairness[657] or protection of trust[658] may require taking them into account in the decision-making. The basis of such protection, however, should be based on fairness and not – as under the ECHR – on

[648] *R. (Reprotech (Pebsham) Ltd) v East Sussex County Council* [2003] 1 WLR 348, 358 (Lord Hoffmann).

[649] Sales & Steyn (n 546) 570. See also Woolf, Jowell & Le Sueur (n 546) 627; Craig (n 559) 680 (observing that the difference between estoppel and legitimate expectations lies in the court having to take into account the broader public interest).

[650] Sales & Steyn (n 546) 577; Forsyth & Wade (n 554) 449; Woolf, Jowell & Le Sueur (n 546) 623.

[651] Sales & Steyn (n 546) 565-566; Forsyth & Wade (n 554) 450-451; Woolf, Jowell & Le Sueur (n 546) 625.

[652] *Hamble Fisheries* (n 559) 553 (Sedley J); Forsyth & Wade (n 554) 451.

[653] Chapter 4, Section C.2.a.

[654] Ibid.

[655] *Rowland v Environment Agency* [2003] EWCA Civ 1885 at [152] (Mance LJ).

[656] Woolf, Jowell & Le Sueur (n 546) 643, 637. See also Forsyth & Wade (n 554) 451 (who support protection in case of 'innocent representees').

[657] Woolf, Jowell & Le Sueur (n 546) 641-643.

[658] Forsyth & Wade (n 554) 451.

the balancing of legality and legal certainty. The latter approach would weaken the rule of law.[659] The protection would not be substantive but could involve a discretionary relief, such as compensation.[660]

4. Protection of Legitimate Expectations: Procedural or Substantive?

Procedural expectations can be protected only through procedural fairness. Substantive expectations may be protected either procedurally or substantively.[661] In case of substantive expectations the court will decide what, if any, protection to afford on the basis of the circumstances of a particular case. To be substantively protected legitimate expectations must comply with stricter requirements than for procedural protection.[662] The substantive protection extends the original mechanism of protection from procedural fairness to substantive fairness. This extension developed in English law but was rejected in Australia. Substantive protection, although generating the bulk of scholarly commentary on legitimate expectations, is only *exceptionally* granted by courts.[663]

a. Procedural Protection

Both procedural and substantive expectations can be protected procedurally. If a legitimate expectation is based on an established practice, on a promise to follow a specific procedure, or on a policy detailing such a procedure, the procedural protection will follow that practice or promises. Procedural protection will not be required only in exceptional cases, e.g. due to national security concerns.[664] If a legitimate expectation is substantive, the court will determine procedural protection by asking what is required by procedural fairness in the circumstances. Procedural fairness usually requires that the individual is given an opportunity to make representations before his expectation is dashed, unless there is an overriding interest not to follow such course. However, the court may merely require that the

[659] Woolf, Jowell & Le Sueur (n 546) 643; Forsyth & Wade (n 554) 452.

[660] Woolf, Jowell & Le Sueur (n 546) 641-643; Forsyth & Wade (n 554) 451.

[661] Sales & Steyn (n 546) 583-584. As to procedural protection of legitimate expectations see e.g.: *McInness v Onslow Fane* [1978] 1 WLR 1520, 1529 (Megharry V.-C.); Woolf, Jowell & Le Sueur (n 546) 371.

[662] E.g. representations must be clear and unambiguous any may require detrimental reliance.

[663] Forsyth & Wade (n 554) 446; Sales & Steyn (n 546) 570.

[664] Forsyth & Wade (n 554) 454.

legitimate expectation is taken into account before a decision is made that affects it.[665]

b. Substantive Protection

The major difference between English law and Australian law lies in their approach to substantive protection of legitimate expectations. English courts allow for their substantive protection, i.e. require that the benefit promised by the administration is actually provided, unless there is an overriding public interest not do to so.[666] This approach – which may be an influence of EU law[667] – has not been adopted in Australia.

Coughlan[668] is the leading case in which English courts recognised that protection of a legitimate expectation can be substantive. The court found that in certain circumstances reversal of a promise to provide an individual with certain benefit can be so unfair as to amount to an abuse of power rather than to a 'simple' procedural unfairness. Miss Coughlan was severely disabled and required permanent care. She accepted to be moved from a hospital to a purpose-built nursing home on the basis of an uncontested promise from the authorities that the new place will be her 'home for life'. A few years later the authorities decided to close the nursing home without providing her with an alternative. She was found to have a legitimate expectation of a home for life, as promised. Reneging on this promise, in the absence of a reasonable equivalent alternative and in the absence of an overriding public interest, constituted an 'unfairness amounting to an abuse of power'. The court acknowledged a previous line of cases which suggested that the concept of legitimate expectations could be extended to substantive protection. [669] It thus resolved scholarly

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[665] *Coughlan* (n 564) 243; Forsyth & Wade (n 554) 454-455.

[666] Forsyth & Wade (n 554) 455.

[667] ibid 317-318, 456.

[668] *Coughlan* (n 564).

[669] *R v Secretary of State for the Home Department ex parte Ruddock* [1987] 1 WLR 1482, 1497 (Taylor J); *Hamble Fisheries* (n 559) at 731 (Sedley J). For the discussion of jurisprudence leading to *Coughlan* see e.g. Supperstone, Goudie & Walker (n 646) 362-366. Cameron Stewart, 'The Doctrine of Substantive Unfairness and the Review of Substantive Legitimate Expectations', in: Groves Matthew and Lee, H.P. (eds), *Australian Administrative Law, Fundamentals, Principles and Doctrines* (Cambridge University Press 2007) 280.

discussions[670] on whether English courts should grant such protection and recognise 'the free standing principle of substantive legitimate expectation'.[671]

This development was resisted in Australia on the basis that such extension allows the courts to interfere with the exercise of governmental powers. The predominant view was that adopting the course chartered in *Coughlan* would offend the basic notion of the separation of powers. It would ask judges to engage in the assessment of substantive fairness of employed policies and thus to perform the functions of the executive.[672] For these reasons the Australian courts were never favourably predisposed towards the idea of substantive protection of legitimate expectations.[673] Although some decisions were not entirely dismissive of it, all cases based on substantive legitimate expectations have failed before Australian courts.[674] The recent decisions of the HCA firmly reject the English doctrine expressed in *Coughlan*.[675]

Two more arguments against substantive protection are added to the above. First, that judges are not in a position to make decisions concerning substantial fairness. The judicial review is not as detailed and individualised as the administrative decision-making. The *Coughlan* court was not equipped to find, as it did, that the implications of its decision were 'financial only'.[676] Secondly, there is no clarity as to *what* balancing test should be used. In fact, an objective test for balancing the

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[670] E.g. Paul Craig, 'Substantive Legitimate Expectations in Domestic and Community Law' (1996) 55 C.L.J. 289; TRS Allan, 'Procedure and Substance in Judicial Review' (1997) 56 C.L.J. 246.

[671] Forsyth & Wade (n 554) 317. Stewart (n 669) 280.

[672] Stewart (n 669) 281, 298; Woolf, Jowell & Le Sueur (n 546) 644; Anthony Mason, 'Procedural Fairness: Its Development and Continuing Role of Legitimate Expectations' (2005) 12 AJ Admin L 103, 108-110.

[673] See e.g. *Attorney-General (NSW) v Quin* [1990] HCA 21 at [34], [37] (Mason CJ); *Minister for Immigration, Local Government and Ethnic Affairs v Kurtovic* [1990] FCA 22 at [26] (Neaves J), [77] (Gummow J); *Lam* (n 619) at [67] (McHugh and Gummow JJ); *Teoh* (n 586) at [3], [28], [32] (McHugh J) as well as federal courts decisions cited by Stewart (n 669) 296). See also Duxbury (n 586) 310.

[674] Stewart (n 669) 297. The *Teoh* case, which concerned legitimate expectations that a signed but not ratified international convention will be applied in administrative proceedings, was close to interfering with the separation of powers. However, the judges were careful to stress that the protection they granted was strictly procedural (*Teoh* (n 586) at [36] (Mason CJ and Deane J), [3], [28], [32] (McHugh J)).

[675] Stewart (n 669) 297. See also Duxbury (n 586) 311; Woolf, Jowell & Le Sueur (n 546) 644.

[676] Stewart (n 669) 297; Forsyth (n 553) 437; Sales & Steyn (n 546) 591.

private interest with the public interest may not exist at all, making the substantive protection of legitimate expectations an 'arbitrary and unpredictable rule'.[677]

The English courts recognise this criticism. They observe that they cannot interfere with administrative discretion when the alleged legitimate expectations arise from general policies. The more general the source of legitimate expectations, the less intrusive the court should be.[678] For example, the court should not scrutinise a decision on financing for schools involving 'wide-ranging issues of social policy' because the court's decision could concern interests that were not represented before it.[679]

5. Legitimate Expectations and Balancing

The question of balancing arises in relation to both procedural and substantive protection of expectations.[680] The expectation of procedural fairness may be overridden by a public interest justifying departure from the expected procedure.[681] Substantive protection may not be accorded if the public interest justifying the change of position by the authorities overrides the interest represented by legitimate expectations.

The balancing between the public and private interests is particularly significant in case of substantive protection of substantive legitimate expectations.[682] While the substantive protection of expectations *limits* the decision-maker's discretion, its exercise needs to retain flexibility for constitutional reasons. The authorities need to respond to new circumstances and protect public interest. Their discretionary powers are conferred by the legislator in situations when regulation by legislation is either impossible or not advisable. The administration uses these powers to judge when and how to apply the general law to particular circumstances. When doing so, it is obliged to act in the public interest. It also cannot fetter its discretion.[683] A decision

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[677] Stewart (n 669) 297-298. See also Sales & Steyn (n 546) 588-591; Woolf, Jowell & Le Sueur (n 546) 614, 633.

[678] *Begbie* (n 630) 1130 (Laws LJ); Sales & Steyn (n 546) 586-587.

[679] *Begbie* (n 630) 1130 (Laws LJ).

[680] Sales & Steyn (n 546) 592; Woolf, Jowell & Le Sueur (n 546) 628-629; *Coughlan* (n 564) 239.

[681] *GCHQ* (n 559) (national security – see Section C.4.a); Sales & Steyn (n 546) 592.

[682] *Coughlan* (n 564) 242; Sales & Steyn (n 546) 589, 592.

[683] Sales & Steyn (n 546) 568; Forsyth & Wade (n 554) 317; Woolf, Jowell & Le Sueur (n 546) 628, 636-637.

whether the private legitimate expectations should outweigh the public interest in discretionary flexibility defines the limits of the discretionary powers in that particular case. Doing so requires striking a fair balance between the two interests.[684]

Commentators enquire whether a determinate balancing test can be identified for this purpose.[685] One of the criticisms of *Coughlan* was that no such test exists.[686] It is agreed, however, that any the standard applicable here should be higher than the *Wednesbury* reasonableness.[687] One such standard could be the proportionality test.[688] It could provide a more structured conceptual framework for the balancing analysis but it also has its critics.[689]

In practice, English courts do not apply any mechanical standard and balance the private and public interests on a case-by-case basis, depending on the circumstances of a particular case.[690] The assessment whether the authority can depart from its earlier conduct is first made by the decision-maker when it departs from its earlier representations. This assessment is then subject to judicial review.[691] The court must take into account all relevant factors concerning the existence of expectations, their legitimacy and the exercise of discretion in the public interest.

Legitimate expectations are not protected if there is an overriding public interest justifying the decision-maker's departure from earlier representations.[692] Such

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[684] Sales & Steyn (n 546) 564; Woolf, Jowell & Le Sueur (n 546) 629; Watson (n 546) 650; *Coughlan* (n 564) 239.

[685] Sales & Steyn (n 546) 573.

[686] See Section C.4.b (comments by Australian commentators). *Coughlan* is viewed as a proposition of abuse of powers as a standard of review (Craig (n 559) 662). However, abuse of powers is viewed as insufficient in practice (see Section C.1)

[687] *Coughlan* (n 564) 242; Sales & Steyn (n 546) 590; Craig (n 559) 620-621. According to this rule a discretionary power may be abused when it is exercised to do something 'so absurd that no sensible person could ever dream that it lay within the powers of the authority' (Forsyth & Wade (n 554) 293)

[688] Laws LJ is a particular proponent of this test. See *Nadarajah* (n 565) at [68]) and *Niazi* (n 554) at [51]). See also Forsyth & Wade (n 554) 456; Craig (n 559) 665-666.

[689] Sales & Steyn (n 546) 590; Forsyth & Wade (n 554) 457; Elliott (n 562) 256.

[690] *Begbie* (n 630) 1130 (Laws LJ); *Bibi (n 627)* at [22] (Schiemann LJ). Sales & Steyn (n 546) 590-591; Woolf, Jowell & Le Sueur (n 546) 632-636; Elliott (n 562) 256; Craig & Schønberg ((n 565) 698-700) proposed four possible approaches.

[691] Sales & Steyn (n 546) 572, 590; Woolf, Jowell & Le Sueur (n 546) 629.

[692] Sales & Steyn (n 546) 580; *Coughlan* (n 564) 242.

overriding public interest may concern national security[693] or other matters of public policy, e.g. public health.[694]

Balancing may be affected by the fact that the authorities, short of fulfilling the expectations, took steps to mitigate the effects of their frustration, satisfying the requirements of fairness.[695] Such mitigation may, but does not have to, consist of compensation of out-of-pocket expenses.[696] The authorities should smooth the position as far as possible, consistently with their other duties.[697] Its mitigating actions should represent 'practical means of eliminating unfairness'.[698]

The key issue in devising an *ad hoc* standard of review is not to assign courts a role that crosses the dividing line between judicial and executive powers. The degree of court's scrutiny must respect this constitutional principle.[699] The court is 'not the primary body for identifying what the countervailing public interest might be' and what importance that public interest has vis-à-vis the interest represented by legitimate expectations.[700] The court thus needs to give weight to the views of the administration about such countervailing public interest.[701] In this context the standard followed by the *Coughlan* court has been criticised for being dismissive of the effects its decision would have on the public body and the other recipients of public services.[702]

6. Conclusions: English and Australian Law

References to legitimate expectations in English law and Australian law are linked with the exercise of discretionary powers by public administration. Legitimate expectations concern the way in which State authorities will exercise their discretion

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[693] *GCHQ* (n 559).

[694] *R. Secretary of State for Health ex parte U.S. Tobacco International Inc.* [1992] QB 353*,* 369.

[695] Woolf, Jowell & Le Sueur (n 546) 635-636.

[696] *R. v Inland Revenue Commissioners ex parte Matrix-Securities Ltd.* [1994] 1 WLR 334, 347 (Lord Griffiths).

[697] *Rowland* (n 655) at [153] (Mance LJ).

[698] *F & I Services Ltd v Commissioners of Customs and Excise* [2001] EWCA Civ 762 at [72] (Sedley LJ).

[699] Woolf, Jowell & Le Sueur (n 546) 613-614. Forsyth & Wade (n 554) 456.

[700] Sales & Steyn (n 546) 590.

[701] ibid 590.

[702] See section C.4.b. (Australian comments).

and are engendered by the conduct of these authorities. Both England and Australia accept that such expectations should be protected through procedural fairness. However, only English courts accept that expectations may be protected substantively by requiring the authorities to fulfil the individual's expectations. Substantive protection of legitimate expectations is controversial and rare in practice. A decision whether an individual has expectations worthy of substantive protection is based a case-by-case objective factual assessment. It involves analysis whether the conduct of the authorities was capable of creating such expectations and whether the individual's reliance on such a conduct was justified. If an individual is found to have had such expectations, the courts assess whether the subsequent conduct of the authorities frustrating those expectations was justified by an overriding public interest. No single standard is used for this balancing of the public and private interests.

The path taken by Australia shows that substantive protection of legitimate expectations is controversial. When a court requires fulfilment of an expectation or compensation of their frustration, it may encroach into the domain reserved for the executive powers. English courts agree that they are not equipped to second-guess the public administration. They cannot take account of all considerations and interests informing the administrative decision-making.

D. Conclusions

How can the experiences of US, English and Australian law support the development of the concept of legitimate expectations in ITL?

All these systems acknowledge that State authorities are not liable for simply frustrating RIBE or legitimate expectations and respect their right to regulate and exercise administrative discretion. RIBE assume that laws will change and that the State will regulate in the public interest thus frustrating expectations. English law respects the rule of non-fettering of discretion and requires absence of an overriding public interest for legitimate expectations to be honoured. Courts attach legal consequences to frustration of expectations when not to do so would have grave consequences to the operation of the society as a whole, undermining the trust the authorities need to govern. Neither US law nor English law offer a clear single rule for the balancing of the private and public interests involved. However, Australian law offers a valuable critique of the potential balancing mechanism. These experiences are an important background for addressing the concept of legitimate expectations in

ITL. They may guide the possible future development of references to legitimate expectations in ITL. They may be a source of methodology and experience related to assessment of expectations.

The experiences of the Anglo-Saxon legal systems may also elucidate the ITL developments so far. English law and Australian law explain at least three phenomena, namely: the insistence that legitimate expectations should only be based on specific representations[703]; the resistance to linking expectations with general laws and property rights[704]; and to suggestions that legitimate expectations are a general principle of law.[705]

RIBE can explain two other phenomena, namely: the arguments that investor's legitimate expectations are engendered by the state of the law at the time of investment[706] and the arguments that the law at the time of investment should not change to the investor's detriment.[707] Moreover, it will be a useful tool of assessment of ITA practice with regard to IIAs which include RIBE and the *Penn Central* test.

This chapter showed that English law concept of legitimate expectations was influenced by EU law and ECtHR jurisprudence, the legal regimes to which we now turn.

[703] Fietta (n 2) 388; Pandya & Moody (n 2) 3.

[704] *El Paso*/Sornarajah, paras. 55-58.

[705] Snodgrass (n 2) (in favour); Roberts (n 167) 214 (against).

[706] Dolzer, 'New Developments?' (n 5) 78-79; Dolzer, 'Impact of Investment Treaties' (n 5) 968-969; Dolzer, 'FET: A Key Standard' (n 5) 100-104; Newcombe (n 14) 45-46; Franck (n 193) 441. See Chapter 7, Section C.2.

[707] See Chapter 7, Section C.2.

Chapter 4 The Origins and Development of Legitimate Expectations Doctrine in EU law and ECtHR Jurisprudence

A. Introduction

This chapter investigates references to legitimate expectations in two European international legal systems: the EU and the ECHR. Section B looks at typical scenarios in which the EU Courts apply references to legitimate expectations. Section C explores how references to legitimate expectations are made by the ECtHR.

In both systems the concept of legitimate expectations is judge-made. The EU Courts ensure that EU law, made by the EU institutions in a broad range of areas, is applied and interpreted in a uniform way. Through its judgements and decisions ECtHR ensures that the States – members of the ECHR comply with their conventional obligations. In both systems references to legitimate expectations were inspired by the legal systems of their member States.

B. EU law and the Principle of Protection of Legitimate Expectations

1. Origins and Rationale of the Principle of Protection of Legitimate Expectations

The principle of protection of legitimate expectations is part of the EU legal order.[708] It is usually paired with[709], and viewed as arising from, the EU law principle of legal certainty.[710] It is also as an emanation of the broader constitutional principle of the rule of law (*Rechstaatsprinzip*) and the principles of fairness or justice

[708] Joined Cases 205 to 215/82 *Deutsche Milchkontor v Germany* [1983] ECR 2633, 2669 (repeated later in e.g. Case C-63/93 *Duff v Minister of Agriculture and Food, Ireland* [1996] ECR I-569, 607-608).

[709] AG Cosmas viewed both as 'a corollary to the principle of legality' which requires the law to be clear so that institutions know the limits of their powers and individuals know the extent of their rights and obligations. (Case C-63/93 *Duff v Minister of Agriculture and Food, Ireland* [1996] ECR I-569, Opinion AG Cosmas, p. I-581). See also Paul Craig, *EU Administrative Law* (Oxford University Press 2012) 549; Herwig CH Hofman, Gerard C Rowe, Alexander H Türk, *Administrative Law and Policy in the European Union* (Oxford University Press 2011) 174; Takis Tridimas, *The General Principles of EU Law* (Oxford University Press 2007) 242.

[710] Case 1/73 *Westzucker GmbH v Einfuhr- und Vorratsstelle für Zucker* [1973] ECR 723, 731. (Note: rules developed by the EU Courts operate as uniform formulas and are often repeated in multiple decisions).

(*Gerechtigkeitsprinzipien*).[711] Together with the principles of proportionality, non-discrimination, equal treatment and protection of fundamental rights, the principles of legitimate expectations and legal certainty constitute the general principles of EU law.[712] All these principles are judge-made. They developed through the ECJ's 'spontaneous judicial incorporation' [713] which saw the principle of legitimate expectations adopted early in the operation of the Communities.[714]

The principle of protection of legitimate expectations and the principle of legal certainty are not always clearly distinguished by the ECJ.[715] Some commentators view them as equivalent but it is better to treat them as separate, albeit parallel, concepts.[716] These two principles play different functions.[717] The principle of legal certainty applies universally and protects accuracy of the rules of law on which everyone is entitled to rely. The principle of protection of legitimate expectations protects specific individuals in concrete situations of trust which are recognised as worthy of protection. Moreover, legal certainty is a static concept, requiring the applicable rules to be clear and precise at a particular point of time. Conversely, protection of legitimate expectations is enjoyed for the future and concerns exercise of administrative powers over a period of time so that 'situations and relationships lawfully created under Community law are not affected in a manner which could not have been foreseen by a diligent person.'[718]

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[711] Dominik Hanf, 'Der Vertrauensschutz bei der Rücknahme rechtswidriger Verwaltungsakte als neuer Prüfstein für das "Kooperationsverhältnis" zwischen EuGH und BVerfG' (1999) 59 HJIL 51, 55. With regard to rule of law see: Schønberg (n 570) 12-24 (exhaustive explanation of the rule of law as the *rationale* of protection of legitimate expectation)

[712] Craig (n 709) 253.

[713] Gian Antonio Benacchio, Barbara Pasa, *A Common Law of Europe* (CEU Press 2005) 78.

[714] Hanf (n 711) 58.

[715] *Duff*/AG Cosmas (n 709) I-581; *Westzucker* (n 710) 731 ('principle of legal certainty by which the confidence of persons concerned deserves to be protected (*Vertrauensschutz*)'); Tridimas (n 709) 242. John A Usher, 'The Influence of National Concepts on Decisions of the European Court' (1976) 1 E.L.Rev. 359, 363-364; Damian Chalmers, Adam Tomkins, *European Union Public Law: Texts and Materials* (Cambridge University Press 2007) 455.

[716] E.g. Jürgen Schwarze, *European Administrative Law* (Sweet and Maxwell 1992) 867-868.

[717] *Duff*/AG Cosmas (n 709) I-581-582; Hanf (n 711) 55; Tridimas (n 709) 252.

[718] *Duff*/AG Cosmas (n 709) I-582; Tridimas (n 709) 252.

In developing the general principles the ECJ drew upon administrative law of EU Member States, particularly German administrative law. This is highlighted with regard to the principle of protection of legitimate expectations[719], although German law's 'reputation for being influential' in this respect cannot be really proven.[720] The origins of the principle of protection of legitimate expectations are associated with the concept of *Vertrauensschutz*.[721] This cross-fertilisation is recognised, but limited. The adoption shares the *rationale* and the general mechanism of protection based on balancing[722], but it does not follow the German concept slavishly. The scope of adoption reflects the different structures and needs of the respective legal systems.[723] In German law the principle protects of 'well-established' rights while in the EU the protection covers situations where there are no clearly established 'rights'.[724] Legitimate expectations may be parallel to individual rights or vested rights, but the concept of legitimate expectations is separate from an individual right.[725]

The concept of protection of legitimate expectations is abstract and context-specific and thus not easy to define.[726] It addresses situations beneficial to an individual or a

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[719] Craig (n 709) 253.

[720] Georg Nolte, 'General Principles of German and European Administrative Law – A Comparison in Historical Perspective' (1994) 57 MLR 191, 191.

[721] e.g. Case 74/74 *Comptoir national technique agricole (CNTA) SA v Commission* [1975] ECR 533, 540 (*CNTA*); *Westzucker* (n 710) 731; Usher (n 715) 363; Nolte (n 720). Kuusikko links legitimate expectations with good faith and the German contractual principle of *Treu und Glauben* (Kirsi Kuusikko, 'Advice, Good Administration and Legitimate Expectations: Some Comparative Aspects' (2001) 7 EPL 455, 469-470). See Chapter 1, Section E and Ch 3, Section C.1.

[722] In German law the mechanism requires *balancing* of legitimate expectations with the duty of the administration to adhere to the law. (Nolte (n 720) 203) The mechanism of *balancing* between legitimate expectations and public interests is inherent in the concept of protection of legitimate expectations.

[723] Developing the general principles the ECJ did not look for 'arithmetical common denominators' among the Member States but rather for the best solutions for adaptation to the needs of the Communities (Craig (n 709) 253, 589; Nolte (n 720) 211; Giacinto della Cananea, 'Legitimate Expectations in European and Italian Law' (2009) 1 Italian J. Pub. L. 110, 112.

[724] Usher (n 715) 364, referring to Case 81/72 *Commission of the European Communities v Council of the European Communities* [1973] ECR 573 (*Staff Case*).

[725] Case C-5/75 *Deuka Deutsche Kraftfutter GmbH v Einfuhr- und Vorratsstelle für Getreide und Futtermittel* [1975] ECR 759, Opinion of AG Trabucchi, p. 777; Schwarze (n 716) 1117; Craig (n 709) 557. The EU Courts sometimes expressly distinguish between 'legitimate expectations' and 'vested rights'. See e.g. Case 92/77 *An Bord Bainne Co-Operative Limited and The Minister for Agriculture* [1978] ECR 497, 514.

[726] Hofman, Rowe & Türk (n 709) 179; Schwarze (n 716) 954.

group of individuals which are worthy of protection and based on their trust in EU institutions. The legitimate expectations of traders[727] concern future conduct of the EU institutions and arise from these institutions' earlier conduct. Protection of expectations is sought when the future conduct turns out to be different than expected.[728] Protection is directed not at rights *stricto sensu* but at certain *favourable situations* created by a decision, representation or other conduct, discussed in the next section. Protection of expectations is not used to enforce rights or bargains, to secure against business risks or to guarantee profits. It does not protect the traders from legislative, administrative or policy changes. Rather, it targets a sudden, unexpected detrimental change in a situation when a prudent trader could have objectively and reasonably trusted the EU authorities to behave in a certain way, when such change was not justified by an overriding public interest.[729]

Although what expectations are 'legitimate' and worthy of protection depends on the circumstances of a particular case, the *rationale* for their protection is instructive in this respect. Translated literally, the phrase '*Vertrauensschutz'* means 'protection of trust' or 'protection of confidence'.[730] This reveals that protection of legitimate expectations is about the protection of *trust* or *confidence* placed by persons in the EU institutions. The principle 'provides that those subject to the law may rely on Union measures or the conduct of its officials'.[731] The need to protect trust in or reliability of the EU institutions stems from the very nature of the EU. It is 'a unique economic and political partnership between 28 European countries'[732] and a highly regulated environment. Sharpston observes that:

> legitimate expectations can only be generated in a regulated environment and arise, indeed, out of the presence of such

[727] EU courts commonly refer to economic operators as 'traders'. The principle of protection of legitimate expectations also applies in staff cases and in these two areas is not clinically isolated. Our focus, however, is on the traders.

[728] Eleanor Sharpston, 'Legitimate Expectations and Economic Reality' (1990) 15 E.L.Rev. 103, 107.

[729] Case 84/78 *Tomadini and Administrazione delle finanze dello Stato* [1979] ECR 1801, 1814-1815; ibid 147.

[730] Usher ((n 817) 363) explains that the term was originally translated as 'protection of legitimate confidence' but the term 'confidence' was thought misleading and changed to 'expectation'. (Case 2/75 *Einfur- und Vorratstelle für Getreide und Futtermittel v Firma C. Mackprang* [1975] ECR 607, Opinion of AG Werner at 622 (referring to 'the principle of the protection of legitimate confidence or expectation').

[731] Hofman, Rowe & Türk (n 709) 179.

[732] The official website of the EU. <http://europa.eu/about-eu/index_en.htm> (accessed 16 April 2014).

> regulation. In a completely non-regulated economic environment, there would be no administrative authorities to raise producers' and traders' hopes for the continuance of a particular pattern of regulation.[733]

Protection of confidence supports the system's proper operation. The traders who cooperate with the EU should not suffer an additional and unexpected detriment as a result of their cooperation. Otherwise, they would be discouraged from cooperating, an effect undesirable for any attempt to regulate the market in the future.[734]

2. Situations of Protection of Legitimate Expectation

The EU law principle of protection of legitimate expectations operates on three major planes: when general administrative or legislative measures change; with regard to revocation of decisions; and in connection with binding representations by the EU institutions vis-à-vis individuals.[735] To them our analysis now turns.

a. Legitimate Expectations and Regulatory Change

The rule underlying the operation of the principle of legitimate expectations in the context of regulatory change is that individuals do not have a legitimate expectation that an existing regulatory regime will be maintained.[736] This has two important implications. First, any EU law changes apply prospectively to situations which arose under the previous state of the law.[737] Secondly, a trader cannot bring a successful claim merely arguing that the legislative change has disadvantaged him, if such change was within the discretionary powers of the EU institutions.[738]

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[733] Sharpston (n 728) 104.

[734] Sharpston (n 728) 111-112, 147 (referring to *Tomadini* (n 729); Tridimas (n 709) 278 ('those who repose faith in the authorities must not suffer as a result'). See *Mulder* in Section B.2.a.

[735]There is no dominant uniform way of classifying legitimate expectations under EU law among those commentators who attempt an exhaustive discussion. Schønberg's classic monograph (Schønberg (n 570)) concentrates on revocation of decisions and situations when administration binds itself, not discussing retroactivity as a separate category. On the other hand, retroactivity plays the main role in Tridimas' analysis (Tridimas (n 709)).

[736] Joined Cases C-37/02 and C-38/02 *Di Lenardo Adriano Srl, Dilexport Srl and Ministero del Commercio con l'Estero* [2004] ECR I-6911, I-6977; Tridimas (n 709) 270.

[737] *Westzucker* (n 710) 729.

[738] Case 245/81 *Edeka Zentrale AG and Federal Republic of Germany* [1982] ECR 2745, 2758; Joined Cases C-133/93, C-300/93 and C-362/93 *Crispoltoni v Fattoria Autonoma Tabacchi* [1994] I-4963, I-4909 (possible reduction in earnings as a result of new regulation is not contrary to the principle of protection of legitimate expectations); Craig (n 709) 573; Schwarze (n 716) 1131.

These two rules are particularly prominent for the organisation of the EU common market. Its functioning requires 'constant adjustments to meet changes in the economic situation'.[739] This justifies broad discretionary powers of the EU institutions and diminished expectations of regulatory stability. Traders are expected to be aware of this context.[740]

As a result, protection of legitimate expectations related to a regulatory change is reserved to exceptional situations. The EU case-law identifies four types of situations where the principle of protection of legitimate expectations was successfully applied, namely: in case of retroactivity; when there were special arrangements between traders and Community institutions[741]; when the law expressly provided that certain interests must be respected in case of a regulatory change; and if such protection arose from past practice or from the very nature of a given market area. These four scenarios will be examined now.

Retroactive measures are generally prohibited in EU law as contrary to the principle of legal certainty.[742] Retroactive application of laws is allowed in exceptional circumstances.[743] The relevant test, formulated in *Racke*[744], requires satisfaction of two conditions. First, the retroactive effect must be necessary for achieving the purpose of the exceptional measure and, secondly, legitimate expectations of those concerned have to be duly respected.[745] Retroactivity is therefore generally premised on respect for legitimate expectations. This, however, does not mean immunity from change.

EU law distinguishes between two types of retroactivity. The first type, 'true' or 'actual'[746] reciprocity, encompasses situations where the change of administrative or legislative measures concerns past events. Here, the new regulations' date of entry

[739] Case C-402/98 *Agricola Tabacchi Bonavicina Snc di Mercati Federica (ATB) and Ministerio per le Politiche Agricole* [2000] ECR I-5501, I-5531; Craig (n 709) 574.

[740] See Section B.3.

[741] Craig (n 709) 575 (a 'bargain of some sort').

[742] See e.g. Case C-331/88 *The Queen v Ministry of Agriculture, Fisheries and Food ex parte Fedesa* [1990] ECR I-4023, I-4069. Craig ((n 709) 550) links it with the rule of law.

[743] Such retroactive application is entirely prohibited in relation to criminal matters. Tridimas (n 709) 252-253; Craig (n 709) 552; Schwarze (n 716) 1123-1124. These matters are outside the scope of our analysis.

[744] Case 98/78 *Firma A Racke v Hauptzollamt Mainz* [1978] ECR 69, 86.

[745] See also Case 99/78 *Weingut Gustav Decker KG v Hauptzollamt Landau* [1979] ECR 101, 111; Case 224/82 *Meiko-Konservenfabrik v Germany* [1983] ECR 2539, 2548.

[746] Schwarze (n 716) 949, 1120; Sharpston (n 728) 134 (retroactivity *stricto sensu*).

into force *predates* its publication.[747] The second type, 'false' or 'apparent'[748] reciprocity, covers situations where regulatory changes have *immediate* application to pre-existing on-going situations.[749] These two types of retroactivity are not always easily distinguishable and the *Racke* test applies to both.[750]

The General Court explained in *Campo Ebro* that:

> there is a breach of the principle of the protection of legitimate expectations if, in the absence of an overriding matter of public interest, a Community institution abolishes with immediate effect and without warning a specific advantage, worthy of protection, for the undertakings concerned without adopting appropriate transitional measures.[751]

EU law therefore protects expectations that a retroactive regulation will be accompanied by appropriate transitional measures.[752] Stronger protection from change may arise only in case of special arrangements or specific protective provisions, as discussed in the following paragraphs. Otherwise, the requirement of 'appropriate transitional measures' is satisfied by way of an appropriate procedure, e.g. a notification about the impending measures[753], a transitional period, or a gradual introduction of changes.[754] However, the requirement of transitional measures may still be outweighed by the overriding public interest, e.g. when notifying the traders of the change would nullify the goals of the measures or allow speculators to make profits.[755]

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[747] Schwarze (n 716) 1120.

[748] ibid 949, 1121; Tridimas (n 709) 266 ('material' or 'quasi-retroactivity').

[749] Sharpston (n 728) 134; Schwarze (n 716) 1121.

[750] Sharpston (n 728) 134; Schwarze (n 716) 1128. Tridimas (n 709) 266; Case C-152/88 *Sofrimport Sàrl v Commission* [1990] ECR I-2477; *CNTA* (n 721).

[751] Case T-472/93 *Campo Ebro Industrial SA, Levantina Agrícola Industrial SA and Cerestar Ibérica SA v Council* [1995] ECR II-421, 441; See also C*NTA* (n 721) 550.

[752] Sharpston (n 728) 159 ('legitimate expectation in transitional measures').

[753] Case C-376/02 *Sichting 'Goed Wonen' v Staatssecretaris van Financiën* [2005] ECR I-3445, 3479. This may also be the case when the notice is published *on the day* when the *retroactive* measures are published. The expectation is not an expectation of holding onto the *status quo* but 'of being told what was happening'. (Sharpston (n 728) 136, discussing *Racke* (n 744))

[754] Case C-110/97 *Netherlands v Commission* [2001] ECR I-8763, 8846 (restriction on rice import licensing introduced by a progressive scheme).

[755] The EU Courts treat speculative risk as risk voluntarily assumed, which is a similar approach to that applied in the US law. Sharpston (n 728) 119, 159; Case 2/75 *Einfur- und Vorratstelle für Getreide und Futtermittel v Firma C. Mackprang* [1975] ECR 607, 616.

In the second situation legitimate expectations arise when special arrangements have been made between the trader and the EU institution. Such arrangements may limit the discretion of the latter and shield the trader from sudden and unexpected changes as well as the general mutability of regulations.[756] The character of such 'bargain' has been summarised as follows*:*

> in order to deal with individual situations the Community institutions have laid down specific rules enabling traders[,] in return for entering into certain obligations with the public authorities[,] to protect themselves – as regards transactions definitely undertaken – from the effects of the necessarily frequent variations in the detailed rules [regulating a given aspect of the common market].[757]

What is required is an individualised arrangement based on specific rules involving advance commitments by the trader in return for protection from change by the institutions. If such arrangement has been made then:

> the principle of respect for legitimate expectations prohibits these institutions from amending those rules without laying down transitional measures, unless the adoption of a measure is contrary to an overriding public interest.[758]

The protection is not absolute and is unavailable if an overriding public interest requires the change and lifts the requirement of transitional measures.[759]

Two cases illustrate operation of this rule. In *CNTA,* a trader obtained an export license and arranged for refunds of monetary compensation amounts[760] to be fixed in advance. In return he paid a deposit and made an irrevocable obligation to export a specific amount of goods. However, before the exports took place the legislation changed and the refunds were abolished at short notice. The ECJ found that the abolition of refunds was unforeseeable. The arrangement between the trader and the EU created a *de facto* guarantee against exchange rate fluctuations which would have induced even a prudent trader not to seek an alternative protection against such risk. The arrangement engendered legitimate expectation that no change will occur, affecting what was arranged.[761] The trader's legitimate confidence in the EU

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[756] *Tomadini* (n 729) 1815.

[757] ibid 1814-1815.

[758] ibid 1815.

[759] On transitional measures see discussion about retroactivity above.

[760] These were payments designed to compensate for fluctuations in exchange rates.

[761] The trader has also entered into transactions from which he could not withdraw without losing the deposit (Schwarze (n 716) 1133).

rules was worthy of protection in those circumstances.[762] There was no overriding matter of public interest justifying the impact of the change on that particular trader. As a result, he should have been compensated for the loss suffered. However, his protection was limited to the unforeseeable, immediate and unjustified change and did not extend to any change.[763]

In *Mulder*[764], our second illustration, the Council sought to limit the overproduction of milk. It passed a law allowing milk producers to undertake not to produce milk for five years in exchange for a premium. Mulder participated in that scheme. After the period of non-marketing he decided to resume production and applied for a milk quota. His application was refused because the reference year to calculate the quota fell during the time when he did not produce milk under the non-marketing arrangement. Mulder was found to have a legitimate expectation not to be subject to the general quota conditions. Four elements were relevant for this finding. First, he was incentivised by the EU to enter into the non-marketing arrangement by the premium; secondly, his undertaking to suspend production was made for the general interest; thirdly, at the time the non-marketing arrangement was made it was not foreseeable that it will prevent the producer from re-entering the market and, fourthly, the milk quotas targeted him precisely because he earlier cooperated with the authorities. No such legitimate expectations would have existed had he ceased the production voluntarily, without the encouragement from the EU institutions.[765] *Mulder* supplies the rationale for protecting legitimate expectations in order to sustain conditions encouraging the traders to cooperate with the EU.[766]

In the third type of situation, the existing law mandates that in case of a regulatory change specific interests of market participants should be taken into account. This was the situation in *Sofrimport*[767], a case concerning licences for import of apples. Issuing of such licenses was suspended with immediate effect. This affected a trader

[762] *CNTA* (n 721) 549-550. Sharpston ((n 728) 128) observes that protection was triggered by the irrevocable nature of the undertaking and inevitability of the loss in case expectations were not protected.

[763] See Section B.4 *in fine*.

[764] Case 120/86 *Mulder v Minister van Landbouw en Visserij* [1988] ECR 2321. See also Case 170/86 *von Deetzen v Hautpzollamt Hamburg-Jonas* [1988] ECR 2355 and a series of subsequent 'milk quota cases', discussed e.g. by: Sharpston (n 728) 110- 112; Schwarze (n 716) 1136-1137; Tridimas (n 709) 275-280; Craig (n 709) 575-576.

[765] *Mulder* (n 764) 2352-2353.

[766] See Section D.1 *in fine.*

[767] *Sofrimport* (n 750).

whose apples were in transit but who had not yet applied for the license.[768] His application was refused under the new law. The trader had a legitimate expectation that his apples will not be affected by the suspension. The expectation was based on an express provision of the relevant law, requiring that any suspensory measures should take into account special position of the goods in transit. The goods in transit were immune from such measures, absent an overriding public interest.[769] No such interest was shown in *Sofrimport* and the Commission was found to have disregarded legitimate expectations of the trader.[770]

The last type of situation, when protection from regulatory changes may be inherent, concerns the agricultural sector. Here, the changes may need to take into account the yearly rhythm of the particular market either because of the past regulatory practice[771], or because of the cyclical nature of a given production activity.[772]

b. Legitimate Expectations and Revocation of Decisions

The second general area utilising the principle of legitimate expectations concerns revocation of decisions. Favourable decisions conferring individual rights on their addressees are binding and cannot be revoked.[773] Protection of legitimate expectations concerns here the addressee's legitimate *expectations of legality and stability* of the situation created by the binding decision.[774] The situation created by the decision cannot be changed unless such change is justified by public policy interests.[775]

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[768] This was a standard practice not a result of trader's negligence.

[769] The requirement of absence of overriding public interest arises from the ECJ jurisprudence not from the provisions of the relevant law.

[770] *Sofrimport* (n 750) 2509-2511.

[771] Case 78/74 *Deuka Deutsche Kraftfutter GmbH B.J. Stolp and Einfuhr- und Vorratsstelle für Getreide und Futtermittel* [1975] ECR 421 (previous changes which took into account the cereal marketing year created legitimate expectations of stability of the yearly rhythm of the market based on such past practice). Schwarze (n 716) 1137-1138.

[772] See e.g. C-368/89 *Crispoltoni and Fattoria autonoma di tabachi di Citta di Castello* [1991] ECR I-3695, I-3720-3721 (tobacco growers and producers can legitimately expect to be informed about restrictions of production in good time).

[773] Joined Cases 7/56 and 3 to 7/57 *Algera v Common Assembly of the European Coal and Steel Community* [1957] ECR 81; Craig (n 709) 557-558; Schønberg (n 570) 73-75; Schwarze (n 716) 1024. Unfavourable decisions can be revoked.

[774] *Algera* (n 773) 55; Case C-90/95 *P Henri de Compte v European Parliament* [1997] ECR I-1999, 2021; Craig (n 709) 557; Schønberg (n 570) 72; Schwarze (n 716) 1024.

[775] *de Compte* (n 774) I-2022; Craig (n 709) 557.

The legitimate expectations of legality and stability are linked with the addressee's knowledge about the decision, requiring it to be properly communicated.[776] A decision may be revoked when there is a legal provision allowing for such revocation[777]; when the parties explicitly consented to such possibility[778]; and when the decision was conditional and the conditions were not met.[779] In the latter case the expectation of legality and stability may depend on how strictly a given institution usually enforces conditions imposed on beneficiaries.[780] Moreover, a decision can be revoked if it was obtained by fraud or deception.[781]

Special rules apply to revocation of *unlawful* decisions. Such decisions create a tension between fairness due to the individual and the requirement of legality of administrative conduct.[782] On the one hand, the individual's legitimate expectations of legality and stability should be protected if he relied in good faith on the illegal decision and because individuals are generally not best placed to detect illegality of administrative decisions.[783] On the other hand, upholding an illegal decision may be against public interest because its existence militates against the rule of law and may legitimise situations where the authorities, 'deliberately or inadvertently, extend their powers beyond their limits set by law'.[784]

Unlawful decisions are always prospectively revocable.[785] They can be revoked retrospectively subject to certain conditions. These require that the revocation is carried out within a reasonable period time and that the public interest in revocation

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[776] Craig (n 709) 557; Schønberg (n 570) 77.

[777] Schønberg (n 570) 73.

[778] Craig (n 709) 558; Schønberg (n 570) 79.

[779] Craig (n 709) 558-559; Schønberg (n 570) 76. Until the conditions are met the decision is revocable.

[780] Craig (n 709) 559.

[781] Case C-96/89 *Commission v Netherlands* [1991] ECR I-2461, 2495; *de Compte* (n 774) I-2021. Craig ((n 709) 558) and Schønberg ((n 570) 79) criticise this broad approach as too strict, penalising innocent misinformation. Understanding of fraud and deception is broad. See Section B.3 *in fine*.

[782] Craig (n 709) 562; Schønberg (n 570) 89.

[783] Schønberg (n 570) 89, 98-99; Joined Cases 42 and 49/59 *Société Nouvelles des Usines de Pontlieue – Acriéries du Temple (SNUPAT) v High Authority of the European Coal and Steel Community* [1961] ECR 101, 87 (*SNUPAT*); *de Compte* (n 774) 2021.

[784] Schønberg (n 570) 89 (footnotes omitted).

[785] ibid 97 (suggesting that the *Campo Ebro* principle would apply here, requiring for a transitional period in case of immediate application and lack of overriding public interest). Similarly, Craig (n 709) 566-567.

outweighs the private interest in upholding it. Balancing of the principles of legality and legal certainty[786] is first undertaken by the EU institution purporting to revoke the decision. It is then assessed by the EU Courts in the process of judicial review.[787]

No legitimate expectations exist if the addressee did not treat the decision as final, e.g. because his sophistication allowed him to notice that the decision was unlawful[788] or because he did not have an expectation in fact.[789] No expectations exist when the addressee contributed to the decision's illegality[790] or when the EU institutions did not exceed reasonable time in noticing and correcting the illegality.[791] The broader implications of revocation should also be assessed, namely whether the addressee can adapt to the changed circumstances in case of revocation[792] and whether non-revocation would affect any third party interests. Financial reliance on the decision is important, but not decisive, for affording protection.[793]

c. Legitimate Expectations Arising from Representations

The third general area utilising the principle of protection of legitimate expectations concerns representations pursuant to which:

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[786] *SNUPAT* (n 783) 87 and Case 14/61 *Koninklijke Nederlandische Hoogovens en Staalfabrieken N.V. v High Authority of the European Coal and Steel Community* [1962] ECR 485, 273-274.

[787] Schønberg (n 570) 97, 98; Case 111/63 *Lemmerz-Werke GmbH v High Authority of the European Coal and Steel Community* [1965] ECR 835, 690.

[788] Schønberg (n 570) 99; Case C-365/89 *Cargill BV v Producktschap voor Margarine, Vetten and Oliën* [1991] ECR I-3045, 3065-3066 (mistake so obvious that other traders contacted the Commission about it; the ECJ found that a 'prudent trader could not have been led to rely on the lawfulness of a measures containing error of that kind'); Case C-15/85 Cons*orzio Cooperative d'Abruzzo v Commission* [1987] ECR 1005, 1036 (the trader had no way of detecting a mistake which was easy to discover by the Commission because irregularities were not manifest and could not be detected by reading the decision and rules on the basis of which it was made have not been published.)

[789] Case 14/81 *Alpha Steel Ltd. v Commission* [1982] ECR 749, 764 (the decision challenged as unlawful).

[790] Case C-500/99 *P Conserve Italia Soc. Coop. arl v Commission* [2002] ECR I-867, 948; Craig (n 709) 565.

[791] Case 112/77 *August Töpfer & Co. GmbH v Commission* [1978] ECR 1019, 1033; Schønberg (n 570) 100-101; Craig (n 709) 563. There are no hard and fast rules here, the EU courts apply the criterion of 'reasonable delay' here, which is heavily case-specific.

[792] E.g. in *Alpha Steel* ((n 789) 770) adjustment of a decision to grant a quota was allowed as by the time of revocation the trader has used only small percent of his quota and refusal to allow larger quota did not affect him adversely. Schønberg (n 570) 99; Craig (n 709) 563.

[793] Schønberg (n 570) 99 (observes that no claim regarding revocation of an illegal decision was successful in the absence of reliance); Craig (n 709) 565.

> [an] individual … is in a situation in which it is clear that the Community administration has, by giving him precise assurances, led him to entertain reasonable expectations.[794]

In this context[795] legitimate expectations are engendered by a 'self-binding action' of the authorities[796] that 'cannot be categorised as final decisions or determinations'.[797]

Like in English law, there are no hard and fast rules as to what conduct of EU institutions constitutes representations giving rise to legitimate expectations.[798] The relevant conduct is analysed on a case-by-case basis. Representations constitute 'explicit or implicit administrative pronouncements of facts, law or intent'.[799] To engender legitimate expectations they need to be precise and specific [800], as well as made by responsible authorities.[801]

Virtually all forms of explicit representations could conceivably become an expectations-creating representation.[802] Oral statements carry less weight than written statements either for evidentiary reasons or because they are often made without proper delegation.[803] However, if uncontested, 'precise, unconditional and consistent' representations that 'came from authorised and reliable sources' can

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[794] Joined Cases T 66/96 and T 221/97 *Mellett v Court of Justice of the European Communities* [1998] FP-II-A 1305, 1335-1336; Craig (n 709) 567.

[795] The EU Courts also use broader statements covering the general areas described in the preceding two sections. See e.g. Case T-489/93 *Unifruit Hellas EPE v Commission* [1994] ECR II-1201, 1222, Case T-72/99 *Meyer v Commission* [2000] ECR II-2521, 2540; Case T-203/96 *Embassy Limousines & Services v European Parliament* [1998] II-4239, 4265.

[796] Schwarze (n 716) 1079.

[797] Schønberg (n 570) 105; Schwarze (n 716) 1079.

[798] Schønberg (n 570) 120; Craig (n 709) 568.

[799] Schønberg (n 570) 105.

[800] ibid 120; Craig (n 709) 568; Case T-465/93 *Consorzio Gruppo di Azione Locale 'Murgia Messapica' v Commission* [1994] II-361, 386; Case T-123/89 *Chomel v Commission* [1990] ECR II-131, 139-140 (silence following request for confirmation not a precise assurance); Case T-571/93 *Lefebvre and others v Commission* [1995] ECR II-2379, 2407-2408.

[801] *Meyer* (n 795) 2541 (assurances not received from EU officials).

[802] Schønberg (n 570) 120; Craig (n 709) 567. They refer to letters, faxes, reports, communications, codes of conduct, consistent practice. In an early commentary Schwarze ((n 716) 1080-1093).

[803] Schønberg (n 570) 121; Schwarze (n 716) 1090-1091. See e.g. Case 21/64 *Macchiorlati Dalmas e Figli v High Authority of the European Coal and Steel Community* [1965] ECR 175, 189 (official approval needed for assurances resulting in abandonment of a cause of action by the authorities).

engender legitimate expectations.[804] Only very precisely worded written representations could have such effect.[805] Legitimate expectations cannot arise from general statements, either oral[806] or written[807], or from representations that are conditional or qualified.[808]

Unlike unlawful decisions, unlawful representations cannot give rise to legitimate expectations.[809] The principle of protection of legitimate expectations cannot justify repetition of an incorrect interpretation of an EU measure[810] or force an EU institution to apply EU law *contra legem.*[811] Similarly, it cannot apply to an undertaking that ignores the applicable law[812], to the conduct of a Member State that is in breach of EU law[813] or to undertakings by an institution which does not have the power to make them.[814]

Legitimacy of an expectation arising from representations is assessed objectively in the circumstances of the case. This involves an analysis of the regulatory context of the representation, the nature of the representation and the knowledge of the addressee.[815] The inquiry into the regulatory context may cover the rules and

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[804] *Mellett* (n 794) 1337; Case T 273/01 *Innova Privat Akademie GmbH v Commission* [2003] ECR II 1093, 1104.

[805] Schønberg (n 570) 123.

[806] Joined Cases 303 and 312/81 *Klöckner-Werke AG v Commission* [1983] 1507, 1529 (a declaration in a phone conversation that the authorities will 'solve the problem' insufficient); Schwarze (n 716) 1090.

[807] Joined Cases T-458/93 and T-523/93 *Empresa Nacional de Urânio SA (ENU) v Commission* [1995] II-2459, 2496 (a letter from the Commissioner of a political character meant only to open negotiations); *Lefebvre* (n 800) 2408 (letters worded in 'very general terms'); Schønberg (n 570) 124.

[808] *Innova* (n 803) 1104-1105 (a fax communicating a provisional decision explicitly stating that it is subject to a final decision); Case T-7/93 *Langnese-Iglo GmbH v Commission* [1995] II-1533, 1553-1554 (a comfort letter reserving rights to reopen the matter).

[809] Craig ((n 709) 588, 589-590) criticises this approach as too strict, arguing that the EU Courts should treat unlawful representations in the same way as unlawful decisions.

[810] Case C-313/90 *Comité International de la Rayonne et des Fibres Synthétiques (CIRFS) v Commission* [1993] I-1125, 1188 (*CIRFS*).

[811] *CIRFS* (ibid) 1188; Joined Cases C-31/91 to C-44/91 *Alois Lageder SpA and others v Amministrazione delle Finanze dello Stato* [1993] I-1761, 1790.

[812] Case 162/84 *Vlachou v Court of Auditors* [1986] ECR 481, 492; Case 188/82 *Thyssen AG v Commission* [1983] ECR 3721, 3734 ('no official can give a valid undertaking not to apply Community law'), Sharpston (n 728) 159.

[813] *Alois Lageder* (n 811) 1790-1791.

[814] ibid 1791.

[815] Schønberg (n 570) 118; Schwarze (n 716) 1134-1135.

procedures applicable to the situation in question and any general assumptions inherent in a given practice area.[816] The wording and the form of the representations will also be relevant.[817] The analysis enquires whether, in the circumstances of a particular case, the alleged representations could have led the claimant to 'a well-founded belief'[818] of the sort claimed by him. The standard of the addressee's knowledge overlaps with the 'prudent trader' standard, discussed in Section B.3.

Embassy Limousines is one of the few successful cases of legitimate expectations engendered by representations.[819] It concerned public procurement of transport services for the European Parliament. Before the results of the bid were announced the claimant, a participant in the bid, was informed by the authorities in an uncontested telephone conversation that an official opinion had been issued in favour of awarding the contract to him. The telephone contact was not part of the bidding procedure. However, it was clear to both parties that such contact was necessary because the future contract required the bidder to increase its capacity. Relying on the telephone conversation the claimant made certain pre-contractual investments, of which he informed the future employer. Those investments were reasonable and realistic in the circumstances. This was because the European Parliament 'induced in its intended co-contracting party the certainty of winning a contract and, in addition, encouraged that party to make irreversible investments'.[820] It thereby encouraged the claimant to 'take risk which went beyond that normally run by tenderers in a tendering procedure'.[821] Similarly to the *CNTA* case, the EU institutions induced a reasonable and prudent trader to take greater risk than he would have taken otherwise.

3. The 'Prudent Trader' Standard

Assessing whether the EU institutions engendered legitimate expectations worthy of protection requires analysis: of the conduct allegedly giving rise to such expectations; of the measures that allegedly frustrated them; and of the conduct and

[816] E.g. in state aid cases the aid is legal only when it is officially found to be legal. See also general assumptions related to organisation of the common market in Sections B.2.a. and B.4.

[817] Schønberg (n 570) 120.

[818] *Meyer* (n 795) 2544.

[819] *Embassy Limousines* (n 795).

[820] ibid 4267.

[821] ibid 4269. Such normal risk includes costs connected with the preparation of the bid.

attitude of the trader who claims to have enjoyed the expectations which were later frustrated. The latter encompasses three major points, namely: whether in light of the circumstances the trader could have reasonably enjoyed the expectations he claims to have enjoyed; whether he could have foreseen the measures that frustrated his expectations and, lastly, whether he acted in good faith.

The EU Courts developed the concept of a 'prudent trader' which sets an objective standard of assessment of the circumstances related to legitimate expectations.[822] It assumes that the trader has some level of knowledge about the market sector in which he operates. The required level of knowledge and sophistication is high because most litigants are professionals and 'may be expected to show considerable diligence in their dealings with the administration'.[823] Sharpston observes that:

> the behaviour expected of the prudent trader is based upon what the well-informed, experienced trader ought to have anticipated (even if he was not in a position to predict every detail of the change), and not what the neophyte, the non-specialist or the small trader might have guessed.[824]

The prudent trader is required to be 'discriminating and well-informed' and thus aware of the highly regulated policy areas.[825] The measure does not have to be foreseeable in every detail, it is sufficient to be foreseeable in some form.[826] A trader is expected to be very well informed and, if relevant information was publicly available, the measure would most probably also be foreseeable. The required knowledge covers political and legal information[827] as well as general economic developments and market trends.[828] The required level of knowledge is very demanding.[829] It implies a detailed enquiry into the relevant information by the court. The trader is protected only against sudden and unforeseeable occurrences.[830]

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[822] Schønberg (n 570) 119; Sharpston (n 728) 158.

[823] Schønberg (n 570) 127. The high standard applies also to staff cases as civil servants are also professionals.

[824] Sharpston (n 728) 150.

[825] Schønberg (n 570) 127.

[826] ibid 127.

[827] Schønberg (n 570) 127 (information about law, proposals for legislation, official communications, policy, general and specialised papers); Sharpston (n 728) 158-159.

[828] Schønberg (n 570) 127.

[829] Craig (n 709) 571. Schønberg ((n 570) 127) and Sharpston ((n 728) 158-159) criticise this approach as disadvantaging smaller traders.

[830] Sharpston (n 728) 107.

In the context of regulatory change, the 'prudent trader' standard means that the trader, aware of the inherent fluctuations of the relevant market area, cannot expect immunity from regulations. He can expect that the law will not apply in an unforeseeable manner, although non-foreseeability is measured against the high standard of knowledge.[831] Assessment of the special arrangements to mitigate regulatory changes will be measured against whether the trader, as a prudent trader, could have foreseen that the arrangement will not protect him from specific change.[832] With regard to revocation of decisions, it is important whether the trader was or could have been aware of the circumstances prompting the revocation, including the decision's unlawfulness. The 'prudent trader' standard is particularly relevant to expectations engendered by representations. The trader's knowledge is crucial for the assessment of his understanding of the expectations-engendering conduct of the authorities in a given context and of the foreseeability of their later inconsistent conduct. There is, however, no test that could be mechanically applied to all these circumstances. Rather, the EU Courts analyse the context of each case assessing the position of the claimant though the lens of the 'prudent and discriminating trader' and in the light of the circumstances of a specific case.

The principle of legitimate expectations is unavailable if the trader had not acted in good faith. Legitimate expectations cannot arise if the relevant decision or representations were based on fraud or deception caused by the addressee. This includes situations when the trader provided the authorities with inaccurate, incomplete, misleading or false information.[833]

4. Balancing the EU Interest with the Private Interest

Legitimate expectations arising from representations need to be balanced against the policy reasons underlying the measures which frustrated these expectations.

This balancing process is based on the premise that the EU institutions enjoy broad discretion. The EU is a dynamic and highly regulated environment, where the EU Council and Commission enjoy broad discretion in complex economic matters. This discretion covers general assessment of a given situation, choice of appropriate measures and their implementation. The rule of law obliges the institutions to act on

[831] Case 108/81 *G.R. Amylum v Council and others* [1982] ECR 3107, 3132-3133 ; Case 265/85 V*an den Bergh en Jurgensand Van Dijk FoodProducts and others v Commission* [1987] ECR 1155, 1181.

[832] *CNTA* (n 721); *Mulder* (n 764) 2353.

[833] See Section B.2.b.

the basis and in accordance with the appropriate laws and in pursuance of EU policies.[834] As a result:

> traders are unable to claim that they have a legitimate expectation that an existing situation which is capable of being altered by decisions taken by those institutions within the limits of their discretionary powers will be maintained.[835]

The principle of protection of legitimate expectations imposes limitations on these broad discretionary powers.[836] The overriding public interest represented by the discretion and the private interest embodied in legitimate expectations are opposing values that need to be balanced to decide whether the trader's expectations should be protected from discretionary powers.[837] Thus, even if a claimant can show that he enjoyed legitimate expectations, their protection still depends on the absence of an overriding public interest justifying their frustration.[838] The EU institutions must show such justifying public interest behind the measures they adopted, for the EU Courts to balance it with the trader's legitimate expectations.

Like English and US courts, the EU Courts have not developed any specific test applicable to this balancing exercise.[839] Schønberg observed that in practice the Courts apply the test of a 'significant, serious, or even extreme imbalance'.[840] Craig suggested that the EU Courts should apply the proportionality test.[841] Given its equitable and *ad hoc* nature, the balancing reflects the EU Courts' 'essentially pragmatic attitude' and is tailored to the circumstances of a particular case.[842] As a result, the principle of protection of legitimate expectations cannot be distilled into a specific mechanical test, lowering the predictability of the principle of protection of

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[834] *Deuka* (n 74) 432; *Racke* (n 744); Sharpston (n 728) 103.

[835] Case 52/81 *Offene Handelsgesellschaft in Firma Werner Faust v Commission* [1982] ECR 3745, 3762-3763; *Edeka* (n 738) 2758.

[836] Sharpston (n 728) 110. Tridimas (n 709) 279) observes that this limitation is more severe than that arising from the principle of equal treatment. This limitation is self-imposed as conduct giving rise to legitimate expectations is also a result of exercise of discretion (see e.g. *Staff Case* (n 724) 584).

[837] Hanf (n 711) 55-56.

[838] Craig (n 709) 584; Hanf (n 711) 57.

[839] Craig (n 709) 585 (courts 'reluctant to assign a discrete legal label to this exercise').

[840] Schønberg (n 570) 119.

[841] Craig (n 709) 586.

[842] Sharpston (n 728) 160.

legitimate expectations. This encourages claims which are, however, rarely successful.[843]

The judicial review of the conduct frustrating expectations is limited to examining 'whether it contains manifest error or constitutes a misuse of power or whether the authority did not clearly exceed the bounds of its discretion'.[844] The EU Courts do not substitute their own evaluation of the matter for that of the competent authority[845] and they usually support a wide margin of manoeuvre for the EU institutions, even if the adopted schemes are subject to criticism.[846]

In case of a rare finding that claimant's legitimate expectations were frustrated and deserve protection, the EU Courts order the EU institutions to make good the damage suffered if the institution was at fault.[847] Such damages are narrowly circumscribed. In *CNTA* the trader could have been compensated only for the loss caused by the withdrawal of the fixed compensatory amount and the re-exposure to the foreign exchange risk. The arrangement did not protect him from the loss of profit and there was no guarantee that the arrangement will be maintained.[848] The compensation claim ultimately failed for lack of evidence of any relevant loss.[849] In *Mulder* the EU institutions were ordered to compensate the damage caused by the refusal of the milk production quotas.[850] In *Embassy Limousines* the claimant was awarded compensation for the investments made in reliance on the representations that engendered his legitimate expectations.[851]

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[843] Tridimas (n 709) 251; Schønberg (n 570) 119. Craig ((n 709) 269) argues that low success rate is due to inability to establish that assurances were specific and precise enough rather than broad margin of discretion. Not in all cases the balancing is express (see e.g. *Embassy Limousines* (n 795)).

[844] *Racke* (n 744) 81. See also e.g. *Deuka* (n 771) 432 (courts 'must restrict themselves to examining whether the evaluation of the competent authority contains a patent error or constitutes a misuse of power').

[845] *Deuka* (n 771) 432; Schønberg (n 570) 118-119.

[846] Sharpston (n 728) 108-109, 128.

[847] For detailed analysis of the question of liability and legitimate expectations see: Schønberg (n 570) 167-236.

[848] *CNTA* (n 721) 550. See Secton B.2.a.

[849] Case 74/74 *Comptoir national technique agricole (CNTA) SA v Commission* [1976] ECR 797, 806.

[850] Joined Cases C-104/89 and C-37/90 *Mulder v Council* [1992] ECR I-3061. The detailed analysis of damage suffered can be found in C-104/89 and C-37/90 *Mulder v Council* [2000] ECR I-203. See Section B.2.a.

[851] *Embassy Limousines* (n 795) 4275 and 4277. The ECJ also added equitable compensation for non-material damage caused by keeping the claimant in uncertainty

5. Conclusions

The principle of protection of legitimate expectations in EU law is 'rather intangible' and cannot be easily defined or described by pointing to some distinguishing features.[852] As a result, it does not lend itself to mechanical applications and any generalisations in its cursory descriptions open doors for misunderstandings.[853] The principle is equitable in character, focusing on equitable and common sense economic considerations that underlie the EU Courts' case-law in this area.[854]

Even though the EU Courts formulate general rules applying to the concept, their application in practice is heavily case-specific and requires careful inquiry into the circumstances of each particular case, often leading to strict distinguishing of claims attempting to rely on similarities with previous cases.[855] As a result, claims based on protection of legitimate expectations rarely succeed.[856] Such claims cannot be successful on the general premise of an unfavourable change of regulations. Something more is required to create specific confidence of a prudent, discriminating and informed participant of the heavily regulated market that could override the public interest in regulating this market and in 'a responsible administration to control speculation and evasion of Community regulations'.[857] Expectations should be protected to prevent systemic distrust between traders and the administration. The next section explores the approach taken to the concept of legitimate expectations by another pan-European legal regime, namely the ECHR.

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and forcing him to make 'useless efforts with a view to responding to the urgency of the situation'.

[852] Eleanor Sharpston, 'European Community Law and the Doctrine of Legitimate Expectations: How Legitimate, and for Whom' (1999) 11 Nw.J.Int'l L.& Bus. 87, 103.

[853] *Deuka*/AG Trabucchi (n 725) 777.

[854] Sharpston (n 853) 103 and (n 728); Tridimas (n 709) 281; *Deuka*/AG Trabucchi (n 725) 777.

[855] See e.g. *CNTA* (n 721) v *Tomadini* (n 729) (claimant's situation outside the transitional regulation); *Mulder* (n 764) v Case C-85/90 *Dowling v Ireland* [1992] I-5305 (the non-marketing was due to the milk producer's ill health and not a result of an individual bargain with the authorities) and Joined Cases 196/88 to 198/88 *Cornée v Coopérative agricole laitière de Loudéac* [1989] ECR 2309 (development plans approved by national authorities distinguished from arrangements in *Mulder* (n 764)); *Sofrimport* (n 750) v *Unifruit Hellas* (n 795) 1223-1225 (the new measures were of different character than the ones in *Sofrimport* and protection of goods in transit did not extend to them).

[856] Schwarze (n 716) 1113-1114; Sharpston (n 728) 159; Craig (n 709) 563, 568, 569; Tridimas (n 709) 251.

[857] Sharpston (n 728) 158.

C. Legitimate Expectations and Property Protection under the ECHR

1. The Origins and Context of the Concept of Legitimate Expectations in the ECtHR Jurisprudence

The ECtHR uses the concept of legitimate expectations in the context of protection of property[858], which is the second most frequently invoked guarantee of the ECHR.[859] Although the use of the concept by the ECtHR is not as widespread and established as in English law and EU law[860], it is still relevant to our analysis.[861]

The ECtHR was a late adopter of the concept, which arrived before it through arguments made under national legal systems. The first cases invoking the concept of legitimate expectations concerned the right to fair trial under Article 6 ECHR.[862] They arose in the English and German legal systems respectively and were influenced by the English law concept of legitimate expectations[863] and the German law concept of *Vertrauensschutz.*[864]

The ECtHR did not indicate the origins of the concept of legitimate expectations in its practice. There is no systematic approach to the ECtHR practice and its case-law

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[858] It has also been invoked in relation to the right to private life (e.g. *Von Hannover v Germany (No. 2)* (2012) 55 EHHR 15) and the right to family life (e.g. *Antwi v Norway*, App no 26940/10 (ECtHR, 14 February 2012))

[859] Luzius Wildhaber, Isabelle Wildhaber, 'Recent Case Law on the Protection of Property in the European Convention on Human Rights' in Binder C et al (eds), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press 2009) 657.

[860] Luzius Wildhaber, 'The Protection of Legitimate Expectations in European Human Rights Law' in Mario Monti and others (eds), *Economic Law and Justice in Times of Globalisation, Festschrift für Carl Baudenbacher* (Nomos 2007) 256.

[861] ibid 253.

[862] It guarantees, among others, the right to fair and public hearing by an independent and impartial tribunal and adequate time and facilities for the preparation of criminal defence.

[863] *Campbell and Fell v The United Kingdom* (1985) 7 EHRR 165, para. 72. A prisoner could legitimately expectat to be released before the end of his prison term based on a *practice* of granting remission. Remission was discretionary but in practice applied to every prisoner. The Court's reference to 'legitimate expectations' resembles that of Lord Denning's in *Schmidt* (n 545).

[864] *Colak v Germany*, App no 9999/82 (ECtHR, 6 December 1988), para. 26. The applicant argued that he was promised that his case will be treated as a lesser crime. The conduct of State authorities did not create legitimate expectation (*Vertrauenstatbestand*). The 'promise' was informal, it was not foreseen in criminal procedure and not formally confirmed by the court.

needs intellectual clarification and doctrinal coherence.[865] Commentators link the origins of the concept in the ECtHR jurisprudence with the EU law's principle of legitimate expectations as 'invoked and adapted to the distinctive context of the [ECHR]'[866] or, more broadly, to a pan-European concept of legitimate expectation influenced by German constitutional law and applied by the EU Courts and national courts.[867]

The concept of legitimate expectations discussed here is used in the context of Article 1 of Protocol 1 to the ECHR ('P 1/1') which states that:

> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provision shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

By expressly referring to the State's right to regulate and eschewing a reference to 'property right' or compensation, P 1/1 is textually at the opposing pole from the minimalist US Takings Clause. The ECtHR practice elucidated that P 1/1 guarantees the right to property[868] and consists of three interrelated[869] rules: the principle of peaceful enjoyment of property; the rule that deprivation of possessions is prohibited unless certain conditions are met; and the rule that the State can limit property rights pursuant to a general interest by introducing laws which the State deems necessary for such purpose.[870]

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[865] Christian Tomuschat, 'The European Court of Human Rights and Investment Protection' in Binder C et al (eds), *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (Oxford University Press 2009) 647; Steven R Ratner, 'Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law' (2008) 102 AJIL 475, 497.

[866] Wildhaber (n 860) 253.

[867] Patricia Popelier, 'Legitimate Expectations and the Law Maker in the Case Law of the European Court of Human Rights' (2006) 1 E.H.R.L.R. 10, 10.

[868] *Marckx v Belgium* (1979-1980) 2 EHRR 330, para. 63.

[869] *James v United Kingdom* (1986) 8 EHHR 123, para. 37 (Note: rules developed by the ECtHR operate as uniform formulas and are often repeated in multiple decisions). See also Wildhaber (n 860) 255.

[870] *Sporrong and Lönrroth v Sweden* (1983) 5 EHRR 35, para. 61.

P 1/1 does not define 'possessions'. The ECtHR interprets this concept as autonomous and independent from classifications applicable in the national laws.[871] This allows the Court it to adopt a broad concept of 'possessions', extending beyond the commonly understood meaning of property.[872] 'Possessions' therefore include existing possessions or assets, including claims, with respect to which the applicant can argue that he has *at least* a legitimate expectation of obtaining effective enjoyment of a property right.[873] The concept of legitimate expectations extends the ECHR's protection beyond the conventional notions of property.[874] However, it is difficult to define in detail. The intellectual rigour of the first two ECtHR cases referring to legitimate expectations, where the concept was based on reliance on specific representations or established practice of the State authorities, was not followed in subsequent case-law. Legitimate expectations have been described in broad terms as 'a legitimate expectation that a certain state of affairs will apply'[875] or a situation 'where the state has given grounds for an individual to think that he or she has some degree of protection in relation to a property-type interest'.[876] These arguable definitions do little to explain the concept. It is therefore more instructive to enquire into the relevant scenarios in which legitimate expectations are invoked.

2. Scenarios in which ECtHR Refers to Legitimate Expectations

Two references to legitimate expectations by the ECtHR are particularly relevant to our analysis. They are used at the applicability stage of analysis and concern situations where the applicant's legal status was found to be based on *ultra vires* administrative acts or situations where the 'possession' in question is a well-founded

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[871] *Gasus Dosier- und Fördertechnik GmbH v Netherlands* (1995) 20 EHRR 403, para. 53.

[872] Tom Allen, *Property and the Human Rights Act 1998* (Hart Publishing 2005) 40; Wildhaber & Wildhaber (n 859) 659-660; Wildhaber (n 860) 255, 258; Ursula Kriebaum, Christoph Schreuer, 'The Concept of Property in Human Rights Law and International Investment Law' in Breitenmoser S et al (eds), *Human Rights, Democracy and the Rule of Law, Liber Amicorum Luzius Wildhaber* (Dike Werlag 2007) 2; Monica Carss-Frisk, *The Right to Property. A Guide to the Implementation of Article 1 of Protocol No. 1 of the European Convention on Human Rights,* Human Rights Handbooks, No. 4 (Council of Europe 2001) 6.

[873] *Malhous v The Czech Republic*, App no 33071/96 (ECtHR, 12 July 2001), p. 16.

[874] Philip Sales, 'Property and Human Rights: Protection Expansion and Disruption' (2006) 11 JR 141, 144.

[875] Carss-Frisk (n 872) 6.

[876] Sales (n 874) 144.

legal claim that could have been pursued before national courts. These two scenarios will be discussed below.

a. Legitimate Expectations and Ultra Vires

Situations where the applicant's legitimate expectations are related to some *ultra vires* administrative actions are the least controversial in the practice of the ECtHR.[877] These cases belong to a broader category where the applicant's situation is tainted by nullity, voidness or illegality.[878] In these cases the applicant does not have a recognised right under national law but it may have a 'possession' under P 1/1.[879] As a rule, the ECtHR refers to legitimate expectations when it finds that, despite being *ultra vires*, the conduct of authorities created a protected legal situation for the property owner.

The leading cases here are *Pine Valley*[880] and *Stretch*.[881] In *Pine Valley* the 'possession' in question concerned the right to develop a plot of land. The applicants purchased the land for the purpose of development, relying on a provisional planning permission registered in an official register which designated the site for industrial warehouse and office development. The site was located in an area zoned for agricultural development preserving a green belt. The applicants were denied a detailed planning permission and, on appeal, the national courts found that the provisional permission was a nullity. Subsequent legislation remedying this this situation did not apply to the applicants. As a result, they could not develop the land and its value dropped substantially. The ECtHR found that at the time when the land was purchased the applicants were 'perfectly entitled to assume' that the planning permission was valid. The permission was equivalent to a favourable decision as to the principle with regard to the proposed development and it could not be reopened by the authorities. The subsequent declaration of nullity constituted an interference

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[877] It is argued that ECtHR's references to legitimate expectations should be limited to this scenario. See *Centro Europa 7 S.R.L v Italy*, App no 38433/09 (ECtHR, 7 June 2012), Concurring Opinion of Judge Vajic; Wildhaber (n 860) 260, 263; Allen (n 872) 57. See Section C.2.b. below.

[878] E.g. in *Beyeler* a transaction between two private parties was invalid but its effects were *de facto* recognised by the authorities. The ECtHR did not refer to 'legitimate expectations' in this case observing that '[t]he complexity of the factual position prevents its being classified in a precise category.' (*Beyeler v Italy* (2001) 33 EHRR 52*,* paras. 104-106)

[879] Allen (n 872) 64.

[880] *Pine Valley Developments Ltd. v Ireland* (1992) 14 EHHR 319.

[881] *Stretch v The United Kingdom* (2004) 38 EHRR 12.

with the applicant's 'possession'. As a result, the applicants 'had at least a legitimate expectation of being able to carry out their proposed development' which was a component part of the property.

A similar situation arose in *Stretch,* where the 'possession' was a right to extend a long-term lease contract with the local authorities.[882] The contract was originally signed for 22 years and its terms provided that the lessee will build light industrial buildings and sub-let them for rent. The contract included an option to renew the lease for a further 21 years, provided that the lessee complied with its covenants. When the lessee applied for renewal, the authorities negotiated the draft of the new lease, which the lessee signed. Subsequently, the authorities notified the applicant that they did not have the authority to sign the lease with the renewal option in the first place and thus the option was *ultra vires* and could not be exercised. The English courts agreed, albeit reluctantly.[883] The ECtHR found that when entering into the lease both the applicant and the authorities have not been aware of any legal obstacle to the renewal option and that the option constituted an important part of the lessee's consideration. He built the required buildings, was sub-letting them and paid ground rent, and thus was clearly expecting the renewal of the lease. The renewal negotiations had reached an advanced stage and the *ultra vires* problem was raised very late. The ECtHR found that the applicant had at least a legitimate expectation to exercise his option to renew the rent.

In both cases, the legitimate expectations of certain enjoyment of the applicants' possessions were *attached* to the existing property rights. In *Pine Valley* the expectation of development was attached to the land. In *Stretch* the expectation of contract renewal was attached to the lease. The applicants detrimentally relied on certain legal acts bearing on their property rights.[884] At the time it was justifiable to treat those acts as having a sound legal basis[885], as they could not be unilaterally changed by the authorities and their illegality was not foreseeable at the time they were issued. It is unclear, however, whether the P 1/1 *protection* concerned

[882] See also *Fedorenko v Ukraine* (2008) 46 EHHR 6 (a currency clause in a sale contract later found to be *ultra vires* which was an important part of the applicant's consideration).

[883] The Court of Appeal observed that it was unjust for the authorities 'to take advantage of their own errors to escape from the unlawful bargains'. (*Stretch* (n 881) 22)

[884] Purchase of property for a certain price based on information in the public register in *Pine Valley* (n 880) and construction of buildings based on the option to renew in *Stretch* (n 881).

[885] *Kopecký v Slovakia* (2005) 41 EHRR 43, para. 47.

expectations of the lease renewal and development of property respectively or expectations that the legal acts on which the applicants' relied will not be retrospectively invalidated. This is particularly relevant in *Pine Valley,* where ignoring the nullity of the provisional development plans was not equivalent to a guarantee that the applicant will be granted the detailed planning permission.

This potential double meaning of legitimate expectations is also visible in *Anheuser-Busch*.[886] A company filed an application to register a trademark. The application was subsequently invalidated based on a retrospective international agreement. The ECtHR found that, since the application gave the applicant certain conditional proprietary rights[887], he had a 'possession' under P 1/1. However, it refused to pronounce that the applicant had 'legitimate expectations'.[888] The question whether the trademark application would have been ultimately successful, an outcome meaning that the registration did not infringe third party rights, was at the heart of the underlying dispute between the applicant and another private party, both of whom claimed rights to that trademark.[889] The Court did not want to suggest that the applicant had a legitimate expectation that the trademark will be registered or an expectation that the application will not be invalidated.[890] It appears therefore that in situations such as *Pine Valley* and *Anheuser-Busch,* where expectations of non-retroactivity are not equivalent to expectations of obtaining an asset, it will be up to the ECtHR's discretion to use the concept of legitimate expectations.[891]

The ECtHR's understanding of 'possessions' in the form of 'at least a legitimate expectation' refers to a justified belief of an applicant that his legal position has a sound legal basis, i.e. it is not invalid or illegal. That sound legal basis is unexpectedly removed when it is declared *ultra vires*. Alternatively, legitimate expectations may be substantive and refer to the rights arising from that sound legal basis.

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[886] *Anheuser-Busch v Portugal* (2007) 45 EHRR 36.

[887] They were conditional on non-infringement of third party rights.

[888] *Anheuser-Busch* (n 886) 78.

[889] The underlying dispute, between Anheuser-Busch Inc. and Budějovický Budvar, concerned registration of the 'Budweiser' trademark in Portugal.

[890] The Court treated references to legitimate expectations as 'a "legitimate expectation" of obtaining an "asset"' (*Anheuser-Busch* (n 886) 65).

[891] In *Anheuser-Busch* (n 886) the dissenting judges argued that the applicant's situation is a 'legitimate expectation'.

b. Legitimate Expectations and Claims

The concept of legitimate expectations is also referred to in situations where the applicant has no 'existing possession' but his proprietary interest is 'in the nature of a claim'.[892] These interests are grounded in a well-founded legal claim.[893] To be a 'possession' under P 1/1, a claim it needs to be 'sufficiently established to be enforceable'[894] and the applicant must have 'at least a "legitimate expectation" that [it] will be realised'.[895]

The proprietary interest of an applicant who has 'an interest in the nature of a claim' cannot arise from the existing national legislation without an intervention of a court.[896] While the ECtHR practice in this context is not entirely clear[897], it applies the concept of legitimate expectations to two distinguishable situations.

In the first type of cases the existence of the applicant's claim is not in question. It is either already recognised by the authorities or established under the relevant law and pursued before national courts. A subsequent legislation makes continuation and/or enforcement of such claim impossible. In *Pressos*[898] the applicants had claims arising from shipping accidents. They arose automatically pursuant to the relevant national law from the very fact of the accident. The accidents were caused by port pilots, who were external service providers and agents of the State. The established national case-law provided that in such case compensation may be claimed directly from the State. The applicants filed their claims before appropriate national courts. As the cases were pending, the State introduced legislation retrospectively excluding its own liability for the pilots' negligence. The ECtHR found that the state of the law at the time of the accident gave rise to the applicants' legitimate expectations. The claimants could expect that their claims will be determined in accordance with that established law.

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[892] *Kopecký* (n 885) 41.

[893] Wildhaber ((n 860) 258) refers to them as 'legitimate expectations as an incidence of a property right'.

[894] *Gratzinger and Gratzingerova v Czech Republic*, App no 39794/98 (ECtHR Grand Chamber, 10 July 2002), para. 74.

[895] ibid 69.

[896] *Kopecký* (n 885) 41.

[897] Tomuschat (n 865) 647 (in need of 'intellectual clarification'); Allen (n 872) 50, 56 ('cannot be described as either clear or coherent').

[898] *Pressos Compania Naviera S.A. v Belgium* (1996) 21 EHRR 301 was the first case in which the ECtHR found that 'possessions' may also encompass legal claims

In a similar case of *Draon* the applicants brought a claim against a State hospital for wrong pre-natal diagnosis which resulted in grave disability of their child. The hospital did not deny its liability and the claimants applied to the courts for the assessment of damages and an interim award. Two interim awards on damages were made and the case was progressing. Before the hearing the State passed a law limiting the amount of recoverable damages by comparison with an earlier, established, law. The ECtHR found that the applicants had legitimate expectations of compensation based on the law and court practice in place before the legislative change.[899]

The second type of cases where legitimate expectations can be 'in the nature of a claim' concerns claims for a restitution of property confiscated by the communist regimes of Central and Eastern Europe. Here, the applicants sought protection of P 1/1 after failing to obtain restitution before their national courts.

The ECtHR treated such cases as not involving claims that were sufficiently established to be enforceable.[900] The restitution cases did not involve legitimate expectations that a current and enforceable claim would be determined in favour of the applicants.[901] Unlike in *Pressos,* the applicants could not show that the national laws or judicial decisions gave rise to some enforceable claims of restitution.[902]

They ECtHR did not interfere with the application of the relevant laws by the national courts. The applicants could not succeed if they did not satisfy the legal conditions for restitution.[903] In *Kopecký*[904], the lower court found that the statutory requirements for restitution were impossible to fulfil in practice. This decision was subsequently overturned by the higher court, who found that the statutory condition was applicable and the applicant failed to fulfil it. The ECtHR refused to engage with the higher court's decision. It argued that its mandate was limited only to the question of arbitrariness before the national courts and, in the absence of such arbitrariness,

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[899] *Draon v France* (2006) 42 EHRR 40*,* paras. 12-28, 70-71.

[900] The ECtHR adopted a generally unsupportive attitude towards the restitution cases. See e.g. Tom Allen, 'Restitution and Transnational Justice in the European Court of Human Rights' (2006) 13 Colum. J. Eur. L. 1, 3.

[901] *Gratzinger* (n 984) 72-73; *Kopecký* (n 885) 49; *Von Maltzan v Germany*, App nos 71916/01, 71917/01 and 10260/02 (ECtHR Grand Chamber, 2 March 2005), para. 84.

[902] *Gratzinger* (n 894) 72-73; *Kopecký* (n 885) 49.

[903] *Gratzinger* (n 894) 3, 72-74 (claimants did not have the required citizenship).

[904] *Kopecký* (n 885).

accepted the finding of the higher court. The claim was therefore not 'sufficiently established' to fall under P 1/1.[905]

In both cases of the claim-related expectations the ECtHR establishes them on the basis of the national law and court practice.[906] However, if the legal basis of a claim is problematic, the Court may refuse to pronounce on the question of legitimate expectations even if it finds existence of 'possessions' on another ground. In *Anheuser-Busch* the ECtHR found that application for a trademark registration put the applicant in a legal situation constituting 'possessions' protected under P 1/1 but refused to decide whether it had a 'legitimate expectation'.[907]

'Possessions' in the form of a claim cannot be based on subjective perceptions. A '*hope* that a long-extinguished property right might be revived' is not sufficient.[908] Existence of legitimate expectations 'in the nature of a claim' is determined by the Court on an objective basis, by reference to the relevant national laws and other legal acts such as judicial decisions.[909] Legitimate expectations cannot arise 'where there is a dispute as to the correct interpretation or application of domestic law and the applicant's submissions are subsequently rejected by the national courts'.[910]

Where the applicant's claim is defeated by way of subsequent retroactive change of law, his expectations are based on *reliance* on the law and legal practice at the time when his claim arose.[911] *Pressos* and *Draon* and the *Pine Valley* are similar in this respect. The infringement of 'possessions' in all of them occurred by way of retroactive extinguishing of favourable situations which the claimants could legitimately have expected to enjoy otherwise.

The reference to legitimate expectations in the context of claims has been criticised as adding nothing to the statement that a claim can constitute a 'possession' where there is a '*sufficient basis*' (rather than a 'legitimate expectation') for it 'in national

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[905] ibid 54-56. See also *Malhous* (n 873).

[906] *Draon* (n 899) 68 ('where the proprietary interest is in the nature of a claim it may be regarded as an 'asset' only where it has a sufficient basis in national law').

[907] In the context 'legitimate expectation' referred to an expectation of obtaining the trademark registration, which was a matter of national courts.

[908] *Gratzinger* (n 894) 69; *Malhous* (n 873) 17.

[909] *Gratzinger* (n 894) 73.

[910] *Kopecký* (n 885) 50; *Jantner v Slovakia*, App no. 39050/97 (ECtHR, 4 March 2003) 29-33.

[911] *Kopecký* (n 885) 48.

law, for example where there is settled case-law of the national courts confirming it'.[912] It is argued that such 'legitimate expectations' refer to the *strength* of the claim rather than its existence. As a result, the mere vesting of a claim is sufficient to establish the existence of 'possession'.[913] Moreover, a finding that a legal claim is sufficiently established to be treated as a 'possession' for the purpose of P 1/1 is based on its 'well-foundedness in domestic law'. It does not depend on references to legitimate expectations:

> To say that the claimant may legitimately expect his claim to be respected or enforced adds nothing of substance; it must, after all, be presumed that well-founded legal claims will be protected in a State that subscribes to the rule of law. Conversely, a claim that lacks a sound basis in domestic law will lie beyond the reach of Article 1, and no expectation, however legitimate or reasonable it may be, will change that.[914]

This critique is in line with the argument that the ECtHR should apply the concept of legitimate expectations to a 'far more limited set of circumstances', namely those represented by *Stretch* and *Pine Valley* cases.[915]

3. Balancing Community Interests with the Interests of the Individual

In the ECtHR practice, the enquiry whether P 1/1 applies to the situation before the Court (and thus whether there is a 'possession' as understood by ECHR) is separate from the inquiry into whether the host State's conduct constituted an interference with that 'possession'. The latter is informed by the two of the three rules expressed in P 1/1. At this stage the ECtHR takes into account whether the State interference with 'possessions' was in the public interest and in accordance with the relevant law and general principles of international law. It needs to respect the State's right to limit property rights in general interest in a way the State considers necessary.[916] These requirements point to the *legality*[917] of adopted measures and require the State to *justify* the necessity and the legitimate aim of its measures.

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[912] ibid 52.

[913] Allen (n 872) 49.

[914] Wildhaber (n 860) 260, 263. See also Tomuschat (n 865) 647 (the reference to expectations 'rather masks the real situation') and *Centro Europa*/Vajic (n 877) (such reference is 'unnecessary').

[915] *Centro Europa*/Vajic (n 877); Allen (n 872) 57.

[916] *Sporrong and Lönrroth* (n 870) 61.

[917] Which, akin to the EU law's principle of legal certainty, includes the requirement that the law is adequately accessible, sufficiently precise and foreseeable. (*Lithgow and*

The central test for assessing State conduct under the ECHR is *proportionality*. It is reflected in the ECHR's reference to instruments 'necessary in a democratic society'[918] and it also applies to P 1/1. Proportionality requires the ECtHR to:

> determine whether a *fair balance* was struck between the demands of the general interest of the community and the requirements of the protection of individual's fundamental rights.[919]

As is evident from the wording of P 1/1, the ECHR leaves the State considerable latitude in formulating and implementing its economic and social policies.[920] As a result, the margin of appreciation left to the State is wide and the ECtHR's intensity of review is low[921], lower than for other substantive provisions of ECHR.[922] This means that the Court 'would neither scrutinise the details of the merits nor refute the presumption of good faith of the interfering measures employed by the [State].'[923]

In using the above tests of legality, legitimacy and proportionality the ECtHR does not follow any mechanistic formulas and reveals little as to the way in which they are applied.[924] Generally, proportionality requires existence of a legitimate aim of the measure and a reasonable connection between the measure and that aim.[925] Although the broad understanding of 'possessions' subsumes many State measures under the ECtHR's scrutiny, the evaluation of their legality, justification and proportionality leaves the States a broad margin of appreciation.[926] The ECtHR leaves the States with broad discretion in framing social and economic policies and in the choice of instruments of their implementation.[927] As a result, although

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Others v United Kingdom (1986) 8 EHHR 329*,* para. 110; *Spacek Sro v Czech Republic* (2000) 30 EHRR 1010*,* para. 60) See e.g. Yutaka Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR* (Intersentia 2002) 152.

[918] See ECHR Articles 8.2, 9.2, 10.2, 11.2, Protocol 4, Article 2.3; Allen (n 872) 123.

[919] *Sporrong and Lönrroth* (n 870) 69; *Stretch* (n 881) 37; *Pressos* (n 898) 38.

[920] Wildhaber (n 860) 255; Allen (n 872) 126.

[921] Allen (n 872) 125.

[922] Wildhaber (n 860) 255.

[923] Arai-Takahashi (n 917) 151.

[924] ibid 152 ('markedly reticent policy of review'); Allen (n 872) 140 ('very little discussion' and application in an 'impressionistic manner').

[925] *Stretch* (n 881) 37; Allen (n 872) 125.

[926] Allen (n 872) 39-40; Arai-Takahashi (n 917) 154 (arguing that this deprives the proportionality test of its essence in some cases).

[927] *Pressos* (n 898) 37, adding that it will interfere only if the State's judgement as to what is 'in the public interests' is 'manifestly without reasonable foundation'; *Draon* (n 899) 75.

proportionality requires that the State does not impose on an individual an 'individual and excessive burden', the ECtHR does not require the States to use the least restrictive methods, leaving to their discretion the choice of the most effective means.[928] Also in assessing proportionality the ECtHR leaves broad discretion to the State.[929] The standard of proportionality applied by the ECtHR to P 1/1 is therefore lax.[930]

How does this general approach impact on the protection of legitimate expectations? In *Pine Valley* the ECtHR found that the retrospective invalidation of the planning permission was an interference with the applicants' peaceful enjoyment of their possessions which included a legitimate expectation of carrying out their planned development.[931] The Court found that the interference was in conformity with the planning legislation designed to protect the environment, which was 'clearly a legitimate aim "in accordance with the general interest"'.[932] Moreover, the national court's decision to nullify the provisional permission was a measure of general application aimed at ensuring that the planning legislation is correctly applied 'across the board' to prevent building in an area preserved as a green belt. Nullification of the provisional permission was 'a proper way – if not the only way – of achieving that aim.'[933] Moreover, since the venture of the applicants was commercial, it, 'by its very nature, involved an element of risk'. The applicants were therefore aware of the zoning plan and the opposition of the local council to any departures from it. As a result, the annulment of the permission was not disproportionate and did not constitute a deprivation.[934]

In *Stretch* the interference with the right to renew the lease by invoking the *ultra vires* doctrine was disproportionate.[935] Neither the applicant nor the State authority were aware of the illegality at the relevant time, the local authorities received rent for the lease and even negotiated its increase at the time of renewal. The renewal option, even *ultra vires*, was not against the public interest, did not affect any third party

[928] Arai-Takahashi (n 917) 154-155; Allen (n 872) 130-141.

[929] Arai-Takahashi (n 917) 156-157, criticising it as 'excessively restrained approach').

[930] ibid 151-152.

[931] *Pine Valley* (n 880) 51, 54.

[932] ibid 57.

[933] ibid 59.

[934] ibid 59.

[935] *Stretch* (n 881) 36.

interests and did not affect the exercise of any statutory functions. Moreover, the law changed in the meantime and this type of option was no longer *ultra vires*. Thus, 'there was nothing *per se* objectionable or inappropriate' in the renewal option.[936]

Compensation awarded for the interference with legitimate expectations was limited. In *Stretch* the ECtHR observed that the interference with the expectations of a lease renewal was not equivalent to finding that the applicant 'was deprived of the property right which would have been bestowed by a further 21 years lease'.[937] Given the great lapse of time (21 years), the sums necessary for complete reparation were uncertain and a just satisfaction was established on an equitable basis.[938] The ECtHR reasoned that a proportionate response to the invalidity of the renewal option would not have to be its enforcement in the original form. It could have taken the form of an alternative benefit, compensation or a return of consideration. The Court followed the latter option, taking as the basis the ground rent paid by the applicant during the rent period. The applicant did not specify his expenses for erecting the buildings on the land. He argued neither that he was unable to recoup his investment through the rent already received nor that he was unable to make a significant profit. As a result, the Court awarded the applicant the sum equal to the ground rent paid during the lease and non-pecuniary damages for 'frustration and not inconsiderable inconvenience'.[939]

In *Pressos* the legislation changing the rules of State liability with regard to pending claims was a deprivation of property by which the State 'quite simply extinguished … without compensation, claims for very high damages'.[940] Explanations presented by the State as to the grounds for adopting the legislation did not justify such fundamental interference and did not preserve a fair balance between the interests at stake.[941] Although the damages for the accidents were established by national courts, the apportionment of liability was not and, consequently, the ECtHR sent the

[936] ibid 39-40.

[937] ibid 50.

[938] ibid 48.

[939] ibid 50-51.

[940] *Pressos* (n 898) 34, 39.

[941] ibid 40-43. Similar conclusion was reached in *Draon*, where the ECtHR found that the legislation extinguishing one of essential heads of damage put disproportionate burden on the applicants. The compensation introduced by the new legislation was not reasonably related to their loss and was not justified on the grounds given by the State. The parties settled on the amount of compensation. (*Draon* (n 899) 82-85; *Draon v France*, App no 1513/03 (ECtHR Grand Chamber, 21 June 2006), para. 32).

issue back to the national courts.[942] In a single case dismissed by the national courts on the basis of the new law[943] the ECtHR made an equitable apportionment of liability, awarding to the applicant 50% of the total amount of damages awarded by the national court, including interest and non-pecuniary damages.[944]

4. Conclusions

Although the ECtHR's approach to legitimate expectations is unsettled and lacks coherence, it is clearly related to the question of invalidation of existing rights and established claims. The ECtHR associates legitimate expectations with a situation in which a claimant can have at least a legitimate expectation of effective enjoyment of a property right and this expectation is eliminated by subsequent State conduct. The ECtHR recognises two categories of such situations. First, when a person expects to exercise an existing right but the legal basis of such expectation is retrospectively invalidated. Secondly, when a person has a well-established pending court claim against the State and the State extinguishes it through subsequent retrospective legislation. Both situations are based on the claimant's reasonable reliance on relevant laws, case-law or State conduct existing at the time when the expectations are formed.

The ECtHR refrains from referring to legitimate expectations when doing so could suggest that the Court is creating a right that the applicant does not have, or that it is allocating a right and stepping into the shoes of a competent national court.[945] It shows similar restraint when assessing the impact of State measures on legitimate expectations, leaving them a broad margin of appreciation. It is the only legal system of those analysed here that applies a specific standard of review, proportionality, to balance the relevant private and public interests. However, it applies it in a lax manner and reveals little detail of its methodology. The intensity of its review of the State actions is low and the protection granted is equitable in character.

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[942] *Pressos* (n 898) 51; *Pressos Compania Naviera S.A. and Others v Belgium* (Article 50), App no 17849/91 (ECtHR, 3 July 1997), para. 10.

[943] The damage arising from the accident was quantified in a national court's judgment but the courts dismissed the case concerning their apportionment after the new ECHR-offending law came into force.

[944] *Pressos* (n 1066) 20-21.

[945] See *Anheuser-Busch* (n 886) and the restitution cases referred to in Sections C.2.a and b.

D. Concluding Remarks

Both EU law and ECtHR jurisprudence use references to legitimate expectations originating in the European national legal systems. The EU Courts apply it to interactions between traders and the EU institutions, i.e. to a dynamic supranational legal order. The ECtHR uses it to monitor interpretation and application of a particular international convention in multiple national legal orders. Nevertheless, they both leave the respective institutions a broad margin of discretion in introducing measures that impact on an individual's legitimate expectations. They apply a low level of review to the merits of the measures introduced by those institutions. As a result, although the threshold of bringing a claim referring to legitimate expectations is low, the threshold to succeed with such a claim is high. The EU Courts' approach is motivated by securing flexibility of reaction of the complex EU institutional machinery to the dynamically changing economic realities, while the ECtHR is motivated by non-interference with the policy decisions of its member States.[946]

How can the legal systems explored in this chapter contribute to the development of the concept of legitimate expectations in ITL? EU law explains the argument that legitimate expectations are related to transparency of the law at the time of investment[947] by linking legitimate expectations with legal certainty. Recent ITA awards taking a strong position that investors are not immune from regulatory changes show that ITL develops along the lines similar to EU law. EU law may also contribute to future developments by supplying methodology for dealing with legal transitions. Moreover, like English law, it will be helpful in developing the concept of legitimate expectations engendered by representations. Moreover, it may contribute to the issue of *ultra vires* as well as to the balancing of private interests and the host States' discretionary powers.

The ECtHR jurisprudence also provides valuable explanations and suggestions for ITL. It elucidates the question of interactions between *ultra vires* and legitimate expectations, suggesting relevant factors and methodology. It elucidates the issues concerning deference to State authority, both for the assessment whether the claimant had expectations based on the state of the law at the time of investment and for the assessment whether legitimate expectations are worthy of protection. Also here it provides suggestions of relevant factors and methodologies for

[946] This is particularly visible with regard to property restitution claims.

[947] Schreuer (n 12) 374; Dolzer & Schreuer (n 13) 133-134; *Frontier Petroleum,* para. 285.

balancing between private and public interests. These themes will be explored in Chapter 8. The next chapter, to which we now turn, discusses the concept of legitimate expectations in general international law.

Chapter 5 Legitimate Expectations and International Law

A. Introduction

International law did not develop a general and universally accepted theory or doctrine of legitimate expectations and uses the concept in a number of contexts. Müller's 1971 monograph on the protection of legitimate expectations as an organising principle of international law is an exception.[948] He treated legitimate expectations as legally relevant expectations arising from conclusive conduct of one State as a result of reliance on that conduct by another State or States. Their legal relevance is justified by the need for reliability and consistency in international relations.[949] The theoretical underpinnings of the have also been addressed in doctrinal discussions on the formation of CIL.

Brown argued that the concept of legitimate expectations has no equivalent in international law. He understood legitimate expectations as pertaining to a legal protection *of an individual* against the harm caused by a State resiling from its previously stated position.[950] This limitation of the concept of legitimate expectations to relations between individuals and States essentially negates any role of the concept in public international law. To the contrary, this chapter aims to show that the concept of legitimate expectations is used in international law and can provide lessons for ITL.

B. Normativity of Custom and Legitimate Expectations

In doctrinal discussions about CIL the concept of legitimate expectations provides an alternative way of approaching the question of the normativity of international custom.[951] International custom consists of two elements: material and so-called psychological, or subjective. The former comprises a State practice of specific duration, consistency and generality. The latter reflects the State's consent or intent to be bound by such a practice or its articulation of such a practice as binding (*opinio juris*).[952] International law theory seeks to identify a mechanism transforming

[948] Müller (n 121) 1.

[949] ibid 1.

[950] Brown (n 5) 9. See also Zeyl (n 48) 208.

[951] Article 38 of the ICJ Statute refers to 'international custom, as evidence of a general practice accepted as law'.

[952] Martti Koskenniemi, *From Apology to Utopia: The Structure of International Legal Argument* (Cambridge University Press 2006) 410; Crawford (n 58) 24-26.

international usage into a binding custom. The articulation of such a mechanism is a major theoretical issue.[953]

The concept of legitimate expectations is used as an objective element in an attempt to answer the question 'why does custom bind?'[954] It reflects a rejection, or at least a critique, of the subjective explanations of the binding nature of custom based on the State's will, belief or consent.[955] The argument based on legitimate expectations is that a State is bound by custom because *other* States have a legitimate expectation that that State will continue in the conduct it has chosen and the other States can rely on such continuation. The reliance and legitimate expectations of other States therefore convert the State practice into a binding obligation.[956] The alternative wording of Article 38(1)(b) of the ICJ Statute should therefore refer to international custom as '[t]he practice of states as evidence of general consensus *or expectations* accepted as law.'[957]

Different justifications are put forward to explain the basis on which the expectations of other States should be taken into account in assessing the binding character of a State practice.

Byers links legitimate expectations with an idea of shared understandings – a collective knowledge of States represented by individuals acting on their behalf – about what is legally relevant.[958] Those shared understandings arise from States' expectations as to the process of formation of CIL. If conditions are met for such expectations to reflect a position that certain conduct gives rise to customary rules,

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[953] Thirlway HWA, *International Customary Law and Codification: An Examination of the Continuing Role of Custom in the Present Period of Codification of International Law* (A W Sijthoff 1972) 47. For an analysis of various approaches see e.g. Koskenniemi (n 952) Chapter 6 and Mendelson (n 4) Chapter III.

[954] Müller (n 121) 88; Brian D Lepard, *Customary International Law: A New Theory with Practical Applications* (Cambridge University Press 2010) 119-120.

[955] Koskenniemi (n 952) 398; Byers (n 4) 18-19, 108, 148; Müller (n 121) 78; Mendelson (n 4) 189, 247, 285-292; International Law Association (ILA), Final Report of the Committee on Formation of Customary (General) International Law, *Statement of Principles Applicable to the Formation of General Customary International Law*, London Conference (2000), 9-10 <http://www.ila-hq.org/en/committees/index.cfm/cid/30)> (accessed 16 April 2014). The analyses by Mendelson and ILA are related, since the former was the Rapporteur in the work undertaken by the latter.

[956] Koskenniemi (n 952) 413; Byers (n 4) 106-107; Mendelson (n 4) 185; Müller (n 121) 78, 81, 85; ILA (n 955) 8-10.

[957] Oliver James Lissitzyn, *International Law Today and Tomorrow* (Oceana Publications 1965) 36 (emphasis added). Mendelson (n 4) 183-184.

[958] Byers (n 4) 148.

such expectations converge into *legitimate* expectations that in the future States will behave consistently with their past conduct.[959]

Mendelson, on the other hand, views the concept of legitimate expectations as a *grundnorm,* i.e. a basic meta-norm to which all norms of international law are traceable.[960] He proposes the basic norm of international law to be: 'States should comply with the legitimate expectations of the international community'.[961] Along similar lines Lepard argues that a State is compelled to fulfil the legitimate expectations of other States created by its own conduct because it perceives doing so as a *moral* or *ethical* imperative.[962]

For Müller, the normative relevance of expectations arises from the normative stability of international law which ensures the ability of States to rely on the conduct of other States. This stability is the defining element of the international community as a community based on law.[963]

Expectations are linked to the social dimension of the international legal process that gives rise to a binding custom. A major intellectual inspiration here was the work of McDougal and his collaborators (the New Haven School). They viewed international law as a 'global process of authoritative decision' in which legal process and social process interact.[964] It is a process of a continuous response and demand, of claims that are made, accepted, rejected or countered by decision-makers on behalf of States.[965] Expectations reflect the questions of authority, namely who is competent to

[959] ibid 106-107, 147-151.

[960] The concept of *grundnorm* was developed by Hans Kelsen (see e.g. *Principles of International Law* (Reinhart & Company Inc 2006) 314).

[961] Mendelson (n 4) 183-184.

[962] Lepard (n 954) 58, 75.

[963] Müller (n 121) 78.

[964] Oscar Schachter, 'Towards a theory of international obligation' in Schwebel SM (ed), *The effectiveness of international decisions: papers of a conference of the American Society of International Law and the proceedings of the conference* (Oceana Publications 1971) 15; Michael W Reisman, Siegfried Wiessner, Andrew R Willard 'The New Haven School: A Brief Introduction' (2007) 32 Yale J.Int'l L. 575.

[965] Myres S McDougal, 'Editorial Comment: The Hydrogen Bomb Test and the International Law of the Sea' (1995) 49 AJIL 356, 356-357; Venkata K Raman, 'The Rôle of the International Court of Justice in the Development of International Customary Law' (1965) 59 ASIL PROC. 169. Higgins' conceptualisation of international law as a process (see Chapter 1, Section C) is viewed as an application of the New Haven School's approach. (Byers (n 4) 207)

make decisions and how.[966] They also reflect the international community's expectations about the requirements of future behaviour.[967]

Proponents of the concept of legitimate expectations conceptualise the process of international law and the role of expectations in a similar way[968] and often acknowledge similarities with the New Haven School.[969] However, the latter was criticised for *imposing* normative outcomes on the States by using pre-determined higher values to override the choices made by the States.[970] By contrast, the proponents of the concept of legitimate expectations emphasise their focus on the *process* of international law and argue that the universal values and policies can be determined by observation and interpretation of that process.[971]

The concept of legitimate expectations emphasises the social context of the normative character of custom. It focuses on the reactions of the States who are expectations-holders, their ability to rely on the conduct which engenders expectations, and their ability to adjust their conduct respectively.[972] The respect for legitimate expectations of other States reflects the value attached by the State bound by custom to its membership in the international community.[973] The ability to rely on the conduct of others to continue is essential for the normative stability of international law.[974]

Legitimate expectations support an empirical or practical analysis of State conduct.[975] The situations in which the legitimate expectations are relevant for the assessment of international custom cannot be defined *in abstracto*. They are too varied to be distilled into a rule or a test.[976] Only a case-by-case analysis of the

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[966] Myres S McDougal, Harold D Lasswell, 'The Identification and Appraisal of Diverse Systems of Public Order', in: McDougal MS and associates (eds) *Studies in world public order* (New Haven Press Martinus Nijhoff Publishers, 1987) 13-14.

[967] Raman (n 965) 172; Lepard (n 954) 119-120.

[968] ILA (n 955) 10; Lissitzyn (n 957) 35; Mendelson (n 4) 189-190; Byers (n 4) 8-9, 24-34, 147 (his approach stems from the international relations' methodology).

[969] Byers (n 4) 206-210; Mendelson (n 4) 179, 188, 189; Müller (n 121) 100-103; ILA (n 955) 10.

[970] Raman (n 965) 170, 177; Byers (n 4) 208.

[971] Byers (n 4) 209; Mendelson (n 4) 185; Müller (n 121) 86.

[972] Byers (n 4) 106.

[973] Lepard (n 954) 58.

[974] Müller (n 121) 78.

[975] ibid 77; Mendelson (n 4) 181, 185; Byers (n 4) Chapter 9.

[976] Mendelson (n 4) 188, 189; ILA (n 955) 4, 9-10.

interactions between States can address the question of what expectations are legitimate and what legitimate expectations are worthy of protection. Such protection can only be granted in those areas of international interactions that are legally relevant.[977] Claims that a given interest is worthy of protection must be weighed against the interests of other subjects of international law and the interests of the international community as a whole.[978] Alternatively, an expectation that is worthy of protection must represent a common interest of at least most States.[979]

This vagueness is the weakest point of the concept of legitimate expectations. It has been criticised for providing no real answer to the question of normativity of custom.[980] It fails to answer the question about the circumstances in which legitimate expectations would signal the existence of a binding customary rule. In search of an answer it turns to an empirical analysis of what the States regard as law.[981] In theory, it offers the lens of legitimate expectations for this interpretative process. In practice, the interpreter is advised to establish the parameters of that lens him or herself by way of empirical case-by-case observations.[982] In effect, the concept of legitimate expectations gives no predictable guidance and is superfluous.[983]

Breadth is another weak point of the concept of legitimate expectations. They are said to be the underlying idea behind all rules or broadly understood sources of international law.[984] This includes treaties, resolutions of the UN General Assembly and unilateral acts of States such as estoppel or unilateral declarations.[985] This expands the vague and indeterminate concept of legitimate expectations onto international law as a whole and risks diluting the concept even further. More importantly, given its flexibility and lack of defined rules, the concept of legitimate

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[977] This distinguishes custom from mere comity. (Müller (n 121) 88; Byers (n 4) 149)

[978] Müller (n 121) 89.

[979] Byers (n 4) 163-165.

[980] Koskenniemi (n 952) 330-333, 413-414; Lepard (n 954) 120.

[981] Mendelson (n 4) 181; Byers (n 4) 107.

[982] Müller (n 121) 86; Mendelson (n 4) 185.

[983] Mendelson recognises this point and observes that the identification of an independent normative element of custom is usually not necessary in practice. (Mendelson (n 4) 186, 258-290) Byers tries to solve this problem by referring to 'shared understandings' but they can also only be established on an empirical case-by-case basis. (Byers (n 4) 147-151)

[984] Mendelson (n 4) 186, 394; Byers (n 4) 107, Müller (n 121).

[985] Mendelson (n 4) 185, 265-368; Byers (n 4) 107; Müller (n 121) Chapters A.1.I and 3, B and C.

expectations may allow treaty interpreters to abuse their mandate. We move now to discussing this issue.

C. Legitimate Expectations and Treaty Interpretation

1. Theory

The concept of legitimate expectations is referred to in the context of treaty interpretation. Here, it is used as a reaction to the shortcomings of the 'objective' approach to treaty interpretation, viewed as focusing too much on the treaty text. It is also an alternative to the 'subjective' approach, criticised for its unrealistic search for an empirically verifiable intention of the treaty party.[986] The New Haven School also employed its methodology in this context, pointing to the 'genuine shared expectations' of the treaty parties' as one of the goals of treaty interpretation.[987]

Müller argued that the principle of legitimate expectations supports treaty interpretation that 'balances in an optimal way the interests of specific treaty parties'.[988] It is not a set formula or an alternative to the general rule of interpretation of Articles 31-33 of the VCLT. Rather, it is a lens through which this rule should be applied.[989]

The principle of legitimate expectations is rooted in good faith which underlies the interpretative process as a whole.[990] It is a touchstone of honesty, or *bona fides*, in international relations and is given effect through an interpretation which weighs the interests of the parties to that treaty.[991] The normative understanding of the treaty provisions is aided by the basic standards applying to the conduct between States and the diligence required from them in international relations.[992] What matters here

[986] Müller (n 121) 145-146; Marion Panizzon, *Good Faith in the Jurisprudence of the WTO: The Protection of Legitimate Expectations, Good Faith, Interpretation and Fair Dispute Settlement* (Hart Publishing 2006) 43.

[987] Myres S McDougal, Harold D Lasswell, James C Miller, *The Interpretation of Arrangements and World Public Order. Principles of Content and Procedure* (Yale University Press 1967).

[988] Müller (n 121) 146.

[989] ibid 148, 153.

[990] ibid 145-146, 151; Gardiner (n 221) 148.

[991] Müller (n 121) 148.

[992] ibid 152.

is the trust, or confidence (*Vertrauen*), reasonably placed by the treaty parties in the treaty text in light of this essentially ethical background.[993]

Interpretation guided by the principle of legitimate expectations emphasises the context of the treaty. The interpreter is asked to look at the circumstances in which the words were used by the parties and seek to achieve contextual justice.[994] It is relevant in what form the treaty was concluded, how diligently the treaty text was prepared and how solemnly the treaty obligation was undertaken.[995]

The principle of legitimate expectations emphasises confidence in the States' fidelity to and responsibility for the word given.[996] The party making the treaty stipulation trusts in the expected effect of its undertaking and the other party reasonably trusts in the meaning of the treaty stipulation. Attention to and protection of the confidence of both treaty parties guides the interpreter towards the objective meaning of the treaty stipulations.[997]

This manifests itself in the approach to the question of the 'ordinary meaning' of the words used.[998] Protection of trust means that the ordinary meaning is not to be understood as some 'natural' or 'literal' sense of these words. Rather, the interpreter needs to investigate the meaning of the words to the parties of that treaty in light of all the relevant circumstances.[999] He is required to investigate the *relative* meaning of the words used, i.e. their meaning in relation to the persons who used them and the circumstances of their use.[1000]

Müller noted that application of the principle of protection of legitimate expectations requires weighing of the State's conduct against the 'minimum requirements of the orderly inter-State co-existence'. This is an aspirational standard for the non-hierarchical and not highly integrated international community of States. However,

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[993] ibid 146.

[994] Koskenniemi (n 952) 177 (criticising)

[995] Müller (n 121) 147.

[996] ibid 147, 149.

[997] ibid 146, 148.

[998] Article 31(1) of the VCLT reads: 'A treaty shall be interpreted in good faith in accordance with the *ordinary meaning* to be given to the terms of the treaty in their context and in the light of its object and purpose.' (emphasis added)

[999] Müller (n 121) 146.

[1000] ibid 149-150.

assumption of the existence of certain socio-ethical principles of international dealings legitimises the use of the principle of legitimate expectations.[1001]

The New Haven School also used the concept of legitimate expectations in treaty interpretation. McDougal and his team constructed an elaborate interpretative methodology.[1002] They viewed 'a disciplined, responsible effort to ascertain the genuine shared expectations of the particular parties to an agreement' as one of the goals of treaty interpretation.[1003] This effort to ascertain expectations is subordinated to the policy-oriented approach. This means that if the genuine shared expectations are inconsistent with the 'fundamental community policy', they need to be overridden by such policy.[1004] Similarly to their general conceptualisation of international law discussed in the previous section, this outcome-imposing approach was subject to critique.[1005]

Both Müller's and McDougal's approaches were formulated at the time when the general rule of interpretation in the VCLT was still in the course of development. To a certain extent they were rooted in concerns that the VCLT would promote an overly textual approach to treaty interpretation.[1006] As a result, interpretation guided by the concept of legitimate expectations sought support in a broader contextual analysis of a treaty. This involved emphasising that the interpreter should not omit to look to the broad scope of circumstances and to State conduct before and after the treaty was concluded, since these elements might be important for the interpretation of the parties' expectations.[1007]

Expectations-based approaches to treaty interpretation are not expressly recognised in the VCLT. However, one leading commentator observes that an account of the expectations of treaty parties is axiomatic in the general rule of interpretation of the

[1001] ibid 153.

[1002] McDougal, Lasswell and Miller (n 987).

[1003] ibid 40.

[1004] ibid 41.

[1005] The critics pointed out that this method of interpretation prescribes specific policy goals (Orakhelashvili (n 24) 309), that it fails to resolve the problem of acute indeterminacy of treaty provisions (Falk (n 221) 347), introduces redundant elements to treaty interpretation (Orakhelashvili (ibid) 313); refers to impossibly vague values (Koskenniemi (n 952) 206-207) and is impractical to apply in real life (Gardiner (n 221) 68).

[1006] Gardiner (n 221) 303; Müller (n 121) 124.

[1007] Gardiner (n 221) 302-303; Müller (n 121) 132.

VCLT.[1008] Moreover, practical application of this rule has shown sufficient flexibility in incorporating material relevant for the determination of the shared expectations of the parties[1009], even though the more detailed theoretical approaches have generally not been followed. Despite this fact, the concept of legitimate expectations has created problems in the process of treaty interpretation in international economic law. This occurred in the context of GATT and the WTO, an area of relevance for the practice of ITL, to which we now turn.

2. Practice: GATT/WTO Concept of Legitimate Expectations

In the practice of interpretation of GATT and the WTO Agreements[1010] the concept of legitimate expectations is a judge-made principle.[1011] It first arose in the context of the so-called non-violation cases under GATT 1947. Its dispute settlement bodies accorded protection against breaches of agreed tariff concessions, occurring through measures nominally consistent with the GATT 1947 but neutralising the effects of the agreed tariffs.[1012] The method to circumvent the agreement in such a way was usually through subsidies.[1013] Because of the low density of the international trade rules at the time, such undermining of an international agreement was theoretically possible. The panels dealt with this problem in an essentially equitable way, by developing the concept of 'reasonable expectations'[1014] or a 'principle of protecting legitimate expectations'.[1015] It was to ensure that

> the level of negotiated reductions of tariff barriers is not offset by actions consistent with positive rights and obligations, but

[1008] Gardiner (n 221) 67.

[1009] ibid 302-303.

[1010] Agreement Establishing the World Trade Organization of 15 April 1994 with Annexes.

[1011] Panizzon (n 986) 129; Orakhelashvili (n 24) 280; Adrian TL Chua, 'Reasonable Expectations and Non-Violation Complaints in GATT/WTO Jurisprudence' (1998) 32 J.W.T. 27, 28.

[1012] PJ Kuyper, 'The Law of GATT as a Special Field of International Law' (1994) 25 NYIL 227, 245-246.

[1013] *European Economic Community — Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, Report of the Panel of 14 December 1989 adopted on 25 January 1990 (L/6627/ - 37S/86) (*EEC — Oilseeds*), paras 144-148; *The Australian Subsidy on Ammonium Sulphate*, Report of the Working Party of 31 March 1950 Adopted by the Contracting Parties on 3 April 1950 (GATT/CP.4/39) II/188 (*Australian Subsidy*).

[1014] Kuyper (n 1012) 246.

[1015] Panizzon (n 986) 128.

> inconsistent with the overall level of multilaterally negotiated liberalization commitments.[1016]

Despite the significant thickening of the web of international regulation under the WTO umbrella, the principle of legitimate expectations did not lose its relevance to Article XXIII (Nullification of Impairment) of the GATT 1994.[1017] However, its use created controversies in practice.

The rationale for the protection of expectations was to protect the reciprocity of tariff concessions. It was assumed that a GATT participant agrees a tariff concession with another participant in the expectation that the latter will not systematically offset the price effects of such concessions. If such expectations had not been protected, States would have been reluctant to make any tariff concessions.[1018] The concept of legitimate expectations does not protect any specific trade flows. It targets the competitive relationship between imported and domestic goods arising from negotiated tariff concessions.[1019] This mechanism assumes that the source of expectations lies in tariff *concessions*[1020], that the offsetting measure could not have been reasonably foreseen at the time the concessions were negotiated[1021], and that the non-violation measures do not systematically offset[1022], reduce or nullify its value.[1023]

The mechanism of non-violation complaints and the related concept of legitimate expectations have been criticised as a 'legal phantasy' which could lead to

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[1016] ibid.

[1017] Panizzon (n 986) 129; Kuyper (n 1012) 249. A similar principle was introduced in Article VI:5(a)(ii) of the General Agreement on Trade in Services (GATS) (Panizzon (ibid) 138-141, 157).

[1018] *EEC – Oilseeds* (n 1013) para. 148. The concept of protection of legitimate expectations is similar here to that applicable to signed but not ratified treaties, discussed in Section C below.

[1019] ibid paras. 147-148. The principle of protection of legitimate expectations also applies to Article III of GATT 1994 (Panizzon (n 986) 133-135).

[1020] Sung-joon Cho, 'GATT Non-Violation Issues in the WTO Framework: Are They the Achilles' Heel of the Dispute Settlement Process?' (1998) 39 Harv.Int'l L.J. 311, 317; Panizzon (n 986) 150.

[1021] *Australian Subsidy* (n 1013) para. 12; *EEC – Oilseeds* (n 1013) para. 148; Chua (n 1011) 41; Thomas Cottier, Krista N Schefer, 'Good Faith and the Protection of Legitimate Expectations in the WTO' in Bronckers M, Quick R (eds), *New Directions in International Economic Law. Essays in Honour of John H. Jackson* (Kluwer Law International 2000) 60.

[1022] *EEC – Oilseeds* (n 1013) para. 148.

[1023] Kuyper (n 1012) 247; Cho (n 1020) 317; Panizzon (n 986) 142; Chua (n 1011) 47-48.

abuses.[1024] Its original rationale should have led to its diminishing importance as international trade regulations became denser.[1025] However, the concept was 'hijacked' by the WTO members.[1026] In *EC – Citrus* the traditional approach was extended when the panel decoupled the expectations from tariff concessions. It introduced an open-ended concept of the 'balance of rights and obligations' that could be upset by measures which did not violate the GATT.[1027] Although the panel report was blocked, the case showed the potential for extension of the non-violation mechanism.[1028] In *Korea – Procurement* the panel dangerously extended the concept to the benefits arising from the process of treaty *negotiations*.[1029] The case encouraged claims involving 'legally unreasonable but politically important expectations' which did not refer to any specific treaty concessions under the WTO Agreements but to general policy obligations.[1030] This approach resembled the trend in ITA to treat policy goals of IIAs concerning e.g. stability or cooperation as a source of treaty obligations.[1031]

The proponents of these developments argued that non-violation complaints could reach beyond tariff concessions. The concept protects benefits accruing under the GATT from being nullified or impaired and these benefits are not limited to tariff concessions. Nullification or impairment of such broadly understood benefits also frustrates reasonable expectations of the complainant.[1032] This allows for the recognition of a multitude of 'benefits' that are 'reasonably expected' from the GATT and thus should be protected. Chua suggested that such extended reasonable

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[1024] Pierre Pescatore, 'The GATT Dispute Settlement Mechanism – Its Present Situation and Its Prospects' (1993) 27 J.W.T. 5, 19.

[1025] Kuyper (n 1012) 247; Helge Elisabeth Zeitler, '"Good faith" in the WTO Jurisprudence: Necessary Balancing Element or an Open Door to Judicial Activism?' (2005) 8 J Intl Econ L 721, 752.

[1026] Cho (n 1020) 319; Panizzon (n 986) 142.

[1027] *European Community – Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region*, Report of the Panel of 7 February 1985 (unadopted) (L/5776), para. 4.37.

[1028] Kuyper (n 1012) 249.

[1029] *Korea – Measures Affecting Government Procurement*, Report of the Panel of 1 May 2000 (WT/DS163/R), paras. 7.84-8.2; Panizzon (n 986) 142, 151. The report was not appealed but it raised 'serious concerns'. The approach was 'overbroad from all points of view' and, if followed, 'would be an enormous broadening of the non-violation concept' (Zeitler (n 1025) 740, 751, 752).

[1030] Panizzon (n 986) 152-153.

[1031] Douglas (n 192) 83-84.

[1032] Chua (n 1011) 39-40.

expectations can follow from: the GATT provisions which 'protect different types of expectations'[1033]; its preambular pronouncements[1034] ; and the representations of the treaty party not reflected in any binding instrument, such as assurances and statements made in negotiations, conduct of the parties (including silence or omissions) and government policies.[1035]

Under this understanding the concept of legitimate expectations 'protects the validity of *assumptions* on which governments act'.[1036] Going even further, Cottier & Schafer argued that the concept of legitimate expectations protects:

> *subjective beliefs* of others, so long as those subjective beliefs, or expectations, can be *logically deduced* from the state's prior actions or inactions.[1037]

Like Chua, they recognised that a State's reliance on actions or words of the other party as a crucial element of the concept. They expanded it by insisting that the expectation that the other party will behave in a certain way is based on 'the *receiver's view* of the agreement'.[1038] They argued that the concept applies also to violation complaints and requires 'looking at rights and obligations *from the point of view of the entitled party'.*[1039]

This approach dovetailed with the jurisprudence of WTO panels. They have attempted to expand the concept of protection of legitimate expectations to very broad and general values such as 'predictability to plan future trade' or 'security and predictability in the multilateral trading system'.[1040] These broad formulations are similar to the tendency to protect 'legitimate expectations of stable and predictable investment environment' in investment treaty disputes, concentrating on the needs of investors as beneficiaries of IIAs.[1041]

[1033] ibid 30.

[1034] Chua (n 1011) 28, 31-32; Zeitler (n 1025) 728.

[1035] Chua (n 1011) 32-34.

[1036] ibid 31 (emphasis added).

[1037] Cottier & Schefer (n 1021) 30 (emphasis added).

[1038] ibid 53. Despite referring to Müller (n 121), Cottier & Schefer's approach is different, as it looks subjectively at the claimant's beliefs. They were inspired by the civil law rules of contract interpretation. However, Müller, who also referred to these rules, was careful to formulate the principle of legitimate expectations as an *objective* one.

[1039] Cottier & Schefer (n 1021) 58 (emphasis added).

[1040] Panizzon (n 986) 195.

[1041] See Chapter 7, Section C.1.

This expansionary trend culminated in the *EC – Computer Equipment*[1042] and *India – Patents* cases.[1043] The panels in those cases attempted to extend the concept of protection of legitimate expectations to violation complaints.[1044] They found that the expectations of the treaty party must be taken into account in the process of interpreting the relevant WTO Agreement. In *India-Patents* the panel found that in the process of interpretation of the TRIPS Agreement[1045] it *must* take into account the legitimate expectations of WTO members concerning that agreement.[1046] The *EC – Computer Equipment* panel similarly stated that good faith treaty interpretation requires interpretation *in light of* the 'legitimate expectations' of an exporting member state.[1047]

This trend was halted by the WTO Appellate Body ('AB'). It criticised the panels for misusing the VCLT rule of interpretation,[1048] and specifically for their use of expectations in treaty interpretation.[1049] The AB observed that taking into account the subjective expectations of only one party to the treaty is not consistent with the general rule of good faith interpretation of treaties.[1050] Article 31 of the VCLT aims at ascertaining *common* intentions of the parties[1051] and any legitimate expectations of the treaty parties have to be reflected in the language of the treaty itself.[1052] The AB opposed the resort to legitimate expectations as an escape from the process of treaty interpretation, finding that the *EC – Computer Equipment* panel *failed* to *examine* the context and the object and purpose of the relevant treaty provisions in accordance with the VCLT.[1053]

[1042] *European Communities – Customs Classification of Certain Computer Equipment*, Report of the Appellate Body of 5 June 1998 (WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R) (*EC – Computer Equipment*).

[1043] *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Appellate Body of 19 December 1997 (WT/DS50/AB/R) (*India – Patents*).

[1044] Panizzon (n 986) 159.

[1045] Agreement on Trade-Related Aspects of Intellectual Property Rights, Annex 1C to the Marrakesh Agreement Establishing the World Trade Organization of 15 April 1994.

[1046] *India – Patents,* para. 7.22.

[1047] *EC – Computer Equipment,* para. 79.

[1048] Panizzon (n 986) 176.

[1049] *India – Patents* (n 1043) para. 48; *EC – Computer Equipment* (n 1042) para. 83.

[1050] *EC – Computer Equipment,* para. 83; see also *India – Patents,* para. 48.

[1051] *EC – Computer Equipment,* paras. 81, 83; Cottier & Schefer (n 1021) 61-62.

[1052] *EC – Computer Equipment,* para. 83; *India – Patents* (n 1043) para. 45

[1053] EC – *Computer Equipment,* para. 89.

The AB rejected the approach to treaty interpretation based on 'subjectivism and autointepretation' by one treaty party.[1054] It observed that taking into account the subjective views of one treaty party about the content of the agreement reached during treaty negotiations would seriously undermine the security and predictability of the treaty arrangements.[1055] It would limit the ability of a treaty party to rely on an objectively identifiable content of its treaty obligations.[1056]

The trend the AB reacted to pursued a concept of legitimate expectations which had little or nothing to do with treaty interpretation. It gave extra-textual elements more weight than the treaty text. It used preambular pronouncements to create new obligations informed by general policy objectives of the WTO Agreements. It relied on the perspective of the claimant rather than the perspective of the treaty parties. This may have been either an overenthusiastic embrace of Müller's interpretative technique or evidence that his approach to treaty interpretation, especially the reliance on extra-textual contextual circumstances, is not manageable in practice because it is too prone to abuse. The above AB's decisions were systemic policy decisions[1057], aiming to avoid perceptions that WTO dispute settlement bodies are stepping 'into the legislator's realm'.[1058] Although such an excess is expressly prohibited under the DSU[1059], such a limitation is also implied in the role of all international courts and tribunals and is thus relevant for investment tribunals.[1060]

One lesson from the WTO experience is that expectations considered in treaty interpretation are only expectations of *both treaty parties*.[1061] Secondly, the WTO experience shows that absent a body with functions comparable to the AB, ITL relies on investment tribunals to self-monitor against potential perceptions of an abusive use of the concept of legitimate expectations. If investment tribunals show less

[1054] Orakhelashvili (n 24) 316.

[1055] *EC – Computer Equipment,* para. 82.

[1056] Orakhelashvili (n 24) 316.

[1057] Zeitler (n 1025) 744, 754-755, 756.

[1058] Panizzon (n 986) 179; Zeitler (n 1025) 752.

[1059] The Dispute Settlement Understanding (DSU) expressly provides in Article 3.2 that the WTO dispute settlement bodies cannot 'add or diminish the rights and obligations provided in the covered agreements.'

[1060] See Chapter 1, Section D and Chapter 2, Section C.

[1061] See also *AES Summit Generation Limited AES-Tisza Erömü Kft v The Republic of Hungary*, ICSID Case No. ARB/07/22, Expert Report of Professor Piet Eeckhout of 30 October 2008 (quoted in *AES Summit*, para. 28): '[t]he intentions of a single contracting party to a treaty, not expressed in the text of that treaty, are not relevant to its interpretation.'

restraint than the AB, the debate about the limits of their mandates will move into the broader process-legitimacy.[1062]

D. Unilateral Declarations, Estoppel and Pre-Ratification Obligations

The concept of legitimate expectations provides a normative justification for the legally binding character of all rules or institutions of international law.[1063] These include the sources listed in Article 38(1) of the ICJ Statute as well as other forms of State conduct producing legal consequences.[1064] This section concerns three types of such conduct: unilateral acts of States (estoppel and unilateral declarations) and the provisional application of treaties. They concern situations when an objectively analysed conduct of a State brings about some legally relevant consequences. State conduct in these situations may be viewed as having a 'self-binding' effect.[1065] However, these situations do not provide mechanical tests of 'application' of the concept of legitimate expectations leading to some predictable outcomes. They all require careful analysis of all relevant circumstances and are rooted in good faith.

The rationale for using legitimate expectations as an explanation of the legally binding character of the State conduct described below is parallel to the one regarding custom. States expect other States to behave in certain ways as a result of their earlier behaviour. They are justified, in the context of a particular type of conduct, to rely that such conduct will indeed take place in the future.[1066] As a result, a conduct that is different from expected may bring legal consequences for the State frustrating such expectations.

1. Unilateral declarations

Unilateral declarations provide the first example of a unilateral State act that can produce legal consequences in international law. They concern 'declarations publicly made and manifesting the will to be bound'.[1067] In the *Nuclear Tests* cases[1068], the

[1062] See Chapter 2, Section B.

[1063] See section A.

[1064] Mendelson (n 4) 365-366.

[1065] Müller (n 121) 81; Lepard (n 954) 58, 75.

[1066] Byers (n 4) 107; Mendelson (n 4) 184-185.

[1067] International Law Commission (ILC), *Guiding Principles Applicable to Unilateral Declarations of States Capable of Creating Legal Obligations, with Commentaries Thereto (2006)*, para. 1 <http://legal.un.org/ilc/texts/instruments/english/commentaries/9_9_2006.pdf> (accessed 16 April 2014).

ICJ found that a series of official public statements by various State representatives expressed the French Government's unqualified intention to cease all atmospheric nuclear testing in the future.[1069] The form, content, chronology, timing and context of these statements were crucial for this finding. The case gave rise to the ILC's work on unilateral declarations.[1070]

To have legal consequences a unilateral declaration has to be specific and may concern legal and factual situations.[1071] It expresses the State's clear and unqualified intention to be bound[1072], has to be made publicly[1073] and does not require any reaction or a *quid pro quo* from another State or States.[1074] If such a declaration is found to exist, the State who has made it may be legally required to follow the course of conduct consistent with its declaration and not to revoke its declaration arbitrarily.[1075]

Unilateral declarations have no pre-determined 'form' and their finding is based on a case-by-case assessment of the text of the State's declarations, their context and all other relevant circumstances.[1076] Not all unilateral acts are unilateral declarations and in case of doubt a restrictive interpretation is called for.[1077]

The general rationale for ascribing legal consequences to unilateral declarations arises from good faith. [1078] However, the normative cause for such legal consequences may be rooted in the State's intention to be bound as well as in the

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[1068] *Nuclear Tests Case (Australia v France)* Judgement of 20 December 1974, I.C.J. Reports 1974, p. 253.

[1069] *Nuclear Tests Case* (ibid) paras. 20, 31-41, 49-52.

[1070] See the analytical guide to the work of the ILC <http://legal.un.org/ilc/guide/9_9.htm> (accessed 16 April 2014), culminating in the *Guiding Principles* (n 1067).

[1071] *Nuclear Tests Case* (n 1068) para. 50; *Guiding Principles* (n 1067) para. 7.

[1072] *Guiding Principles* (n 1067) para. 9.

[1073] In the *Nuclear Tests Case* ((n 1068) para 50) these were official communiques, statements as well as media interviews and press conferences made 'publicly and *erga omnes*'.

[1074] One of the differences between estoppel and unilateral declaration is that the latter does not require detrimental reliance. (Byers (n 4) 107) However, reactions to a unilateral act may be relevant for the assessment of their legal significance. (*Guiding Principles* (n 1067) para. 3) The main characteristic of a unilateral declaration appears to be intent to be bound. (*Guiding Principles* (n 1067) Preamble)

[1075] *Guiding Principles* (n 1067) para 9.

[1076] *Nuclear Tests Case* (n 1068) para. 46; Mendelson (n 4) 367; *Guiding Principles* (n 1067) para. 7.

[1077] *Nuclear Tests Case* (ibid) paras. 43-44; *Guiding Principles* (n 1067) para. 7.

[1078] *Nuclear Tests Case* (ibid) para. 46; *Guiding Principles* (n 1067) para 1.

expectations of other States engendered by the declaration. Their relevance will depend on the circumstances of a particular case.[1079] In the *Nuclear Tests* case the ICJ pointed to the 'trust and confidence ... inherent in international co-operation' and to the increasing essential importance of such co-operation to international relations. Respect for good faith allows States to 'take cognizance of unilateral declarations and place confidence in them' and entitles them to 'require that the obligation thus created is respected'.[1080]

2. Estoppel

Estoppel provides another example of a situation where a unilateral conduct of a State can create legal consequences. Here, too legitimate expectations are identified as a rationale for attaching legal consequences to the State conduct.[1081]

Estoppel originates from common law. Its scope is broader than that of unilateral declarations [1082] and its characteristics have been authoritatively elucidated by Bowett.[1083] Like unilateral declarations, estoppel involves a voluntary, unconditional, clear and unambiguous statement by an authorised State representative. It differs from unilateral declarations in two important ways. First it concerns only facts and not law.[1084] Secondly, the addressee of the State conduct must have relied on it in good faith either to its detriment or to the advantage of the party making the representation.

As in the case of unilateral declarations, ascertaining the existence of an estoppel requires interpretation of State conduct in its context, in consideration of all the circumstances of the case.[1085] However, intention to be bound is not a prominent

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[1079] ILC, *Report of the International Law Commission on the Work of Its Fifty-Second Session (2000), Topical Summary of the Discussion Held in the Sixth Committee of the General Assembly During its Fifty-Fifth Session Prepared by the Secretariat* (2000) U.N.Y.B.I.L.C. Vol. II(2), para. 258; *Guiding Principles* (n 1067) preamble ('it is often difficult to establish' which of the two should be the reason for protection).

[1080] *Nuclear Tests Case* (n 1068) para. 46. See also Robert Kolb, 'Principles as Sources of International Law (With Special Reference to Good Faith)' (2006) 53 NILR 1, 10.

[1081] Byers (n 4) 11, 107; James Cameron, Kevin R Gray, 'Principles of international law in the WTO Dispute Settlement Body' (2001) 50 ICLQ 248,260; Müller (n 121) 9-10.

[1082] Crawford (n 58) 421.

[1083] DW Bowett, 'Estoppel before International Tribunals and Its Relation to Acquiescence' (1957) 33 B.Y.B.I.L. 176, 188-194.

[1084] Mendelson (n 4) 366 (but observes that this requirement is 'not entirely clear').

[1085] Bowett (n 1083) 189-190.

feature of estoppel.[1086] As a result, reliance and the related expectations play a more prominent role in assessing the consequences of the State conduct than with regard to unilateral declarations.[1087]

The legal consequence of estoppel is binding preclusion. The State whose conduct was found to constitute an estoppel is *estopped* (prohibited) from denying the 'truth' of its representation.[1088] Although estoppel does not create a 'right', it is nevertheless of great practical or evidentiary importance.[1089] Its legal consequences are rooted in good faith. Estoppel is identified when an inconsistent conduct of a State causes determent or prejudice to another State who has relied on that conduct.[1090] Detrimental reliance may prove that the other State have relied on, or acted in confidence in, the conduct of the State and its future consequences.[1091] In other words, it may identify legitimate expectations that need to be protected.

However, undue focus on detrimental reliance may be misleading. It may overshadow the assessment of the State conduct capable of giving rise to estoppel. The form, context and circumstances of that conduct are equally important for the finding of estoppel and its legal consequences. Commentators point out that in the common law estoppel is resorted to 'with great caution' and treated as a principle of 'equity and justice'.[1092]

3. Provisional Application of Treaties

A more specific example of the operation of the concept of legitimate expectations is provided by so-called provisional application of treaties. Article 18 of the VLCT provides that a State should refrain from acts defeating the object and purpose of a treaty with regard to which that State took specific steps leading to its ratification, acceptance, approval or entry into force.[1093]

[1086] Crawford (n 58) 421.

[1087] Müller (n 121) 22.

[1088] Crawford (n 58) 420; Bowett (n 1083) 188.

[1089] Malcolm N Shaw, *International Law* (Cambridge University Press 2008) 518.

[1090] Bowett (n 1083) 186; Crawford (n 58) 420; Müller (n 121) 10.

[1091] Byers (n 4) 107; Müller (n 121) 10-11.

[1092] Crawford (n 58) 421; Shaw (n 1089) 515.

[1093] Signed the treaty, exchanged instruments constituting a treaty subject to ratification or expressed consent to be bound by a treaty and its entry into force is pending.

In other words, a State that is in the process of acceding to a treaty may not act in a way defeating the treaty's object and purpose, even though it is not yet formally bound by its terms. This obligation is rooted in good faith.[1094] Its rationale is linked with the concept of legitimate expectations.[1095] Article 18 protects 'legitimate expectations of other participants in the treaty-making process that a State which has expressed its acceptance of the treaty, albeit not in binding form, would not work against the object of its acceptance.'[1096] These expectations arise from the fact that the State has entered into a multi-step process which has not yet been completed or aborted.[1097] Such expectations should be protected because, as observed by Lauterpacht, a treaty is a result of 'a painfully achieved compromise' and States may be compelled to agree to it because other States did. If no legal obligation is attached to the signature

> the concessions made by other signatories will have been made in vain seeing that the consideration which they could *legitimetely* [sic] *expect* will not be forthcoming.[1098]

These expectations reflect general expectations of all States-signatories to a given treaty, not specific expectations of a particular State.[1099]

This situation resembles the reciprocity-based rationale supporting the concept of legitimate expectations in the context of GATT/WTO. Moreover, it refers to a formalised context of treaty-making. This makes it easier to assess the predictable internationally acceptable conduct of a State that has taken concrete steps on its path to be bound by a treaty. Finally, the legal consequences attached to the taking of those steps are not inflexible. A State is not bound if it makes it clear that it does

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[1094] Harvard Law School Research in International Law Codification of International Law, Part III: Law of Treaties, Draft Convention on the Law of Treaties (1939) 29 AJILS 657, Article 9; Paul V McDade, 'The Interim Obligation Between Signature and Ratification of the Treaty' (1985) 32 NYIL 5, 21.

[1095] Mendelson (n 4) 394; McDade (n 1094) 21; T-115/94 *Opel Austria GmbH v Council of the European Union* [1997] ECR II-39, paras. 78, 84-85.

[1096] Oliver Dörr, Kirsten Schmalenbach (eds), *Vienna Convention on the Law of Treaties, a commentary* (Springer 2012) 220.

[1097] ibid 227. See also: Mark E Villiger, *Commentary on the 1969 Vienna Convention on the Law of Treaties* (Martinus Nijhoff Publishers 2008) 247.

[1098] International Law Commission, Law of Treaties, Report by Mr. H. Lauterpacht, Special Rapporteur, 24 March 1953, Doc. A/CN.4/63. in Documents of the fifth session including the Report of the Commission to the General Assembly (1953) U.N.Y.B.I.L.C. Vol. II (A/CN. 4/8ER. A/1953/Add. 1) 109-110 (emphasis added). See also Harvard Law School Research in International Law Codification of International Law, Part III: Law of Treaties, Text with Comment (1939) 29 AJILS 666, 780-781.

[1099] McDade (n 1094) 27.

not intend to be bound by the treaty[1100] or when the treaty did not enter into force without 'undue delay'.[1101]

E. Conclusions

Although the concept of legitimate expectations is not universally applied in international law, it constitutes an important undercurrent of the theory of international law. It arises from the understanding of the process of international law as a social interaction, where a conduct of a State causes reaction of another State or States. It attaches value to the ability of States to co-operate with other States and their ability to rely on their actions expecting certain conduct, or legal consequences, to follow. It sees trust or confidence in international legal relations as value to be considered in the assessment of the legal consequences of State actions. In effect, this represents the very idea of law and may be viewed as too broad to contribute to the persuasiveness of any arguments based on legitimate expectations.

However, the concept has certain lessons for ITL. The concept of legitimate expectations is a very flexible instrument. It needs to be handled with caution to prevent its abuse to favour the party who claims to have some legitimate expectations. The concept is prone to circularity. Stating that a State is able to expect certain conduct of another State because it is accepted that such conduct will be forthcoming does not answer the question why such acceptance exists, how it can be identified and why it should be considered legally relevant. Similarly, an enquiry following only legitimate expectations of one party and ignoring the conduct on which it relied, its context and all the relevant circumstances, allows the concept of legitimate expectations to overwhelm the analytical process. As a result, it risks skewing the analysis in favour of one party.

To be free from suspicion of abuse, the concept of legitimate expectations needs clear formulation of what is expected, as shown by the original idea behind the concept of reasonable expectations under GATT or Article 18 of the VCLT. Absent such clear indication the decision-makers risk converting general policy goals into expectations. References to expectations then become speculative and start serving the political interest of one party. To avoid this situation references to expectations need to be based on a thorough analysis of the conduct of the State whose actions give rise to the expectations, its context and circumstances. The expectations of

[1100] Article 18(a) of the VCLT.

[1101] Article 18(b) of the VCLT.

another State need to be balanced with the interest of the State whose conduct is the alleged source of expectations and the interests of international community. The concept of legitimate expectations can only be used as one of the many factors in the analysis of the legal consequences of State actions, representing the social and equitable dimension of that assessment. Most of all, the decision-makers need to exercise self-restraint in order to apply the concept in an acceptable way.

Chapter 6 The Origins and Development of Legitimate Expectations in International Investment Law: Indirect Expropriation

A. Introduction

References to legitimate expectations in ITA/ITL are predominantly associated with the FET standard. Some tribunals and commentators view legitimate expectations as the core element of this standard[1102] or even perceive protection, or effectuation, of legitimate expectations as its main goal.[1103] However, references to legitimate expectations are made also in relation to indirect expropriation. These are less frequent but no less important. Early references to 'investment-backed expectations' and 'legitimate expectations' in ITA/ITL practice and scholarly writings were linked with concerns about the way in which first investment tribunals applied the indirect expropriation standard. Exploration of these references allows for a better understanding of the more recent uses of the concept of legitimate expectations. It also clarifies why it is incorrect to associate 'reasonably-to-be-expected economic benefit of property' with the concept of legitimate expectations. Compared with current practice, this historical background highlights that the use of the concept of legitimate expectations under the indirect expropriation standard is essentially the same as under the FET standard. This suggests existence of an overarching notion of legitimate expectations spanning both treatment standards that deal with regulatory risk. As a result, any conclusions from the present comparative analysis will be applicable to both standards. This is all the more important because, as shown below, a growing number of IIAs refer to 'investment-backed expectations' as one of the factors relevant for the assessment of indirect expropriation.

[1102] *Saluka,* para. 302 ('dominant element' of the FET standard); *El Paso,* paras. 339, 348 ('basic touchstone' of FET); *Duke Energy Electroquil Partners & Electroquil S.A. v Ecuador*, ICSID Case No. ARB/04/19, Award of 18 August 2008 [*Duke*], para. 340 ('important element'); *EDF v Romania,* para. 216; Alvik (n 2) 193-197.

[1103] Arif H Ali, Kassi Tallent, 'The Effects of BITs on the International Body of Investment Law: The Significance of Fair and Equitable Treatment Provisions' in Rogers CA and Alford RP (eds), *The Future of Investment Arbitration* (Oxford University Press 2009) 202, 214, 215, 221; *Electrabel*, para. 7.75; *Generation Ukraine, Inc. v Ukraine*, ICSID Case No. ARB/00/9, Award of 16 September 2003 [*Generation Ukraine*]*,* para. 20.37; *Impregilo*, para. 285; *Rumeli*, para. 609; *Alpha,* para. 420.

B. '*Metalclad* Definition' and the Meaning of 'Reasonably-to-Be-Expected Economic Benefit of Property'

The first reference to expectations in the context of investment treaty protection against regulatory risk was made by a NAFTA tribunal in *Metalclad* in an attempt to define indirect expropriation. The case concerned a US investment in a landfill in Mexico. Its operation was 'barred forever' by administrative actions of local authorities and a legislation declaring the landfill's site an ecological reserve.[1104] Applying NAFTA Article 1110 which mentions indirect expropriation but does not define it, the Metalclad tribunal described expropriation as including

> not only open, deliberate and acknowledged takings of property (…) but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.[1105]

The *Metalclad* tribunal was the first investment treaty tribunal to find expropriation and the first whose award was later partially annulled.[1106] The annulment decision described the above definition as 'extremely broad' and capable of including as expropriatory legitimate rezoning of property by State authorities.[1107] The 'Metalclad definition' found itself at the centre of the debate criticising the early ITA awards for approaching the vague IIA standards too broadly.[1108]

The '*Metalclad* definition' and the reaction it provoked have two implications for our analysis. First, the meaning of 'reasonably-to-be-expected economic benefit of property' provides an important context to subsequent references to 'legitimate expectations'. This issue is addressed in this section. Secondly, the critical response to *Metalclad* brought about references to expectations by ITA tribunals, commentators and IIAs that are at the core of our analysis. In search for ways to

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[1104] *Metalclad*, paras. 106, 109.

[1105] ibid, para. 103.

[1106] *The United Mexican States v Metalclad Corporation*, 2001 BCSC 664, Reasons for Judgement of 2 May 2001.

[1107] ibid, para. 99.

[1108] Gonzalo Guzman-Carrasco, '"Indirect Expropriation" in US Free Trade Agreements: The US Trade Act of 2002 and Beyond' (2004) 4 International Law: Revista Colombiana de Derecho Internacional 273, 284; Francisco Orrego Vicuña, 'Carlos Calvo, Honorary NAFTA Citizen' (2002) 11 N.Y.U.Envtl.L.J. 19, 28; Vicky Been, Joel C Beauvais, 'The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine' (2003) 78 N.Y.U. L. Rev. 30.

constrain the broad approach taken by investment tribunals, the critics looked into other legal systems. This brought about references to concepts referring to expectations. These issues are addressed in the following two sections.

Let us turn first to the meaning of 'reasonably-to-be-expected economic benefit of property'. The *Metalclad* award does not explain how the tribunal arrived at its definition of indirect expropriation and how it should be applied. Because the tribunal found that the landfill investment was 'completely lost'[1109] it did not need to apply its own definition and verify whether less than a total loss of investment could amount to an expropriation. The '*Metalclad* definition' suggests that a reduction of profits or returns expected from a foreign investment is sufficient for a finding of indirect expropriation. This would mean that indirect expropriation requires lesser interference with an investment than direct expropriation.[1110] This lowering of the threshold for indirect expropriation was, unsurprisingly, embraced by investors, who argued in subsequent disputes that host State's measures merely diminishing expected economic benefits of their investments constituted compensable indirect expropriation.[1111]

The 'reasonably-to-be expected economic benefit of property' can be understood in two ways. First, as a *property* protected against expropriation and, secondly, as an economic benefit, e.g. an income stream, expected from that property. In the latter case the '*Metalclad* definition' would be redirecting the expropriation enquiry from

[1109] *Metalclad,* para. 113.

[1110] Stern (n 13) 39; Michael W Reisman, Rocío Digón, 'Eclipse of Expropriation?' in Arthur Rovine (ed), *CIAM: The Fordham Papers*, Vol. 2 (Martinus Nijhoff Publishers, 2009) 31; Matthew C Porterfield, 'International Expropriation Rules and Federalism' (2004) 23 Stan. Envtl. L.J 3, 58-59; Matthew C Porterfield, 'State Practice and the (Purported) Obligation under Customary International Law to Provide Compensation for Regulatory Expropriations' (2011) 37 N.C.J.Int'l L.& Com.Reg. 159,168, 171.

[1111] *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v The United Mexican States*, ICSID Case No. ARB(AF)/04/05, Award of 26 September 2007 [*ADM*], paras. 230-232, 246; *Corn Products International, Inc. v The United Mexican States*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility of 15 January 2008, para. 83; *EnCana Corporation v Republic of Ecuador*, UNCITRAL, LCIA Case No. UN 3481, Award of 3 February 2006 [*EnCana*], para. 177; *Paushok S, CJSC Golden East Company, CJSC Vostokneftegaz Company v The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability of 28 April 2011 [*Paushok*], para. 332; *Waste Management, Inc. v United Mexican States*, ICSID Case No. ARB(AF)/00/3, Final Award of 30 April 2004, paras. 141, 159; *Methanex Corporation v United States of America* (NAFTA/UNCITRAL), Final Award of the Tribunal on Jurisdiction and Merits of 3 August 2005 [*Methanex*], Part IV Chapter D, paras. 4-5; *Merrill*, paras. 140, 148-149; *Generation Ukraine*, para. 20.27; *Ulysseas*, para. 180; *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability of 3 October 2006 [*LG&E*], para. 198; *Metalpar*, paras. 166-171.

interference with property rights to an *economic* impact on their exercise. Consequently, a diminution of expected economic benefits (e.g. streams of income) from the investment could be expropriatory. How did subsequent tribunals react to arguments based on these alternatives?

Faced with the first alternative, the tribunals rejected arguments that expectations of economic benefit from an investment are a property right *per se* protected from expropriation. They found that the profit-generating capacity of an investment does not constitute an investment. It may, however, be its accessory element relevant at the valuation stage.[1112] This position is in line with the tribunals' approach that expropriation must affect investment as a whole and therefore does not allow for 'conceptual severance' of an investment for the purpose of finding of an expropriation.[1113] No case of partial expropriation has ever been found by ITA tribunals. As a result, economic benefit cannot be isolated as a separate investment capable of expropriation.

The above position is in line with CIL. Although CIL does not define property, it recognises that expropriation encompasses tangible as well as intangible property, including contractual rights.[1114] Proprietary situations protected from expropriation are identified case-by-case, by reference to relevant municipal law, international law and the jurisprudence of international courts and tribunals.[1115] This creates grey areas when no rights are 'vested'[1116] under municipal law and there is no relevant

[1112] *Chemtura Corporation v Government of Canada*, UNCITRAL, Award of 2 August 2010 [*Chemtura*], para. 243; *Methanex,* Part IV, Chapter D, para. 17; *Merrill,* paras. 140-141; *Cargill, Incorporated v United Mexican States*, ICSID Case No. ARB(AF)/05/2, Award of 18 September 2009 [*Cargill*]*,* para. 356.

[1113] *Feldman M v Mexico* (NAFTA), ICSID Case No. ARB(AF)/99/1, Award of 16 December 2002 [*Feldman*]*,* para. 152; *Cargill,* para. 367; *Merrill,* para. 144; *Grand River Enterprises Six Nations, Ltd., et al v United States of America*, Award of 12 January 2011 [*Grand River*]*,* para. 155; *Burlington Resources Inc. v Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability of 14 December 2012 [*Burlington*]*,* para. 257.

[1114] John H Herz, 'Expropriation of Foreign Property' (1941) 35 AJIL 243, 244-245; Gillian White, *Nationalisation of Foreign Property* (Stevens & Sohns 1961) 48. For the protection of contractual rights see: *Norwegian Shipowners' claims* (*Norway v USA*, Decision of 13 October 1922, UN Reports of International Arbitral Awards, Vol. I (1922), pp. 307-346) and *Case Concerning Certain German Interests in Polish Upper Silesia (The Merits) No. 7*, Collection of Judgements, Publications of the PCIJ, Ser. A – No. 7, 1926, pp. 43-45.

[1115] Herz (n 1114) 244.

[1116] On the doctrine of 'vested rights' see: G Kaeckenbeck, 'The Protection of Vested Rights in Inernational Law' (1936) 17 B.Y.I.L. 1; M Sornarajah, *The Pursuit of Nationalized Property* (Martinus Nijhoff Publishers 1986) 212-213; ILC, *International Responsibility, Fourth Report by F.V. Garcia-Amador, Special Rapporteur, Responsibility of the State for Injuries Caused in Its Territory to the Person of Property of Aliens –*

'precedent' in international law or jurisprudence of international courts and tribunals, but the alien's situation could nevertheless be seen as deserving protection.[1117] The alien is inevitably interested in continuation of such favourable proprietary situations.[1118] However, these may change to his detriment as a result of a legitimate exercise of administrative or legislative powers. It is recognised that international law cannot protect against every such change. No clear-cut answer exists in CIL as to how to demarcate between protected rights and 'mere interests, expectancies, favourable situations etc.'[1119]

Despite this uncertainly CIL generally does not recognise expectations of economic benefit of property as qualifying for protection against expropriation.[1120] In *Oscar Chinn*[1121] the PCIJ denied protection when the host State's measures deprived a British investor of the ability to carry out profitably his shipping business in the Belgian Congo.[1122] The Court refused to recognise 'possession of customers and the possibility of making a profit' as representing 'anything in the nature of a genuine vested right'.[1123] It noted that 'favourable business conditions and goodwill are transient circumstances, subject to inevitable changes.'[1124]

On the other hand, international law commonly recognises relevance of expectations of future benefit of property at the valuation stage. Here, expectations reflect a functional concept of property acknowledging that the key importance of business-related property rests not in the value of individual assets but in their ability to

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Measures Affecting Acquired Rights, 29 February 1959 (1959) U.N.Y.B.I.L.C. Vol. II, 9-10.

[1117] ILC, *International Responsibility* (ibid) 9.

[1118] Herz (n 1114) 245.

[1119] ibid 245. Commentators were also not unanimous on the issue. See Herz (ibid) 246 (with references).

[1120] Herz (n 1114) 245; White (n 1114) 48.

[1121] *The Oscar Chinn Case (United Kingdom v Belgium)*, Judgement of 12 December 1934, PCIJ Series A/B Fascicule No. 63, pp. 63-90 (*Oscar Chinn* case).

[1122] Chinn's business became unprofitable when the host State (Belgium) started subsidising his competitor, a host State-supervised company. (ibid, p. 26).

[1123] ibid, p. 88. Therefore, 'the notion of goodwill is too vague to be regarded as a separate property right apart from the enterprise to which it is attached'. (White (n 1114) 49)

[1124] *Oscar Chinn* case (n 1121) p. 88. State practice also supports such conclusion. (White (n 1114) 49).

generate economic benefits.[1125] For the purpose of such 'going concern' valuation economic enterprise is treated 'as an organic totality', including 'legitimate expectations of the owners' with regard to expected returns.[1126] Those legitimate expectations represent a 'premium' added to the value of the assets reflecting 'the enterprise's ability to attract customers and generate revenues.'[1127] This functional understanding of property, represented under IIAs by the notion of 'investment', is shared by ITA tribunals.[1128]

The second alternative understanding of 'reasonably-to-be-expected economic benefit of property' is that it reflects an economic impact sufficient for the finding of expropriation. This understanding has also been rejected by ITA tribunals. The *Waste Management* tribunal agreed that non-payment of fees under a concession agreement deprived the investor of reasonably-to-be-expected economic benefit of his investment but such

> loss of benefits or expectations is not a sufficient criterion for an expropriation, even if it is a necessary one.[1129]

This expresses the dominant view.[1130]

ITA tribunals usually apply a 'substantial deprivation' test[1131], requiring *neutralisation* of an investment for a finding of indirect expropriation.[1132] This neutralizing effect is

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[1125] *Case Concerning the Factory at Chorzów Factory (Claim for Indemnity) (Merits)*, *No. 13,* Collection of Judgements, Publications of the PCIJ, Series A – No. 17, 13 September 1928, p. 49; Wälde & Kolo (n 13) 835.

[1126] AMINOIL, 21 ILM 976 1982, para. 178.

[1127] Allahyar Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran-US Claims Tribunal* (Martinus Nijhoff Publishing 1994) 429 (describing IUSCT jurisprudence).

[1128] See e.g. *Methanex,* Part IV, Chapter D, para. 17.

[1129] *Waste Management*, para. 159.

[1130] *ADM*, para. 248; *Pope & Talbot Inc v The Government of Canada* (NAFTA), Interim Award of 26 June 2000 [*Pope & Talbot*]*,* paras. 101-102; *LG&E,* paras. 191, 198; *Suez/InterAgua*, para. 126; *Suez/Vivendi*, para. 137; *El Paso,* paras. 249-256; *Burlington*, para. 399. In direct response to *Metalclad* the new generation of US IIAs provide that 'an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred.' (Annex B, Section 4(a)(i) of the 2012 US Model BIT: Treaty Between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment <http://www.state.gov/documents/organization/188371.pdf> (accessed 16 April 2014).

[1131] UNCTAD, *Expropriation: UNCTAD Series on Issues in International Investment Agreements II: A sequel* (United Nations 2012) Sales No. E.12.II.D.7, p. 64; Katia Yannaca-Small, 'Indirect Expropriation and the Right to Regulate: How to Draw the Line?' in Yannaca-Small K (ed), *Arbitration under International Investment Agreements.*

linked with a 'significant degree of deprivation of fundamental rights of ownership'.[1133] Such deprivation can manifest itself in a number of ways, e.g. when the host State conducts the investment's day-to-day operations, detains its employees, appoints directors or interferes with its management or with exercise of shareholders' rights.[1134] ITA tribunals routinely apply these criteria[1135], adding sometimes that economic loss is not a decisive factor for the finding of expropriation.[1136] An alternative approach[1137] views 'substantial deprivation' as a reflection of an economic impact on the investment.[1138] Regardless of the approach taken, both accept that a mere deprivation of expected benefits of investment is insufficient for a finding of expropriation.

The *'Metalclad* definition' of indirect expropriation turned out to be 'the outlier' that was in fact never applied by any ITA tribunal.[1139] Subsequent tribunals either distinguished it on the facts[1140], observed that the '*Metalclad* definition' did not

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A Guide to Key Issues (Oxford University Press 2010) 460-467; Stern (n 13) 40-43; Newcombe & Paradell (n 1) 344; McLachlan, Shore & Weiniger (n 12) 298.

[1132] Tribunals use various expressions to illustrate that effect, e.g. 'virtual taking or sterilising of an enterprise' (*Waste Management*, para. 160); 'substantially complete deprivation' (*Plama*, para. 193); 'effective neutralisation' (*CME Czech Republic B.V. v Czech Republic*, UNCITRAL, Partial Award of 13 September 2001 [CME], para. 604); deprivation that 'approaches total impairment' (*Fireman's Fund Insurance Company v The United Mexican States*, ICSID Case No. ARB(AF)/02/01, Award of 17 July 2006 [*Fireman's Fund*], para. 176).

[1133] *Pope & Talbot,* para. 99.

[1134] ibid*,* para. 100.

[1135] See e.g. *Chemtura*, paras. 245, 247; *PSEG*, para. 278; *Biwater Gauff (Tanzania) Ltd. v Tanzania*, ICSID Case No. ARB/05/22, Award of 24 July 2008 [*Biwater*]*,* para. 452; *CMS Gas Transmission Company v Argentina*, ICSID Case No. ARB/01/8, Award of 12 May 2005 [*CMS*]*,* paras. 263-264; *LG&E,* para. 199; *BG Group Plc. v Argentina*, UNCITRAL, Final Award of 24 December 2007 [*BG Group*]*,* para. 271; *Enron Corporation and Ponderosa Assets, L.P. v Argentina*, ICSID Case No. ARB/01/3, Award of 22 May 2007 [*Enron*]*,* para. 245; *Sempra,* para. 284.

[1136] *Biwater*, para. 465; *Deutsche Bank AG v Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/09/02, Award of 31 October 2012, paras. 504-505.

[1137] *Total*, para. 196.

[1138] E.g. *Glamis Gold, Ltd. v United States of America*, UNCITRAL, Award of 8 June 2009 [*Glamis Gold*], paras. 355-356; *Plama,* para. 193; *Bayindir,* para. 459; *Burlington,* para. 397; McLachlan, Shore & Weiniger (n 12) 302; Fietta (n 2), 398.

[1139] Ratner (n 865) 512.

[1140] E.g. by observing that: the test was based not only on 'reasonably-to-be-expected economic benefit' but also on transparency and investor's reliance on the host State's representations (*Feldman*, para. 146)

correspond with the *Metalclad* tribunals' actual findings [1141], or even reinterpreted it as an example of the 'substantial deprivation' standard. [1142] The concept of 'reasonably-to-be-expected economic benefit' refers to investor's economic expectations and such expectations do not play a decisive role in the finding of expropriation. Such expectations are not included in the references to 'legitimate expectations' in the context of indirect expropriation. As a result, the term 'reasonably-to-be-expected economic benefit of property' has a different underlying meaning than 'legitimate expectations' and conflating the two is incorrect.[1143]

C. Critique of *Metalclad*: 'Legitimate / Investment-Backed Expectations' as Factors Relevant for the Elucidation of Vague IIA Standards

As mentioned above, the *Metalclad* award provoked strong criticism[1144], adding to an already growing critique of IIAs and the ITA practice.[1145] The main point of criticism was that the '*Metalclad* definition' left no space for the host State's sovereign right to regulate in the public interest.[1146] This exceeded the US law standards of regulatory expropriation on which NAFTA Article 1110 was supposed to be modelled.[1147] More

[1141] Observing that the *Metalclad* tribunal found a complete frustration of investment's operation (*ADM,* para. 247) or complete loss of ability to generate a commercial return (*Burlington*, para. 398); that the '*Metalclad* test' stands only in isolation from the facts of that case (*Waste Management,* para. 159); that the test 'must be read in the context of the facts' of that particular case (*EnCana*, para. 177) or that careful reading of the case does not support a conclusion that substantial deprivation of value can be viewed as expropriation (*El Paso,* paras. 249, 252).

[1142] *Occidental Exploration and Production Company v Ecuador*, LCIA Case No. UN3467, Final Award of 1 July 2004 [*Occidental*], paras. 88-89; *El Paso,* para. 252. See also Vicuña (n 1108) 28; Paulsson & Douglas (n 13).

[1143] Yannaca-Small (n 1131) 475; Anne K Hoffmann, 'Indirect Expropriation' in Reinisch A (ed), *Standards of Investment Protection* (Oxford University Press 2008) 162-163; Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford University Press 2008) 164; Federico Ortino, 'Legal Reasoning of International Investment Tribunals: A Typology of Egregious Failures' (2012) 3 JIDS 31, 46.

[1144] See Been & Beauvais (n 1108) for a summary of the criticism and immediate reactions to *Metalclad*.

[1145] Peter Muchlinski, 'The Rise and Fall of the Multilateral Agreement on Investment: Where Now?' (2000) 34 Int'l Law 1033, 1046; International Institute for Sustainable Development, 'NAFTA's Chapter 11 and the Environment. Addressing the Impacts of the Investor-State Process on the Environment' (prepared by Howard Mann, Konrad von Moltke) (1999); M Sornarajah, 'Protection and Guarantees of Investment' (2000) 26 CLB 1290, 1294.

[1146] Dolzer, 'New Developments' (n 5) 72.

[1147] Been & Beauvais (n 1108) 35-36; Porterfield, 'International Expropriation' (n 1110); Guzman-Carrasco (n 1108) 282-283; Joseph E Stiglitz, 'Regulating Multinational Corportations: Towards Principles of Cross-Border Legal Frameworks in a Globalized

specifically, the *Metalclad* award was criticised for finding environmental and land use regulation expropriatory, potentially opening the floodgates to similar challenges.[1148] This raised concerns that the way in which tribunals began to interpret and apply the IIAs provisions on expropriation could significantly limit the host State's right to regulate and require it to compensate foreign investors for detrimental impact of a broad range of regulatory measures.[1149]

One reaction came from the US Congress. It sought to ensure that in substantive protections for foreign investors the USA are not greater than those enjoyed by domestic ones and that those rights are comparable to those 'available under United States legal principles and practices.'[1150] It mandated the US President to seek standards of expropriation and compensation consistent with such principles and practice.[1151] Consequently, from the early 2000's US IIAs include an elucidation of indirect expropriation rooted in the US Constitutional law '*Penn Central* test'.[1152] It states that indirect expropriation is determined based on 'a case-by-case, fact-based enquiry' and on a consideration of relevant factors. It lists three such factors, including 'the extent to which the government action interferes with distinct, reasonable investment-backed expectations'.[1153] This elucidation, used in the Model

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World Balancing Rights and Responsibilities' (2008) 23 Am.U.Int'l L.Rev. 452, 460-461; M Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' in Catherine A Rogers and Roger P Alford (eds), *The Future of Investment Arbitration* (Oxford University Press 2009) 287.

[1148] Been & Beauvais (n 1108) 33.

[1149] ibid 34; Lowe (n 14) 452-453; OECD, *'Indirect Expropriation' and the 'Right to Regulate' in International Investment Law* (prepared by Yannaca-Small C) (2004) No. 2004/4 Working Papers on International Investment, p. 2; Muchlinski (n 11) 590-591.

[1150] Bipartisan Trade Promotion Authority Act of 2002, Sec. 2102(3), 111 Stat. 2001-2002 995; Mark Kantor, 'Fair and Equitable Treatment: Echoes of FDR's Court-Packing Plan in the International Law Approach Towards Regulatory Expropriation' (2006) 4 L.P.I.C.T. 231, 236; Porterfield, 'International Expropriation' (n 1110) 41-43; Porterfield, 'State Practice' (n 1110) 177.

[1151] Bipartisan Trade Promotion Authority Act of 2002, Sec. 2102(3)(D), 111 Stat. 2001-2002 995.

[1152] Kantor (n 1150) 236-237; Coe & Rubins (n 14) 625; Porterfield, 'International Expropriation' (n 1150) 7. This was a part of broader 'recrafting of the substance and procedure in investment treaties' in response to this wave of discontent with the ITA. See Schill (n 19) 64-65.

[1153] The other factors are: the economic impact and the character of the government action. (Annex B of 2004 US Model BIT <http://www.state.gov/documents/organization/117601.pdf> (accessed 16 April 2014) and 2012 US Model BIT.

BIT and the US Free Trade Agreements ('FTAs')[1154], has also been adopted by Canada in its IIAs and the 2004 Model FIPA.[1155] Similar changes were introduced by other States.[1156]

The above reactions illustrate three important developments relevant for the references to 'legitimate expectations' or 'investment-backed expectations' by investment tribunals. First, they show that indirect expropriation cannot be defined and needs to be established case-by-case with help of relevant factors.[1157] Secondly, 'investment-backed expectations' is one of such factors. Thirdly, clarifying tests and factors are derived from relevant national and other established legal systems.

These three developments are also visible in the ITA practice and scholarship. Commentators and tribunals increasingly referred to multi-factor case-by-case analysis as a basis for expropriation analysis.[1158] They began referring to 'legitimate expectations'[1159] or 'investment-backed expectations'[1160] as one of such factors.

[1154] This text is replicated in FTA's between the USA and Australia, Chile, Colombia, Korea, Morocco, Oman, Panama, Peru and Singapore. See the US Trade Representative information: <http://www.ustr.gov/trade-agreements/free-trade-agreements> (accessed 16 April 2014).

[1155] Annex B.13(1)(b) of the 2004 Model FIPA: Agreement Between Canada and […] for the Promotion and Protection of Investments <http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf> (accessed 16 April 2014). Canada followed this model in all its IIAs in recent years. See DFATD information: <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/index.aspx?lang=eng> (accessed 16 April 2014). It is also replicated in Australia – Chile FTA of 30 July 2008 (Annex 10-B).

[1156] Article 4.2.b of the Bilateral Agreement for the Promotion and Protection of Investments between the Government of the Republic of Colombia and the Government of the People's Republic of China of 22 November 2008); Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA**)** of 27 February 2009 (Annex Chapter 11) and ASEAN Comprehensive Investment Agreement (Annex 2). See UNCTAD (n 1131) 74.

[1157] Reed & Bray (n 13) 14; Verhoosel (n 13) 473; CG Christie, 'What Constitutes a Taking of Property Under International Law' (1962) 38 B.Y.B.I.L. 307, 338; Paulsson & Douglas (n 13) 149; Yannaca-Small (n 1131) 455.

[1158] Coe & Rubins (n 14) 625; Paulsson & Douglas (n 13) 149; OECD (n 1149) 10; Wälde (n 14) 402 and (n 199) 224; Newcombe (n 14) 40; Yannaca-Small (n 1131) 460; Fortier & Drymer (n 14) 306; *Tecmed,* para. 122; *Fireman's Fund,* para. 176; *ADM,* paras. 249-250; *Cargill,* para. 322; *Glamis Gold,* para. 356; *LG&E,* para. 190; *Impregilo,* para. 269.

[1159] Dolzer, 'New Developments' (n 5) 78-79; Fortier & Drymer (n 14) 306-308; Wälde (n 14) 402 and (n 127) 224; Paulsson & Douglas (n 13) 157; *Tecmed,* para. 122; *ADM,* para. 250; *LG&E,* para. 190 ('reasonable expectations'); *Impregilo,* para. 269 (referring to conduct contrary to 'commitments undertaken').

[1160] OECD (n 1149) 10, 19, 22 ('reasonable and investment-backed expectations'); Coe & Rubins (n 14) 624; Newcombe (n 14) 45; *Fireman's Fund,* para. 176 ('reasonable 'investment-backed expectations'); *Cargill,* para. 322; *Glamis Gold,* para. 356.

These references were often associated with specific legal systems, in particular US constitutional law, EU law and ECtHR jurisprudence.[1161] These more developed legal systems were regarded as a useful inspiration.[1162] Even in cases when expectations were not expressly referred to in a relevant IIA, references to expectations became a standard factor in the indirect expropriation test. However, terminology used was not consistent and the terms 'investment-backed expectations' and 'legitimate expectations' were used interchangeably.[1163]

D. References to 'Legitimate / Investment-Backed Expectations' in Connection with Indirect Expropriation

As shown above, ITA tribunals and commentators acknowledge that legitimate expectations or investment-backed expectations play a role in indirect expropriation claims. In more detailed observations they frequently refer to 'legitimate expectations'. The variety of situations associated with legitimate expectations mirrors both the breadth and the subject-matter covered by references to legitimate expectations under the FET standard, discussed in the next chapter. As under the latter standard, also with regard to indirect expropriation it is noted that legitimate expectations may arise from the state of the law at the time of investment[1164] or from 'fundamental features or assumptions of a claimant's realistic economic projections when entering into the investment.'[1165] They may arise from the host State's representations vis-à-vis an investor and on investor's reliance on those representations.[1166] Expectations are associated with the time of making the investment.[1167] It is argued that investor expectations, especially when his

[1161] Lowe (n 14) 461-462; Dolzer, 'New Developments' (n 5) 73, 78-79; Fietta (n 2) 378; Yannaca-Small (n 1131) 455-459; Wälde & Kolo (n 13) 824 et seq.; *Tecmed,* p. 122; *Glamis Gold,* para. 356.

[1162] Lowe (n 14) 460.

[1163] This trend continues in more recent references, see e.g. Dolzer & Schreuer (n 13) 104-106; Newcombe & Paradell (n 1) 350-351; UNCTAD (n 1131) 73-76.

[1164] Dolzer & Schreuer (n 13) 104; Coe & Rubins (n 14) 624 (also referring to expectations associated with investor's chosen business model and the nature of his enterprise).

[1165] Fietta (n 2) 384-385. See Chapter 7, Section C.2.

[1166] *Merrill*, para. 150; *National Grid plc v The Argentine Republic*, UNCITRAL, Award of 3 November 2008 [*National Grid*], paras. 151-154; *Azurix Corp. v The Argentine Republic*, ICSID Case No. ARB/01/12, Award of 14 July 2006, paras. 316, 318; *Feldman,* paras. 148-149; see also Dolzer & Schreuer (n 13) 104; Paulsson & Douglas (n 13) 154, 157; Muchlinski (n 11) 592; UNCTAD (n 1131) 75. See Chapter 7. Section C.4.

[1167] *ADM,* para. 250; *Merrill*, para. 150. See Chapter 7, Sections C.2-4.

investment was induced by the host State and based on formal government permissions under local law, should be protected in a way that balances investor's requirement for stability and host State's need to regulate in the public interest.[1168] Legitimacy of expectations concerning future regulatory changes depends on their predictability by the investor[1169] and on any stabilising commitments he might have received from the host State.[1170] Moreover, tribunals also refer to assumed expectations, noting that investors have 'legitimate and reasonable expectation that they would receive fair treatment and just compensation'.[1171]

Because of their similarity to the references to legitimate expectations under the FET standard, the above suggests that legitimate expectations refer to expectations of treatment or use of investment.[1172] However, some commentators argued that these expectations represent proprietary rights because they 'will primarily be manifested in the investor's concrete investment' and consist of interests acquired under the host State's law.[1173] Legitimate expectations were similarly linked with host State's commitments by investors who claimed that their legitimate expectations arose from the host State's 'legal commitments, assurances and guarantees expressly offered to the investor' that gave rise to their acquired rights.[1174] It was consequently suggested that those acquired rights, or legitimate expectations, were expropriated when the host State reneged on its commitments.[1175] Similar argumentation was used under the FET standard. This approach, although endorsed by some commentators[1176], had not been accepted by tribunals. Confronted with such claims, the tribunals found that claimants had certain 'acquired rights' under host State

[1168] Newcombe (n 14) 45.

[1169] Dolzer & Schreuer (n 13) 105; Muchlinski (n 11) 592; *Methanex*, Part IV, Chapter D, para. 9.

[1170] *Methanex*, Part IV, Chapter D, para. 7; Muchlinski (n 11) 592. See Chapter 7, Sections C.2 and 4, Section D.1 and Section E.1.

[1171] *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary*, ICSID Case No. ARB/03/16, Award of the Tribunal of 2 October 2006 [ADC], para. 424. See Chapter 7, Section C.1.

[1172] Lowe (n 14) 461-462; UNCTAD (n 1131) 73.

[1173] Newcombe & Paradell (n 1) 350. See also Dolzer (n 13) 30; Fortier & Drymer (n 14) 306.

[1174] *CMS*, paras. 255-256; *Enron*, para. 88.

[1175] *CMS*, para. 256; *Enron,* paras. 87, 234-235; *Sempra*, para. 274. For a critique of this approach see *El Paso*/Sornarajah.

[1176] Newcombe & Paradell (n 1) 350-351. This approach may be an extension of arguments made by Paradell on behalf of the investor, whom he represented in *CMS*.

law.[1177] However, these 'acquired rights' were not referred to in the tribunals' final findings.[1178] The tribunals rejected the expropriation claims. Under the FET standard they treated the host State's commitments as undertakings of treatment and not as investor's 'acquired rights' protected under the standard.

Some tribunals and commentators observe that interference with investor's rights and reasonable expectations reflects the economic impact of the expropriatory measure.[1179] This is close to the '*Metalclad* test'. It suggests that impact on investor's economic expectations can constitute expropriation.[1180] However, tribunals are quick to add that expropriation will not be found if the economic impact is not substantial.[1181] As a result, given that the threshold of substantial deprivation is high and ITA tribunals do not recognise partial expropriation, references to economic expectations are not relevant for the indirect expropriation test unless they represent total annihilation of the investment.[1182] Therefore, the term 'legitimate expectations' does not include economic expectations at the present stage of development if ITL.

As a result, the references to legitimate expectations that resemble the FET approach are usually made *in abstracto*. ITA tribunals rarely investigate investor's legitimate expectations under the indirect expropriation standard. Both, the abstract statements and the ITA practice show that 'legitimate expectations' and 'investment-backed expectations' reflect the same ideas as under the FET standard. The following examples illustrate this point.

In *Metalclad* representations on which the investor relied to proceed with his investment contributed to indirect expropriation. He could reasonably believe in the host State's representations that he had all necessary permits to proceed with the

[1177] *CMS*, paras. 133, 144; 151; *Enron*, para. 102, 127.

[1178] *CMS,* paras. 260-264, 273-284; *Enron,* paras. 240-250, 256-268; *Sempra,* paras. 278-288, 296-304.

[1179] *LG&E*, para. 190; *Tecmed*, para. 122; Paulsson & Douglas (n 13) 152; Coe & Rubins (n 14) 624; Fietta (n 2) 384-385.

[1180] An extreme version of this argument suggests that investor's legitimate expectations of return on his investment are guaranteed by an IIA and constitute property interest protected against expropriation. See: *EnCana Corporation v Republic of Ecuador*, UNCITRAL, LCIA Case No. UN 3481, Partial Dissenting Opinion of Horacio A. Grigera Naón of 30 December 2005, paras. 17-26. For a critique see: *EnCana*, fn 138 and Newcombe & Paradell (n 1) 357.

[1181] *LG&E*, para. 191.

[1182] *ADC*, para. 304.

landfill's construction. Subsequent conduct of the host State was inconsistent with those representations and prevented operation of the investment.[1183]

In *RDC* the actions of the host State created investor's legitimate expectation that he had a valid contract with the host State. This case was based on the treaty text expressly referring to 'investment-backed expectations'. [1184] The investment concerned railroad infrastructure and services in Guatemala. It was based on three contracts between investor and the host State. One of the contracts was signed but never approved and the host State could not explain the absence of such approval. The tribunal found that the contract was *de facto* performed by both parties. The host State benefited from this performance and accepted payments under the contract. In these circumstances the tribunal found that the investor had a legitimate expectation that the contract was legally valid and its operation was not harmful to State interests. These expectations were affected when the host State subsequently declared the contract invalid due to its harmfulness to State interests. The invalidity, however, did not create substantial enough effect on the investment to constitute expropriation.[1185]

In *Ulysseas* the issue was whether the host Sate gave investor assurances, and thus created his expectations, about conclusion of power purchase agreements. The evidence showed that a responsible minister indicated during meetings with the investor that such agreement could be signed. He created an expectation in the investor on which the latter acted by submitting proposed contract terms. However, the assurances were not firm and specific enough to create a *legitimate* expectation. The minister refereed the investor to another State body and it quickly became clear that no such contract could be signed. The prejudice towards investor was limited. Moreover, the investor did not use another opportunity to sign such contracts at a later time.[1186] This analysis was an incidental factual matter. It is unlikely that, even if the tribunal found that such assurances have been made, they would have contributed to the finding of indirect expropriation.

In *Fireman's Fund* the investor, a financial institution that had invested in a Mexican bank, based its expropriation claim on an argument that the host State breached its

[1183] *Metalclad*, paras. 106-107. See also *CME* (paras. 611-612) and *Tecmed* (para. 150), where reliance on representations was relevant for the finding of expropriation when the expropriaton was caused by the reversal of those representations.

[1184] CAFTA-DR, Chapter 10, Annex 10-C, Section 4(a)(ii).

[1185] *RDC,* paras. 116-123, 150-152.

[1186] *Ulysseas*, paras. 191-197.

undertaking to recapitalise the failing bank. The tribunal analysed existence of the alleged undertaking using investment-backed expectation as a relevant factor.[1187] It found that discussions during the relevant meeting led only to 'an agreement to agree, subject to further negotiations'. The agreement was not binding, was subject to respective approvals, required formalisation, further negotiations and regulatory changes.[1188] In its assessment of legitimacy of investor's expectations the tribunal took into account the level of risk voluntarily undertaken by the investor, who invested in a 'troubled bank' during a financial crisis, thus taking high commercial risk.[1189] Again, the analysis was incidental and, even a finding of legitimate expectations would not have supported a finding of expropriation.[1190]

In *Feldman* the investor could not reasonably rely on various oral and written communications between him and the Mexican tax authorities. These communications were 'at best ambiguous and misleading' and would have been in direct conflict with applicable law. In those circumstances the investor, as a reasonable person, should have obtained professional advice and formal clarifications from appropriate authorities.[1191]

In *Methanex* the tribunal, analysing foreseeability of future regulation that allegedly indirectly expropriated the investment, looked for specific stabilising representations. In passages that became important under the FET standard[1192], it observed that the investor could have expected regulatory stability only if he had been induced to invest by the host State's specific stabilisation commitments. No such commitments were found and the specific environment of the relevant economic activity increased risk of regulatory changes in the future.[1193]

When compared with the analysis in the next chapter, the above examples show that ITA tribunals understand the concept of legitimate, or investment-backed, expectations under the indirect expropriation standard no differently than under the FET standard.[1194] They investigate interactions between investors and the host State

[1187] *Fireman's Fund,* paras. 176, 207.

[1188] ibid*,* paras. 193-199.

[1189] ibid*,* paras. 179-180, 218.

[1190] ibid*,* para. 199.

[1191] *Feldman,* paras. 114, 132, 134, 149.

[1192] See Chapter 7. Section D.1. Fietta ((n 2) 391-392) argues that the tribunal's comments belong under FET standard and not expropriation analysis.

[1193] *Methanex*, Part IV, Chapter D, paras. 7, 9-10.

[1194] See Chapter 7. Section D.1.

for existence of host State's conduct placing the investor in a situation legally relevant for the finding of indirect expropriation. The *Fireman's Fund* and *Feldman* awards show that also with regard to indirect expropriation tribunals referring to legitimate expectations investigated business risk taken by the investor.[1195] In *RDC, CME, Metalclad* and *Tecmed* tribunals found existence of such expectations. In the latter three cases the economic impact on the investment of the host State's subsequent frustration of expectations amounted to its total destruction and consequently to a finding of expropriation.

The type of legitimate expectations most relevant to indirect expropriation may be related to a retrospective invalidation of contractual or quasi contractual arrangements in an on-going relationship with the host State, if such invalidation causes substantial deprivation. This would be consistent with pre-ITA international arbitration, as illustrated by the cases of *SPP*[1196] or *Shufeldt*.[1197] In both cases, investors had legitimate expectations of legality of their contractual or quasi-contractual arrangements with the host State. Those expectations were later dashed when the host State retrospectively invalidated the legal arrangements that were the foundations of the investment, totally annihilating it. In cases when the matter of legitimate expectations was incidental no such wholesale retrospective invalidation occurred.

There appears to be a consensus that indirect expropriation *protects* investor's legitimate expectations engendered by specific representations.[1198] Such expectations arise from specific stabilising undertakings concerning regulatory *status quo* procured by the investor, who relies on those undertakings to invest.[1199]They are also extended to expectations related to investor's reliance on 'representations and undertakings'[1200] or to abrogation, annulment or invalidation of contractual commitments or authorisations by the host State.[1201]

[1195] See also Newcombe & Paradell (n 1) 350.

[1196] *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award on the Merits of 20 May 1992 [*SPP*].

[1197] *Shufeldt claim (Guatemala, USA),* Decision of the arbitrator H.K.M. Sisnett of 24 July 1930, Reports of International Arbitral Awards, Vol. II, pp. 1079-1102.

[1198] Paulsson & Douglas (n 13) 157; Lowe (n 14) 462; Muchlinski (n 11) 592; Newcombe & Paradell (n 1) 363; *Methanex,* Part IV, Chapter D, para. 7; Newcombe (n 14) 49.

[1199] Paulsson & Douglas (n 13) 157-158; Lowe (n 14) 462; Muchlinski (n 11) 592; *Methanex,* Part IV, Chapter D, para. 7; Verhoosel (n 13) 456.

[1200] Paulsson & Douglas (n 13) 158.

[1201] Newcombe (n 14) 46, 49.

The above cases support the proposition that if the investment's continuation depends on a legal structure endorsed by the host State through representations, contractual or quasi-contractual arrangements with the investor, the subsequent abrogation of such structure leading to 'substantial deprivation' constitutes indirect expropriation. Legitimate expectations arise here from the State conduct creating the legal situation on which the investor relied. These are expectations of non-abrogation of the investment or of its legality, not expectations of a successful investment project. If the effect of State measures does not constitute a substantial deprivation, legitimate expectations are merely a 'useful guiding principle'[1202] in assessing specific circumstances of the case. *RDC* award shows that expectations are protected only if deprivation of investment is substantial, which is rarely the case.[1203] As a result, arguments based on frustration of legitimate expectations receive more sympathetic reception under the FET standard, where there is no deprivation threshold.[1204]

To assess whether there has been an indirect expropriation, tribunals investigate whether the host State's measures were justified in light of investor's legitimate expectations. This requires balancing of the private interest behind the expectations and the public interest behind the expropriatory measures.[1205] Such weighing is rare in practice for at least three reasons. First, no such balancing is required when there is no 'substantial deprivation'. Secondly, balancing is viewed as unnecessary if expropriation results from breach of specific commitments.[1206] Such commitments are understood narrowly as either stabilisation representations or contractual or quasi-contractual commitments the abrogation of which leads to a destruction of investment. In cases associated with legitimate expectations where tribunals found expropriation, namely in *CME, Metalclad* and *Tecmed,* only the latter involved such balancing. The tribunal weighed investor's expectations of long-term operation of his investment with public's environmental and health concerns behind the measures

[1202] Paulsson & Douglas (n 13) 157.

[1203] Fietta (n 2) 384. 385, 399.

[1204] ibid 385, 399; Newcombe & Paradell (n 1) 351.

[1205] Newcombe & Paradell (n 1) 364.

[1206] ibid 363. But see Wälde & Kolo (n 13) 843-844), who argue that breach of commitments by the host State (either by their abrogation, breach by use of sovereign powers or by enactment of new regulation) should be a factor in the assessment whether there was indirect expropriation and be balanced with host State's regulatory powers. See also Verhoosel ((n 13) 463) who argued that, absent stabilisation commitments, the impact of regulatory changes on other types of commitments could be assessed on a reasonableness basis.

that led to the investment's permanent closure. It used for this purpose the proportionality standard.[1207] The third reason for general avoidance of balancing may be the tribunals' reluctance to view themselves as a proper forum to scrutinise sensitive decisions about limits of governmental powers, thus shunning weighing of private and public interests and preferring less politically sensitive solutions.[1208]

E. Conclusions

The role of references to legitimate expectations under indirect expropriation is not as prominent as under the FET standard. However, their history clarifies two important points. First, legitimate expectations are not economic expectations of investors. Secondly, the references to legitimate expectations were inspired by developed legal systems during a search for established concepts that could help discipline an overly broad application of IIA standards by ITA tribunals.

Understanding legitimate or investment-backed expectations under indirect expropriation is in line with the developments under the FET standard, discussed in the next chapter. The process of resorting to 'legitimate expectations' and 'investment-backed expectations' represents a single trend and occurred simultaneously under both standards. The critical reactions to the overbroad application of the vague FET standard by ITA tribunals mirror the developments described above. This was seen as reflecting a standard much broader than CIL minimum standard[1209] and the NAFTA States narrowed this practice by issuing an interpretative statement.[1210] Commentators turned to more developed legal systems for help.[1211] This brought about references to 'legitimate expectations'[1212] and 'investment-backed expectations'[1213] inspired by EU law, English law and ECtHR jurisprudence.[1214] It was also accepted that the FET standard cannot be defined *in*

[1207] *Tecmed,* paras. 122-150.

[1208] Lowe (n 14) 464-465; Dolzer (n 13) 64-65.

[1209] Lowe (n 14) 454.

[1210] NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions of 31 July 2001, Section 2.

[1211] Wälde (n 14) 377, 385-386 and (n 199) 197-198.

[1212] Dolzer, 'FET: A Key Standard' (n 5) 103-104; Schreuer (n 12) 374; Vicuña (n 109) 353-356 and (n 1108) 193.

[1213] Wälde (n 14) 377, 387 ('investment-backed legitimate expectations', 'legitimate investment-backed expectations').

[1214] Wälde (n 14) 377, 385-387 and (n 199) 197-198, 207-209; Vicuña (n 109) 355-356 and (n 1108) 193-194.

abstracto, its application should to proceed on a case-by-case basis and that investor's legitimate expectations are one of the relevant factors in this enquiry.[1215]

Also here references to 'investment-backed expectations', 'legitimate expectations' or hybrids of the two terms were used interchangeably. They were treated by some commentators[1216] and tribunals[1217] as a reflection of a single idea, underlying both the FET and indirect expropriation standards. This approach was amplified by the increased use of the FET standard as the main standard of investment protection. The requirement of 'substantial deprivation' created a very high threshold for the finding of indirect expropriation and tribunals were willing to consider investors' claims under the vaguer FET standard. The FET therefore eclipsed the indirect expropriation standard, prompting suggestions that it is applied *in lieu* of the latter.[1218] The details of this process will now be considered in the next chapter.

[1215] Wäelde (n 14) 385; Lowe (n 213) 73; Jan Ole Voss, *The Impact of Investment Treaties on Contracts between Host States and Foreign Investors* (Martinus Nijhoff Publishers 2011) 204; Tudor (n 1143) 164.

[1216] Lowe (n 14) 257-262; Wäelde (n 16) 381 and (n 199) 202 (referring to 'disappointment of legitimate investment-backed expectations build up by governmental assurances: the reliance principle'); Dolzer, 'Impact of Investment Treaties' (n 5) 968-969; Vicuña (n 109) 353-356.

[1217] *Thunderbird,* paras. 137-167; *Cargill,*para. 344; *Glamis Gold,* paras. 356, 542, 461; *Grand River,* paras. 126-127.

[1218] Fietta (n 2) 389, 397; Reed & Bray (n 13) 14; Reisman & Digón (n 1110) 28, 32-33; Wäelde (n 16) 384; *Thunderbird/*Wälde, para. 37. This shift is compounded by approach of some tribunals treating the FET standard as a fall-back in cases when the facts of the case do not allow for a finding of expropriation. (*Sempra,* para. 297; *PSEG,* para. 393) However, most commentators view FET as a standard separate and independent from the expropriation standard (Lowe (n 213) 73; Kläger (n 12) 297; Weiler & Laird (n 317) 267-268; McLachlan, Shore & Weiniger (n 12) 203).

Chapter 7 The Origins and Development of Legitimate Expectations in Investment Treaty Law: Legitimate Expectations and the FET Standard

A. Introduction

This chapter shows how investor's legitimate expectations are referred to in the context of the FET standard. It commences with an introduction of the theoretical underpinnings of these references. It then analyses the types of the host State's conduct that may give rise to foreign investor's reasonable reliance and thus to legitimate expectations.[1219] The term 'conduct' can be interpreted to mean various factual situations, referred here as 'sources'. This chapter recognises four types of such sources. At the most general legitimate expectations of FET arise directly from an IIA. This is an abstract concept of legitimate expectations, discussed in Section C.1 below. Further, expectations can arise from the state of the host State's law and other circumstances existing at the time the investment is made, from specific representations of the host State vis-à-vis the foreign investor, or from 'commitments' undertaken by the State towards the investor in very specific circumstances. The latter three sources focus on the specific circumstances of a particular case as a root of legitimate expectations. They inform the remainder of this chapter, which focuses on their legitimacy and protection and the balancing of the private and public interests in their application. The last part of this chapter summarises its findings and identifies issues requiring clarification.

B. Theoretical Underpinnings

The theoretical underpinnings of the concept of legitimate expectations in ITL are not clear. The FET standard is itself elusive and controversial. It is viewed as a standard of justice to be achieved in a fair and equitable (i.e. balancing) process. It requires balancing of investment protection with the host State's need to adapt to changing conditions and to act in the public interest. It enquires into what is right in a given situation by weighing all relevant circumstances. Such flexibility is crucial for the accommodation of relevant economic, social, cultural and political differences between communities, which can be reflected in perceptions of a foreign investor vis-

[1219] *Thunderbird*, para. 147.

à-vis those of a host State.[1220] The standard is also viewed as a general principle of due process which 'encapsulates the minimum requirements of the rule of law'.[1221] Commentators from the civil law tradition view it as equivalent to a general clause of good faith, filling gaps left by more specific IIA standards.[1222]

These views about the FET standard are reflected, albeit rarely, in the references to investor's legitimate expectations. Legitimate expectations are associated with investor's reasonable reliance on the host State's conduct and the legal consequences of subsequent frustration of investor's expectations arising from such reliance.[1223] This mechanism is linked with the good faith underpinning both the host State's conduct, its 'receipt' by the investor and his reliance on it.[1224] It is sometimes noted that investor's reliance reflects his reasonable trust or confidence[1225] that his expectations will materialise[1226], or 'reciprocal trust and good faith' between the investor and the host State.[1227] Others observe that it is the expectations-engendering conduct of the host State that must be 'trust-inspiring'.[1228] Legitimate expectations are also associated with stability and transparency of the legal framework into which the investor invests.[1229]

[1220] Muchlinski (n 11) 635-636; McLachlan, Shore & Weiniger (n 12) 202, 204-206; Kläger (n 12) 256. But see Wälde (n 14) 385 and (n 199) 207; Francisco Orrego Vicuña, 'Regulatory Authority and Legitimate Expectations: Balancing the Rights of the State and the Individual under International Law in a Global Society' (2003) 5 International Law FORUM du droit international, 188, 193-194193-194 and (n 109) 355-256) who associate it with preventing abuse of law.

[1221] McLachlan, Shore & Weiniger (n 12) 205; see also: Vandevelde (n 165); Stefan Schill, 'Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law', IILJ Working Paper 2006/6 (Global Administrative Law Series) <www.iilj.org> (accessed 16 April 2014); Dolzer & Schreuer (n 13) 123.

[1222] Dolzer, 'FET : A Key Standard' (n 5) 91; Dolzer & Schreuer (n 13) 122.

[1223] Tribunals in *Suez/Vivendi* (para. 226) and *Suez/InterAgua* (para. 207) particularly highlighted the element of reliance.

[1224] *El Paso,* para. 348; *Tecmed,* paras. 160, 173; *OKO,* para. 276; *Total,* paras. 121, 128; *Thunderbird /*Wälde, para. 25; Weiler & Laird (n 317) 275.

[1225] *Tecmed*, para. 160; *OKO*, para. 70; Schill (n 1221) 18.

[1226] *Tecmed*, para. 160; *OKO*, para. 70.

[1227] *Total,* para. 121.

[1228] *Thunderbird/*Wälde, para. 21.

[1229] Schreuer (n 12) 374; Dolzer & Schreuer (n 13) 133-134.

C. Sources of Legitimate Expectations

1. Legitimate Expectations Based on Investor's Reliance on an IIA: Legitimate Expectations of FET

According to one view, legitimate expectations can be engendered by investor's reliance on the FET standard in an IIA clause. This is expressed as investor's legitimate expectations of FET.[1230] This may be just another way of expressing the host State's IIA obligation to treat investors fairly and equitably.[1231] Such understanding dovetails with the general international law use of the concept of legitimate expectations as equivalent to *pacta sunt servanda*[1232], albeit extended beyond the treaty parties to treaty beneficiaries.[1233]

The FET standard, however, has no defined normative meaning. It is not possible to say *in abstracto* what treatment is an unfair and inequitable in violation of an IIA. This is particularly problematic when the standard is treated as 'autonomous'. In such case it is independent from the CIL minimum standard of treatment and its scope and content can be determined only based on other investment awards.[1234]

The concept of legitimate expectations was suggested as a way of supplying the FET standard with normative content. It is used to 'define'[1235] the FET standard *in abstracto* or to apply it to the circumstances of a particular case. It expresses the standard in terms of investor's expectations of a particular treatment. These expectations are formulated in a norm-like way, e.g. as expectations of transparency, consistency, freedom from ambiguity, non-arbitrariness or non-discrimination. They are 'presumed legitimate'[1236] because their source is not identified beyond investor's expectations. This approach was first applied in *Tecmed*, where the tribunal 'defined' the FET standard through a long list of State conduct generally expected by a foreign investor.[1237] The tribunal observed, among others, that the host State's treatment

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[1230] *Saluka,* para. 301; *Metalclad,* para. 99.

[1231] Newcombe & Paradell (n 1) 280.

[1232] Brown (n 5) 1; Byers (n 4) 125.

[1233] Weiler & Laird (n 317) 276.

[1234] Fietta (n 2) 396-397.

[1235] Attempting to define a vague treaty standard of indirect expropriation the *Metalclad* tribunal referred to 'reasonably-to-be-expected economic benefit of property'. This term should not be equated with 'legitimate expectations' (see chapter 6).

[1236] Tudor (n 1143) 168.

[1237] See the full text of the 'definition' in Chapter 2, Section D.

cannot affect 'the basic expectations that were taken into account by the foreign investor to make the investment'[1238] and that foreign investors expect consistency, total transparency as well as absence of ambiguity and arbitrariness.[1239]

Tecmed tribunal's approach was replicated in other awards.[1240] They are also reflected in claims of legitimate expectations of stability and predictability of the regulatory framework in which they made their investment.[1241] The main criticism of this approach is that such expectations, and thus the content of the FET standard, is not derived from the facts of a particular case. The contents of the definition are either unrelated to the tribunal's findings[1242] or reverse-engineered to fit its decision.[1243] Such approach allows tribunals 'add new legitimate expectations at any time'[1244], making the concept infinitely expandable.[1245]

The *Saluka* tribunal suggested that such legitimate expectations, i.e. expectations of transparency, good faith, non-discrimination etc., are a 'dominant element' of the FET standard.[1246] On this basis Weiler & Laird argued that there is a single standard of 'regulatory fairness' the content of which should be established by reference to investor's legitimate expectations.[1247] The content of this 'single, comprehensive international tort of regulatory misconduct'[1248] is established through asking 'what kind of treatment a reasonable investor was entitled to expect from the state'.[1249]

[1238] This approach may have been inspired from the first monograph on the FET standard which 'defined' it as an indication that investors 'will be subject to treatment compatible with some of the main expectations of foreign investors.' (UNCTAD, *Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements* (United Nations 1999) Sales No. E.99.II.D.15, p. 3; Vasciannie (n 12) 99).

[1239] *Tecmed*, para. 154. This approach has been criticised. See Douglas (n 289) 28; Alireza Falsafi, 'The International Minimum Standard of Treatment of Foreign Investors' Property: A Contingent Standard' (2007) 30 Suffolk Transnat'l L.Rev. 317, 340-341; *MTD Annulment*, paras. 66-71; *El Paso,* para. 342.

[1240] E.g. *Saluka,* para. 307; *Lemire* paras, 267-268; *Rompetrol,* para. 278; *Arif,* para. 537.

[1241] Here, the claim is derived from findings of some tribunals that such stability is an essential element of the FET standard, or even of the CIL minimum standard. See Section C.2.

[1242] Douglas (n 289) 27.

[1243] Vandevelde (n 165) 68.

[1244] ibid 68.

[1245] Tudor (n 1143) 165.

[1246] *Saluka*, paras. 302-303 (referring to *Tecmed, CME, Waste Management* and *Occidental*).

[1247] Weiler & Laird (n 317) 269, 299.

[1248] Wäelde & Kolo (n 13) 848.

[1249] Weiler & Laird (n 317) 271-272.

Such expectations cover 'the entirety of [investor's] regulatory experience'[1250] and are reflected in a 'basket of legal concepts, or regulatory indicators', such as transparency or non-discrimination.[1251] The standard should safeguard 'regulatory fairness' and investor's expectation to be treated in accordance with it.[1252]

This brings the FET standard close to a standard of good governance.[1253] Investors have legitimate expectations of good governance and IIAs define disciplines of such good governance, the breach of which triggers an obligation to compensate.[1254] However, a 'common, universally shared core of good-governance expectations'[1255] was never expressly agreed among States and its specific sources were never authoritatively identified.[1256] Weiler & Laird's proposition gives the concept of legitimate expectations the central role in specifying the content of good governance.

They argue that such expectations should be protected because investors rely on IIAs and expect that the treaties will be complied with. Reliance on treaty provisions should be treated as reliance on the host State's *specific* representations. They argue that *every* IIA includes the host State's promise of 'regulatory fairness', specifically of a 'transparent and predictable regulatory environment'.[1257] This implicit and general promise is directed at foreign investors at large. However, it is treated as a *specific* promise because regulatory fairness is 'a foundational element' of an *individual* investor's decision to invest.[1258] Unfortunately, Weiler & Laird provide no convincing explanation of how the specific content of this general promise should be

[1250] ibid 282.

[1251] ibid 300.

[1252] ibid 260.

[1253] Dolzer, 'Impact of Investment Treaties' (n 5) 972; *Suez/Vivendi*/Nikken and *Suez/InterAgua*/Nikken, paras. 20, 26.

[1254] Thomas Wälde, 'The Effectiveness of International Law Disciplines, Rules and Treaties in Reducing the Political and Regulatory Risk for Private Infrastructure Investment in Developing Countries' (2000) 5-5 CEPMLP Journal (internet printout on file with author).

[1255] Also referred to as 'expectations of fair and equitable governance' or 'the minimum expectation in the 21st century' as equivalent to contemporary minimum standard of treatment (see Wälde (n 14) 385-386 and (n 199) 207).

[1256] Commentators identified such potential sources: the IIA practice, other international instruments, including human rights treaties and UN General Assembly resolutions as well as treaties in force between two specific home- and host-States relevant to a given dispute, WTO law and EU law. (Wälde (n 14) 286 and (n 199) 207) or standards of good governance developed by World Bank and IMF (Dolzer, 'Impact of Investment Treaties' (n 5) 972).

[1257] Weiler & Laird (n 317) 277. See also *Thunderbird*/Wälde (paras. 4-6).

[1258] Weiler & Laird (n 317) 277 (emphasis added). Criticised by Yost (n 2) 43.

identified.[1259] Another commentator explained that this content is derived from investors' perceptions and expectations[1260], thus making the argument circular. The argument resembles the approach taken under GATT that its provisions should be interpreted in accordance with assumptions and subjective beliefs of one treaty party.[1261]

The approach represented by Weiler & Laird has been criticised as subjective and circular. It suggests that investor expectations are a source of the host State's obligations[1262] and that their scope depends on how the foreign investor understood them. Critics point out that the content of the FET standard should be derived from what a host State has consented to in an IIA and not from 'any set of expectations investors may have or claim to have'.[1263] Accepting that investors have some inherent expectations shaping the content of the FET standard overextends the concept of legitimate expectations.[1264] The concept of legitimate expectations should operate within the confines of the FET standard.[1265] Critics argue that legitimate expectations should only arise from investor's reasonable reliance on the host State's assurances or representations.[1266] Absent such representations or assurances, references to legitimate expectations offer no criteria and no supporting theory to establish their existence and content objectively.[1267] In essence, the presumed legitimate expectations are either derived from investor's legitimate expectations[1268] or from the tribunal's arbitrary declaration that State is expected to

[1259] Weiler & Laird ((n 317) 277, 300) refer to good faith and expectations arising from a particular legal order.

[1260] Katia Yannaca-Small, 'Fair and Equitable Treatment: Recent Developments' in Reinisch A (ed), *Standards of Investment Protection* (Oxford University Press 2008) 124 and 'Fair and Equitable Treatment' in Yannaca-Small K (ed), *Arbitration under International Investment Agreements. A Guide to Key Issues* (Oxford University Press 2010) 398. See also Schill (n 120) 163 and (n 1354) 15.

[1261] See Chapter 5, Section 2.

[1262] *MTD Annulment*, para. 67; *OKO,* para. 246; Andrés Rigo Sureda, *Investment Treaty Arbitration, Judging Under Uncertainty* (Cambridge University Press 2012) 77; Schill (n 1221) 17.

[1263] *MTD Annulment*, para. 67.

[1264] Fietta (n 2) 396.

[1265] ibid 397.

[1266] Vandevelde (n 165) 67; Fietta (n 2) 396; Pandya & Moody (n 2) 3.

[1267] Vandevelde (n 165) 67-68.

[1268] Sanja Đajić, 'Mapping the Good Faith Principle in International Investment Arbitration: Assessment of Its Substantive and Procedural Value' (2012) 46 Zb Rad Prav Fak Novy Sad 207, 214.

behave in certain way.[1269] This approach eliminates the need to actually interpret the treaty.[1270] Moreover, the open-ended catalogue of what State conduct investors can legitimately expect means that the FET standard or 'regulatory fairness' is potentially unlimited and could be used to eliminate all risks to foreign investors.[1271]

Such abstract and inherent legitimate expectations of FET should be distinguished from the three sources of legitimate expectations discussed in the remainder of this chapter.

2. Legitimate Expectations Based on the State of the Law at the Time of Investment

The second type of the host State 'conduct' giving rise to investor's legitimate expectations are the circumstances in which the investment is made. The central element of these circumstances is the legal framework of the host State at the time of investment.[1272] It influences investor's legitimate expectations about the way in which his investment will be treated.[12731274] Three elements inform the analysis of investor's legitimate expectations here: the host State's legal framework at the time of investment, giving rise to expectations; the time at which investor's expectations are assessed; and the investor's *reliance* on this general legal framework when he invests.[1275]

Few FET claims rest on the proposition that investor's legitimate expectations were engendered *only* by the state of the law at the time of investment.[1276] It is said that expectations may arise from host State's 'laws, regulations, declared policies, and

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[1269] Vandevelde (n 165) 67-68. See also McLachlan, Shore & Weiniger (n 12) 243; *MTD Annulment,* para. 71.

[1270] Đajić (n 1268) 214-215.

[1271] Pandya & Moody (n 2) 1; Vandevelde (n 165) 68; *MTD Annulment,* para. 71.

[1272] McLachlan, Shore & Weiniger (n 12) 234; Dolzer & Schreuer (n 13) 134; Dolzer, 'Impact of Investment Treaties' (n 5) 968; Dolzer, 'FET: A Key Standard' (n 5) 100; Kriebaum & Schreuer (n 872) 273; Muchlinski (n 40) 535; Potestà (n 2) 89, 110; Felipe Mutis Téllez, 'Conditions and Criteria for the Protection of Legitimate Expectations under International Investment Law' (2012) 27 ICSID Rev. 432, 437; Kläger (n 12) 186.

[1273] McLachlan, Shore & Weiniger (n 12) 234; Dolzer & Schreuer (n 13) 134-135; Muchlinski (n 40) 535.

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[1275] Dolzer & Schreuer (n 13) 134; Dolzer, 'Impact of Investment Treaties' (n 5) 968; Potestà (n 2) 111.

[1276] *Grand River*, para. 141.

statements'[1277] or, broader still, 'from all the circumstances of the case'.[1278] This is reflected in the *Tecmed* proposition of respect for investors' 'basic expectations … taken into account … to make the investment'.[1279] Potential sources of legitimate expectations are therefore viewed broadly. The key moment for their assessment is the time when investor makes his investment.[1280] However, it is also pointed out that legitimacy of expectations must be assessed at each decisive step of investment's 'creation, expansion, development, or reorganisation'.[1281]

This type of legitimate expectations gives rise to two types of claims. First, investors argue that the laws gave rise to their specific expectations of treatment. Secondly, and more often, investors argue that they legitimately expected stability and predictability of that initial legal framework throughout the duration of their investment.[1282]

This latter claim reflects a general consensus that the legal framework for foreign investment, which is often a long-term and capital-intensive project, requires some basic stability and predictability.[1283] An investor relies on this framework to plan and make his investment, and needs stability to realise these plans.[1284] This need is also expressed in terms of 'legitimate expectations', e.g. as legitimate expectations of stability and predictability.

[1277] *Suez/InterAgua,* para. 230; *Suez/Vivendi,* para. 222. Similarly *National Grid,* para. 173, *Enron,* para. 262; *El Paso*, para. 378 and *Continental*, para. 261.

[1278] *EDF v Romania*, para. 219; *El Paso*, para. 358.

[1279] *Tecmed*, para. 154.

[1280] *Ulysseas*, para. 250; *Oostergetel*, paras. 232-233; *Electrabel*, para. 7.76; *Frontier Petroleum*, para. 287; *AES Summit*, para. 9.3.8; *Plama*, para. 176; *Jan de Nul*, para. 265; *Biwater*, para. 602; *Duke*, para. 340.

[1281] Ursula Kriebaum, Christoph Schreuer, 'At What Time Must Legitimate Expectations Exist?' in Werner J, Ali AH (eds), *A Liber Amicorum: Thomas Wälde, Law Beyond Conventional Thought* (Cameron May 2009) 276; *Frontier Petroleum*, para. 287; see also Téllez (n 1272) 435.

[1282] Potestà (n 2) 88.

[1283] Newcombe & Paradell (n 1) 285; Peter Muchlinski, 'Regulating Multinationals: Foreign Investment, Development, and the Balance of Corporate and Home Rights and Responsibilities in a Globalizing World' in Alvarez JE and others (eds), *The Evolving International Investment Regime: Expectations, Realities, Options* (Oxford University Press 2011) 41; Dolzer & Schreuer (n 13) 134; *Parkerings*, para. 333; Tudor (n 1143) 169; Mairal (n 5); UNCTAD (n 12) 63-64; Voss (n 1215) 206.

[1284] Dolzer & Schreuer (n 13) 134; *Saluka*, para. 301; *Suez/InterAgua,* para. 230; *Suez/Vivendi,* para. 222; Téllez (n 1272) 433.

However, there is less of a consensus about the legal implications of such expectations. Some commentators and tribunals suggested that the FET standard provides high protection from subsequent regulatory changes. Dolzer argued that:

> The pre-investment legal order forms the framework for the positive reach of the expectation which *will be protected* and also the scope of considerations upon which the host state is entitled to rely when it defends against subsequent claims of the foreign investor.[1285]

In his view, protection of expectations is informed solely by the law existing at the time of investment. The State *must* at all times be aware of such expectations harboured by foreign investors and it *must* take these expectations into account when it subsequently changes that law.[1286] As long as an investor could rely on the law at the time of investment, he is protected from its subsequent changes.[1287] The *Tecmed* tribunal also insisted that investor's basic expectations *cannot be affected* by host State's conduct.[1288] The *Occidental* tribunal pronounced that under international law 'there is certainly an *obligation not to alter* the legal and business environment in which the investment has been made' and the host State is obliged to 'ensure both the stability and predictability of the governing legal framework.'[1289] Such approach of strong protection against regulatory change was reinforced by findings of other tribunals that stability is an essential element of the FET standard.[1290] This prompted claims that the host State, by changing its regulations, abrogated investor's rights arising from those regulations and breached the FET standard.[1291]

On the other hand a growing number of investment awards and scholarly writings indicate that protection of expectations of stability and predictability is not

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[1285] Dolzer, 'FET: A Key Standard' (n 5) 103 (emphasis added); see also Téllez (n 1272) 434, 435.

[1286] Dolzer, 'Impact of Investment Treaties' (n 5) 969; Dolzer, 'FET: A Key Standard' (n 5) 103; Dolzer & Schreuer (n 13) 134-135.

[1287] Dolzer (n 238) 72.

[1288] *Tecmed*, para. 154.

[1289] *Occidental*, paras. 191-192 (emphasis added). See also *Frontier Petroleum,* para. 285 (expectations based on the legal framework 'will be protected').

[1290] *Occidental*, para. 183; *CMS*, para. 274; *LG&E*, para. 124; *BG Group*, para. 307; *Enron*, para. 260; *Duke*, paras. 339-340; *Sempra*, para. 300. See also Christoph Schreuer, 'Fair and Equitable Treatment (FET): Interactions with other Standards' in Coop G, Ribeiro C (eds), *Investment Protection and the Energy Charter Treaty* (JurisNet, 2008) 89.

[1291] *El Paso*, para. 353; *Total,* para. 113; *Ulysseas,* para. 240; *Unglaube,* para. 248; *AES Summit,* para. 9.3.15; *Bayindir,* para. 184; *Parkerings,* para. 329.

absolute.[1292] The essentially presumed expectations[1293] of stability were criticised for turning the FET standard into a *de facto* stabilisation clause, for extending the standard beyond what was agreed in the IIAs and beyond the CIL minimum standard of treatment.[1294] Recent awards are clear that investors cannot expect that the host State's law in force at the time of investing will remain completely unchanged *ad infinitum*.[1295] Change and evolution of laws and economic circumstances over time is a normal feature of investment climate.[1296] Every investor should be aware of this fact.[1297] Those changes may even need to be far-reaching and impose significant burdens on investors[1298], especially in a severe economic crisis.[1299]

It is by now well recognised that the standard language of IIAs does not guarantee stability and immutability of the regulatory framework within which the investment is made.[1300] The IIAs limit host State's sovereign powers but do not eliminate its right to regulate domestic matters in public interest.[1301] This applies to IIAs that do not refer to stability; that expressly refer to stable conditions for investment as an element of host State's substantive obligations [1302] ; and that mention stability in their preambles.[1303]

Investors therefore have no inherent legitimate expectations of stability and predictability. Their expectations of total immutability of the legal and business

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[1292] *Saluka*, para. 305; *El Paso*, para. 350; Schreuer (n 12) 374; Newcombe & Paradell (n 1) 282, 288; Potestà (n 2) 111-113; Voss (n 1215) 212; *Thunderbird*/Wälde, para. 30.

[1293] See previous Section.

[1294] Sornarajah (n 8) 355; Lowe (n 14) 455; Zeyl (n 48) 221-223; *EDF v Romania*, para. 218; *Suez*/*Vivendi*/Nikken and Suez/*InterAgua*/Nikken, paras. 2-3, 26-28; UNCTAD (n 12) 67.

[1295] *Saluka*, para. 305; *El Paso*, paras. 350, 379; *Oostergetel*, para. 224.

[1296] *EDF v Romania,* paras. 217-218; *Parkerings*, para. 332; *Paushok,* paras. 299, 270; *Mobil*, para. 153; *El Paso,* para. 352.

[1297] *AES Summit,* para. 9.3.34; *Saluka*, para. 305; *Parkerings*, para. 332; Muchlinski (n 40) 550-551.

[1298] *Mobil*, para. 153; *El Paso*, para. 363; *Paushok*, para. 305.

[1299] *El Paso*, para. 374; *Impregilo*, para. 291; *Total*, para. 162.

[1300] *Mobil*, para. 153; *BG Group*, para. 298; *Total,* paras. 117, 120; *El Paso,* paras. 365-367; *Impregilo,* para. 290; *Plama*, para. 219.

[1301] *Saluka*, para. 305; *Parkerings*, para. 332; *Plama*, para. 177; *EDF v Romania,* para. 217 ('normal regulatory power'). *Enron*, para. 261; *CMS*, para. 277; McLachlan, Shore & Weiniger (n 12) 239, 261.

[1302] *AES Summit*, paras. 9.3.28-29 (ECT Article 10(1)'s reference to stability of investment conditions is not a stability clause).

[1303] *Continental*, para. 258; *Total,* paras. 115-116; *El Paso,* paras. 369-372.

framework and total immunity from State regulation based solely on a standard IIA wording are neither reasonable nor legitimate.[1304] Such expectations may be reasonable only if the host State made specific stabilising representations.[1305]

3. Legitimate Expectations Arising from 'Commitments': Argentina's Privatisation Programme

Investor's legitimate expectations can arise from 'commitments' undertaken by the host State in a regulatory framework introduced to attract foreign investment.[1306] This type of legitimate expectations developed in very specific circumstances.[1307] The relevant disputes arose from Argentina's large-scale privatisation of public utilities (water, gas and electricity), designed to attract substantial foreign capital to improve their infrastructure and quality.

A broad range of Argentina's conduct gave rise to investors' legitimate expectations. First, it was the new national regulatory framework introduced for the purpose of privatisations. It included: IIAs, general and specific sectoral laws, licenses and concessions granted to investors who purchased shares in the privatised enterprises and regulatory instruments containing terms and conditions of those licenses and concession. Secondly, it was the international marketing campaign promoting the privatisations to foreign investors, and, thirdly, the bidding process and interactions between investors and the authorities during that process. Declarations by Argentina's President in connection with the ratification of IIAs were also relevant for assessing investors' legitimate expectations.[1308]

This regulatory framework included certain safeguards forming specific guarantees or 'commitments'. They applied to the long-term licenses and concessions underlying operation of the privatised utilities[1309] and included mechanisms aiming to protect foreign investors against changes in the parity of the local currency and large

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[1304] *El Paso*, paras. 352, 372; *Continental*, para. 258; *EDF v Romania*, para. 217.

[1305] See Section D.1. But see *Total* (para. 122) suggesting that some stability can be inherent in the prospective nature of regulation applying to long-term investment projects.

[1306] Téllez (n 1272) 436; Pandya & Moody (n 2) 11.

[1307] *CMS, LG&E, BG Group, Sempra, Enron, El Paso, Suez/Vivendi, Suez/InterAgua, National Grid*.

[1308] *CMS*, paras. 53-56, 133-135; *LG&E*, paras. 35-51; *Enron*, paras. 41-43, 101, 103, 128; *Sempra,* paras. 82-84; *National Grid,* paras. 51-55, 176-177; *BG Group,* paras. 300, 305.

[1309] *CMS*, para. 197; *Enron*, para. 44; *BG Group*, para. 173; *Suez/Vivendi*, para. 34; *Suez/InterAgua*, paras. 92, 101-102.

increases of costs.[1310] They secured returns allowing investors to cover reasonable costs and earn reasonable return on investment.[1311] They concerned protections against devaluation of the local currency[1312] and, in the gas sector, prohibitions of unilateral changes to the licenses without investor's prior consent[1313] and of freezing of tariffs under pain of compensation.[1314]

Three elements were important for the findings that this regulatory framework and commitments it included gave rise to investors' legitimate expectations. First, they existed when the investment was made[1315]; secondly, investors relied on them to make their investments[1316] and, thirdly, expectations were engendered not only by the framework and the 'commitments' but also by the motives behind their introduction.

Not all tribunals explained what expectations were created.[1317] However, all of them found that the 'commitments' created mechanisms allowing for stability of the economic regime of the concessions and licenses throughout their duration, especially in case of changed circumstances.[1318] They gave rise to investor's expectations that Argentina will exercise its regulatory discretion within the limits defined in that regulatory framework.[1319]In case of changed economic circumstances investors could expect that the regulatory framework will be adjusted or renegotiated

[1310] *CMS*, paras. 133, 144; *LG&E*, paras. 49, 119, 133; *Sempra*, paras. 85, 110, 114, 151, 168; *Enron*, paras. 101-103; *BG Group*, paras. 162, 165, 167-169, 172, 305; *Suez/Vivendi*, paras. 38, 79, 82-83, 106-111, 126, 231, 234; *Suez/InterAgua*, paras. 78, 92, 115.

[1311] *CMS*, para. 179; *LG&E*, paras. 119, 133; *Sempra*, para. 168; *Enron*, para. 44; *BG Group*, para. 162; *Suez/Vivendi*, paras. 80, 126, 231; *Suez/InterAgua*, para. 112.

[1312] *CMS*, para. 133; *LG&E*, paras. 49, 119, 133; *Sempra*, paras. 85, 141, 148, 158, 160; *Enron*, paras. 127, 129, 134; *El Paso*, paras. 511-514; *BG Group*, paras. 164, 166, 171, 305.

[1313] *LG&E*, para. 49; *Sempra*, para. 85; *Enron*, para. 44; *BG Group*, paras. 170, 305.

[1314] *LG&E*, paras. 119, 133; *Sempra*, para. 85; *Enron*, para. 44; *BG Group*, para. 305.

[1315] *CMS*, para. 275; *LG&E*, paras. 127, 130; *BG Group*, para. 298; *Enron*, para. 262; *Sempra*, para. 303; *Suez/InterAgua*, paras. 203, 205; *Suez/Vivendi*, paras. 222, 224; *National Grid*, para. 173.

[1316] *CMS*, para. 275; *LG&E*, para. 133; *Enron*, paras. 262, 264-265; *Sempra*, para. 299; *Suez/InterAgua*, para. 207; *Suez/Vivendi*, paras. 226, 231; *National Grid*, para. 178.

[1317] *LG&E*, para. 133; *National Grid*, paras. 173-179.

[1318] *El Paso*, para. 515; *Suez/Vivendi*, paras. 38, 83; *Suez/InterAgua*, paras. 112, 216; *Enron*, para. 155.

[1319] *Suez/Vivendi*, para. 237; *Sempra*, paras. 168-169; *Enron*, paras. 103-104, 144, 154; *Suez/InterAgua*, paras. 216-217.

'in an orderly manner', in accordance with mechanisms provided therein.[1320] The 'commitments' engendered investor's expectations that the regulatory framework will not be entirely transformed or totally dismantled during the concession or license period.[1321]

The above findings were based on the overall circumstances of the cases and in light of the recognised minimum level of stability inherent in foreign investment protection.[1322] Three elements influenced the tribunals' findings of investor's expectations of stability, namely: the regulatory framework, the 'commitments' and the stability obligation inherent in the FET standard.[1323] It is difficult to ascertain from awards the weight attributed by tribunals to each of these elements. However, some tribunals were clear that investors were not generally immune from regulatory changes subsequent to their making of the investment.[1324] The 'commitments' immunised investors from a *complete change* of the regulatory framework and created expectations concerning the process through which such change should occur.[1325]

However, subsequent tribunals confronted with claims based on 'commitments' shunned the above approach[1326] and were careful to distinguish the disputes before them due to 'significant factual and contextual differences'.[1327] Methodology employed by them differed from the one employed by the 'commitments' tribunals. In particular, the former assessed each alleged source of expectations on its own

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[1320] *CMS*, paras. 161, 183; *Sempra*, para. 168; *Suez/Vivendi*, paras. 241-242; *Enron*, paras. 104, 129, 137, 143, 186; *BG Group*, para. 310; *Suez/InterAgua*, para. 222; it can be inferred from *National Grid*, para. 179.

[1321] *CMS*, paras. 275, 277, 284; *Sempra*, para. 303; *Enron*, paras. 261-262, 264, 267; *BG Group*, para. 307; *El Paso*, para. 517. Such conclusion can be also implied from *LG&E*, paras. 133-139 and *National Grid*, para. 179. *Suez/Vivendi* (para. 231) and *Suez/InterAgua* (para. 212) formulated them in a more general way as expectations that the host State will respect the concession throughout its lifetime.

[1322] That minimum was either (controversially) linked with recognition of stability as a necessary element of the FET standard (see Section C.2.) or with inherent nature of regulatory frameworks underlying long-term investment. (*Total*, para. 122).

[1323] Potestà (n 2) 111-112.

[1324] *El Paso*, paras. 87, 365-374, 390; *Impregilo*, paras. 290-291.

[1325] Some tribunals did not use legitimate expectations and viewed the issue of commitments as contractual. In *Impregilo* (paras. 292-296) the tribunal saw them as outside its mandate while in *EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A. v Argentina*, ICSID Case No. ARB/03/23, Award of 11 June 2012 [*EDF v Argentina*] (para. 1022) it analysed them under an umbrella clause.

[1326] *Continental*, para. 260; *Metalpar*, paras. 186-187; *Total*, paras. 147-148, 177-180.

[1327] *Continental*, para. 260; *Total*, paras. 177-178.

terms, not as part of an attractive framework deliberately designed to induce the investment.[1328] This approach developed to address legitimate expectations arising from 'representations', to which we now turn.

4. Legitimate Expectations Arising from Representations

Investor's legitimate expectations can arise from 'representations' of the host State on which the investor had reasonably relied.[1329] Some tribunals and commentators associate legitimate expectations only with representations or with a contractual or quasi-contractual relationship between an investor and a host State.[1330] By contrast with 'commitments', the 'representations' approach concentrates on the specific conduct of the host State vis-à-vis the investor and analyses it in more detail.[1331]

There is no definition of what representations give rise to legitimate expectations.[1332] They may arise from various conduct of the host State and need to be analysed in the circumstances of each case.[1333] Representations may consist of oral statements, either recorded in minutes or reconstructed in witness testimonies; of correspondence; of negotiations evidenced by various materials[1334]; or of some other pattern of behaviour.[1335] They can take a form of a conduct or a declaration.[1336] Usually, representations are reflected in a pattern of behaviour[1337] in dealings between investor and the host State.[1338]

[1328] *Continental*, para. 261; *El Paso*, paras. 390-396; *Total*, paras. 145-146, 149-150.

[1329] E.g. *CME*, paras. 157, 611; *Waste Management*, para. 98 (these two early awards did not associate this mechanism explicitly with 'legitimate expectations' but were later subsumed under it), see e.g. Wälde (n 14) 387, Schreuer (n 12) 375-377); *Plama,* para. 176; *Glamis Gold,* para. 621; *Merrill,* para. 150; *Grand River,* para. 140; *Mobil,* paras. 152, 156; *Total,* para. 121; Potestà (n 2) 89; Kriebaum & Scheuer (n 1281) 274; Newcombe & Paradell (n 1) 279; Pandya & Moody (n 2) 11.

[1330] *EDF v Romania*, para. 216; *PSEG*, para. 241 (but see paras. 255, 275); *Metalpar*, paras. 186-187; *Glamis Gold*, paras. 22, 622,766; *Merrill*, paras. 150, 242 (the tribunal was split on the issue); Wälde (n 14) 387 and (n 199) 208-209; UNCTAD (n 12) 68; Vandevelde (n 165) 68.

[1331] Potestà (n 2) 107.

[1332] Newcombe & Paradell (n 1) 280.

[1333] *El Paso*, para. 375; *Arif*, para. 539.

[1334] *Kardassopoulos*, paras. 445-449; Potestà (n 2) 103.

[1335] *Mobil*, para. 156; Mairal (n 5) 434-435; Voss (n 1215) 205; *Thunderbird/*Wälde, paras. 13, 32; Newcombe & Paradell (n 1) 280.

[1336] *Total*, para. 118.

[1337] *Mobil*, para. 156.

[1338] *MTD Annulment*, para. 69.

The host State conduct giving rise to legitimate expectations is characterised as 'clear', 'explicit' [1339] , 'precise', 'unambiguous', 'definitive', 'unequivocal'; and 'specific'.[1340] Representations must be specific as to the addressee[1341] and as to their subject-matter.[1342] They need to be addressed directly to the investor[1343] or to an identifiable group of investors.[1344] The more specific the State conduct, the more likely the tribunal will find that its addressee was entitled to rely on the representations. [1345] Representations cannot be conditional or qualified. [1346] Best efforts undertakings are usually not regarded as specific representations giving rise to legitimate expectations.[1347]

Representations need not be formally legally binding.[1348] It is unclear, however, to what extent an *ultra vires* conduct can give rise to investor's legitimate expectations. The answer may depend on the circumstances of a particular case. Expectations can arise from host State's conduct inconsistent with local law, provided that the investor had 'clean hands'.[1349] On the other hand, due diligence requires the investor to know that he is dealing with the competent authorities[1350] and that representations

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[1339] Some commentators and tribunals refer to 'implicit' representations (e.g. *Grand River*, para. 141; *Frontier Petroleum*, para. 285; *Total*, para. 120; Dolzer & Schreuer (n 13) 134; Schreuer (n 12) 374; Kläger (n 12) 164-165). However, this term has never been fully explained and is confusing (see e.g. *El Paso*, para. 217).

[1340] *Total*, paras. 117, 121; *Continental*, para. 261; *El Paso*, para. 375; *Unglaube*, paras. 250, 270; *Feldman*, para. 148; *Glamis Gold*, paras. 24, 800; *Grand River*, para. 141; *Mobil*, para. 152; *OKO*, paras. 247-248; *Duke*, para. 351; Mairal (n 5) 429; McLachlan, Shore & Weniger (n 14) 237; McLachlan (n 165) 377; Newcombe & Paradell (n 1) 281.

[1341] *Total*, para. 119; *El Paso*, para. 375.

[1342] *El Paso*, para. 375.

[1343] *El Paso*, para. 376; *Grand River*, para. 141; UNCTAD (n 12) 69.

[1344] *Unglaube*, para. 270. Reference to a 'group of investors' may have been drawn from the 'commitments' approach and needs to be treated with caution.

[1345] *Total*, para. 121.

[1346] Newcombe & Paradell (n 1) 286; *GEA*, para. 291; *Frontier Petroleum*, para. 465 (a letter from the State expressly saying that it had no possibility to intervene on behalf of investor). But see different approaches of tribunals to disclaimers in information memoranda presented by Argentina. The *Total* tribunal (para. 146) observed that the memorandum warned investors of potential risks; the *LG&E* (para. 150) the tribunal drew no consequences from the disclaimers, while the *National Grid* tribunal (para. 177) found that it was disingenuous for the host State to invoke such disclaimers.

[1347] *GEA*, para. 291.

[1348] *El Paso*, para. 376; *OKO*, para. 262; Mairal (n 5) 414, 434 (observing that the conduct may be informal, i.e. not constituting a contract, a regulation or a formalized administrative act).

[1349] Newcombe & Paradell (n 1) 282.

[1350] *MTD Annulment,* para. 69.

are made 'by government officials in an official way'[1351], even if they are not formalized e.g. in a decision. Abrogation of an on-going investment due to illegality may occur from a legitimate judicial process or from an abuse of national law procedures.[1352]

In appropriate circumstances representations may consist of 'a reiteration of the same type of commitment in different types of general statements'.[1353] Host State's conduct giving rise to 'representations' needs to be coherent and intended to engender expectations of the investor.[1354] Some tribunals add that the conduct *must* have been undertaken to induce the investor to invest.[1355]

Some tribunals introduced a 'hierarchy' of potential sources of investor's expectations. Political statements are treated as having the least legal value.[1356] General legislative statements do not give rise to expectations of stability, because by nature they are subject to modification, withdrawal or cancellation.[1357] Unsurprisingly, the 'commitment' approach, discussed in the previous section, encouraged claims alleging either existence of legitimate expectations of stability inherent in the legal framework in force at the time of investment[1358] or existence of 'commitments' protecting investors' position from future regulatory changes.[1359] However, tribunals generally required existence of stabilising representations and observed that such representations need to comply with the requirements of specificity.[1360]

[1351] *Thunderbird/*Wälde, para. 21.

[1352] *RDC,* para. 235 (abuse of *lesivo* process); *Arif,* paras. 398, 547(b)-(c) (controversially criticising invalidation of transactions by host State's judiciary despite not finding denial of justice).

[1353] *El Paso*, para. 377; see also *Unglaube*, para. 270.

[1354] *El Paso*, para. 379; *Total*, para. 119.

[1355] *Glamis Gold*, paras. 22, 621, 800-801; *Mobil*, para. 152; McLachlan, Shore & Weniger (n 14) 237; Mairal (n 5) 438 (less categorically).

[1356] *Continental*, para. 261; *El Paso*, paras. 378, 392-395.

[1357] *Continental*, para. 261; *Total,* paras. 100, 309, 312*; El Paso*, paras. 376, 394, 397-400; *Mobil*, para. 153. But see *Total* (para. 122), where the tribunal noted that stability expectations may be engendered by inherently prospective nature of laws aimed at regulating long-term investment projects.

[1358] *El Paso*, para. 353; *Total,* para. 113; *Ulysseas,* para. 240; *Unglaube,* para. 248; *AES Summit,* para. 9.3.15; *Bayindir,* para. 184; *Parkerings,* para. 329.

[1359] *Ulysseas*, para. 216; *AES Summit*, para. 9.3.15; *Total,* para. 143.

[1360] *El Paso*, para. 375; *Ulysseas*, para. 249; *Toto Construzioni Generali S.P.A. v Republic of Lebanon*, ICSID Case No. ARB/07/12, Award of 7 June 2012 [*Toto*], para. 244; *Plama*, para. 219.

As a result, broad 'catalogues' of host State's conduct that may give rise to legitimate expectations need to be treated with caution.[1361] Moreover, tribunals who shunned the 'commitments' approach in the circumstances of Argentina's privatisation programme saw its promotional activities merely as 'political and commercial incitements' and not as conduct capable of engendering expectations of legislative stability.[1362] In this context the *El Paso* tribunal rejected[1363] the argument that Argentina's commercial and political statements vis-à-vis potential foreign investors can be analogous to the public international law doctrine of unilateral declarations.[1364]

Investment tribunals acknowledge that representations giving rise to legitimate expectations, specifically when they concern stabilisation of the legal framework underlying the investment, can be contained in agreements, contracts, quasi-contractual obligations or stabilisation clauses.[1365] Contractual undertakings set within a complex regulatory framework need to be scrutinised in the context of all circumstances of a given case, including reasons and effects of such undertakings. Some tribunals noted that contractual or quasi-contractual 'representations' give rise to expectations of host State's compliance with them.[1366] Others found that engagement of high ranking State officials in contractual negotiations with the investor gives rise to legitimate expectations that the contract complies with the host State's law.[1367] Moreover, an investor may have assumed legitimate expectations that his contractual relationship with a private entity will not be interfered with by the State.[1368]

Tribunals require that representations are made at the time of investment[1369] and investors rely upon them to invest.[1370] Some tribunals treat the timing requirement as

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[1361] Dolzer & Schreuer (n 13) 134.

[1362] *El Paso*, paras. 392-395.

[1363] ibid, para. 392.

[1364] See Chapter 5, Section D.1.

[1365] *Total*, para. 117; *Unglaube*, para. 250; Kriebaum & Scheuer (n 1281) 274; Newcombe & Paradell (n 1) 280.

[1366] *Continental*, para. 261; *El Paso*, para. 278. But see *Thunderbird*/Wälde (para. 13), who associated legitimate expectations with 'commitments … of a less formal character'.

[1367] *Kardassopoulos*, para. 317; *Kardassopoulos v Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction of 6 July 2007 [*Kardassopoulos*/Jurisdiction], paras. 191-192.

[1368] *Alpha*, para. 422.

[1369] *Continental*, para. 260; *Unglaube*, para. 269.

strict, finding that any purported representations made after the investment is made cannot give rise to legitimate expectations.[1371] Other tribunals observe that reliance on representations may be linked with incurring costs after the investment was made.[1372] As a result, investor's reliance on representations after the investment was made can also be reasonable and justifiable in the circumstances[1373], especially when linked with 'expansion, development or reorganisation of the investment'.[1374]

The host State's conduct often does not meet the threshold set by the tribunals to engender legitimate expectations. The standard of proof in this regard rose over the years.[1375] Alleged representations are often too vague and general.[1376] There is often no evidence that the alleged representations were made during meetings or such evidence is contested.[1377] However, witness evidence of such assurances is acceptable if it is unchallenged by the other party.[1378] Written evidence, either as minutes of meetings or as correspondence, is often inadequate to prove existence of specific representations.[1379]

D. Legitimacy and Reasonableness of Investor's Expectations

1. General Considerations: *Caveat Investor*

Legitimate expectations are not static and tribunals assess their legitimacy and reasonableness in light of all relevant circumstances of a particular case.[1380] This

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[1370] *Continental*, para. 260; *El Paso*, para. 376; *Total*, para. 118; *Unglaube*, para. 269; *Mobil*, para. 152; *OKO*, para. 247; McLachlan, Shore & Weniger (n 14) 237.

[1371] *Frontier Petroleum*, para. 468; *Jan de Nul*, para. 265; *Duke*, para. 365; *Thunderbird*, para. 167.

[1372] *Total*, para. 118.

[1373] *OKO,* para. 247; *Kardassopoulos*, paras. 439, 441; UNCTAD (n 12) 71.

[1374] Kriebaum & Scheuer (n 1281) 276; *AES Summit*, paras. 9.2.8-14; *OKO,* para. 270.

[1375] Compare approaches by *Metalclad* and *Thunderbird* tribunals to evidence of relevant 'representations'. The latter does not give any factual details of representations on which the investor was found to have reasonably relied. The latter engages in a detailed factual analysis of the available material.

[1376] *White Industries Australia Limited v The Republic of India*, Final Award of 30 November 2011 [*White Industries*], para. 10.3.17; *Frontier Petroleum*, para. 468.

[1377] *Oostergetel*, paras. 249-250; *Jan de Nul*, para. 262; *MTD,* paras. 149-158.

[1378] *Kardassopoulos*, para. 445.

[1379] *GEA*, paras. 277-283, 287-291; *Frontier Petroleum*, paras. 465-466; *AES Summit*, paras. 9.3.19-20; *EDF v Romania*, paras. 243-245; *Plama*, paras. 212-213; *Feldman*, para. 132.

[1380] Newcombe & Paradell (n 1) 286; Fietta (n 2) 389; Tudor (n 1143) 167.

applies to legitimate expectations engendered by circumstances existing at the time of investment[1381], by 'representations'[1382] and by 'commitments'.[1383] All of these sources require contextual assessment.[1384] Such enquiry may supply investors with a wide range of facts in support of legitimacy or reasonableness of their expectations. However, tribunals highlight that not all circumstances can be used for this purpose.[1385] This assessment is guided by a number of factors and is directed at assessing the level of investment risk the investor took upon himself in a particular case.[1386]

Circumstances of each case may also give rise to requirements on investor's part, which is referred to as '*caveat investor*'.[1387] With regard to the state of the law at the time of investment this rule means that investor 'must take foreign law as he finds it'[1388], cannot complain that it is applied to him[1389] and has to comply with it.[1390]

Another aspect of this rule is an assumption that investors are prudent and experienced.[1391] Before they invest, they are required to conduct due diligence of the law of the host State and other relevant circumstances.[1392] This may require

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[1381] *El Paso*, paras. 358, 359, 364; *Saluka,* para. 304; *Oostergetel*, para. 114; *Biwater*, para. 602; *EDF v Romania*, para. 219; Potestà (n 2) 113, 119-120.

[1382] *Total*, para. 121; *OKO*, para. 247.

[1383] *Suez/Vivendi*, para. 229; *El Paso*, para. 355.

[1384] *Total*, paras. 121, 123, 155-156.

[1385] *El Paso*, para. 355. See also *Arif*, para. 536; *Parkerings*, para. 344.

[1386] Muchlinski (n 40) 534; *LG&E,* para. 130; Newcombe (n 14) 45; Franck (n 27) 440.

[1387] Muchlinski (n 40) includes three requirements here: that investor refrains from unconscionable conduct, adequately assesses investment risk and conducts his business in a reasonable manner.

[1388] McLachlan, Shore & Weiniger (n 12) 236-237, 261; *White Industries,* para. 10.3.15; Potestà (n 2) 110; Kläger (n 12) 186.

[1389] McLachlan, Shore & Weiniger (n 12) 237; Dolzer, 'FET: A Key Standard' (n 5) 102 and (n 266) 72; *MTD*, para. 205; Potestà (n 2) 110.

[1390] Muchlinski (n 40) 552.

[1391] *Mobil,* para. 158; *Unglaube,* para. 258; *Plama,* paras. 220, 222, 268, 270, 300; *EDF v Romania*, para. 313; *Grand River*, para. 144; *Oostergetel*, para. 254. Tribunals do not apply a lower threshold if the investor is inexperienced (see e.g. *Plama*). Thus, they are not sympathetic to complains that the requirement of due diligence may put too heavy burden on investors. (see e.g. *Thunderbird*/Wälde, paras. 4-6, 12, 47; Dolzer, 'Impact of Investment Treaties' (n 5) 968) Tribunals require investors 'to take the rough with the smooth' before they can claim treaty protection (Sureda (n 1393) 81-82).

[1392] *Parkerings*, para. 333; *EDF v Romania*, para. 219; *Electrabel*, para. 7.78; *Plama*, para. 268; *Biwater*, para. 601; *MTD*, para. 164; Muchlinski (n 40) 534-535, 550*;* McLachlan (n 165) 246-247; Dolzer, 'FET: A Key Standard' (n 5) 104; Téllez (n 1272) 434; UNCTAD (n 12) 78; Mairal ((n 5) 442-443) treats it as a factual requirement.

obtaining professional advice.[1393] The assumption of investor's knowledge of the environment in which he invests includes the state of the host State's law[1394] and, depending on the circumstances, the operation of its judiciary and administration.[1395] If the investor ignores the factual context important for his investment decision, he bears the consequences of such omission.[1396]

Legitimacy of investor's expectations concerning regulatory changes is influenced by the 'regulatory climate' of a given industry.[1397] Risk of regulatory changes is higher when the area has been traditionally subject to intense regulation and intense public interest.[1398] This lowers investor's expectations that he will not be subject to regulation or that the existing regulation will not change. For example, an investor investing in production and marketing of tobacco products must be aware that they have historically been subject to extensive regulation.[1399] A similar conclusion was reached with regard to the market for gasoline additives in California:

> Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the federal and state level, operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons.[1400]

As a result, the investor could not have expected immunity from the host State's regulatory environment of that particular market.

[1393] Muchlinski (n 40) 553; *Feldman*, para. 132; *Parkerings,* para. 342; *Plama*, para. 221; *MTD*, para. 164.

[1394] *Oostergetel,* para. 254; *Mobil*, para. 158; *Plama*, para. 222; *Thunderbird*, para. 164; *Total*, paras. 124, 149; Dolzer, 'Impact of Investment Treaties' (n 5) 968-969; Dolzer, 'FET: A Key Standard' (n 5) 103.

[1395] *White Industries,* paras. 10.3.11, 10.3.14-15; *Unglaube,* para. 258.

[1396] *Total*, paras. 155-158 (if investor treated policy developments affecting future existence of the underlying regulatory framework as irrelevant he cannot later complain that the framework has changed).

[1397] *LG&E,* para. 130; *Glamis Gold*, paras. 800-801; Mairal (n 5) 444; Potestà (n 2) 119; UNCTAD (n 12) 71.

[1398] *Grand River*, para. 144; *Methanex*, Part IV, Chapter D, para. 9; *Ulysseas*, paras. 253-256; *Glamis Gold*, para. 767.

[1399] *Grand River*, para. 145.

[1400] *Methanex*, Part IV, Chapter D, para. 9.

Investors can mitigate the risk of regulatory changes by obtaining specific commitments from the host State addressing his particular concerns.[1401] However, if relevant local laws are unclear and/or subject to diverse administrative and judicial practice, investors cannot use ITA to resolve such uncertainties and should request clarifications and assurances from the host State.[1402] Investor's expectations of stability are lower if he cannot show that he tried to procure such specific representations [1403] or when he could have procured a stabilisation clause but failed to do so.[1404]

Legitimacy of investor's expectations may be influenced by the 'overall investment climate of the host country'.[1405] The relevant circumstances may include social, economic or historical context that should have impacted the investor's decision to invest[1406] (referred also as the host State's level of development[1407]) and the relevant business risk.[1408] The investor should maintain reduced trust in measures introduced by the State at the time of a worsening economic crisis.[1409] In *Metalpar* the investor, who had business experience in the host State and awareness that the relevant industry was struggling, had no legitimate expectations of immunity from the impending economic crisis and from the regulatory changes required in such crisis.[1410] An economy in transition generally involives higher risk of subsequent regulatory changes, as well as a promise of higher returns.[1411] An investor investing

[1401] *Ulysseas*, para. 254; *Methanex*, Part IV, Chapter D, para. 7-9; *Glamis Gold*, para. 767; Potestà (n 2) 113, 114; Voss (n 1215) 212; Fietta (n 2) 389; Newcombe & Paradell (n 1) 296.

[1402] See Section E.1.

[1403] *Mobil*, para. 169.

[1404] *Paushok*, paras. 302, 370.

[1405] Muchlinski (n 40) 545. See also Potestà (n 2) 113; UNCTAD (n 12) 14; Tudor (n 1143) 164.

[1406] *Impregilo,* para. 290; *Suez/InterAgua*, paras. 209-210; *Suez/Vivendi,* paras. 228, 230; *El Paso,* paras. 358-364; *National Grid,* para. 174; *Parkerings,* paras. 335-336; *Duke,*para. 340; *Metalpar,* paras. 187, 201-202; *Bayindir,* para. 192; *Paushok,* para. 302. Kriebaum observes that such elements are not systematically considered (Ursula Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (2011) 10 L.P.I.C.T. 383, 385).

[1407] Potestà (n 2) 118; Kriebaum (ibid) 404; UNCTAD (n 12) 71; Tudor (n 1143) 165; Nick Gallus, 'The Influence of the Host State's Level of Development on International Investment Treaty Standards of Protection' (2005) 6 JWIT 711.

[1408] *National Grid,* para. 175; *Total,* paras. 157-158.

[1409] *Continental*, para. 262.

[1410] *Metalpar,* para. 187.

[1411] *Generation Ukraine*, para. 20.37; Muchlinski (n 40) 534, 545.

in a transitional or post-war economy is assumed to know that the law is likely to change more frequently than in a stable developed State.[1412] Similarly, it is unreasonable for an investor to rely on politicians' declarations and continue with his investment project when he knows that its existence depends on which political faction is in power and the political climate is volatile.[1413]

2. Objective Assessment of Legitimacy and Reasonableness of Investor's Expectations

Legitimacy of investor's expectations must be assessed objectively.[1414] The overall 'investment climate' cannot automatically excuse maladministration or inability to implement and enforce laws and policies.[1415] The assumption of investor's prudence should also not automatically excuse the host State's obligation to act transparently.[1416] Objectivity of assessment is influenced by the tribunal's approach to transparency.[1417] According to an older approach, obligation to provide investors with transparent legal framework is broad and inherent in the FET standard.[1418] This transparent legal framework gives rise to investor's legitimate expectations.[1419] More recent approaches show more restraint.[1420] Generally, the outcome of the objective assessment of legitimacy of investor's expectations is difficult to predict from existing investment treaty jurisprudence.[1421] Muchlinski suggests that this assessment could

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[1412] *Parkerings*, para. 335; *Toto*, para. 245; *Paushok*, 302.

[1413] *Bayindir*, paras. 190-195.

[1414] *Glamis Gold*, para. 22; *Mobil*, para. 152; *El Paso*, paras. 356, 364; *Toto*, paras. 165-166; *Electrabel*, para. 7.76; *EDF v Romania*, para. 219; Muchlinski (n 40) 535; Téllez (n 1272) 433.

[1415] Muchlinski (n 40) 546; *GAMI Investments, Inc. v The Government of the United Mexican States*, UNCITRAL, Final Award of 15 November 2004 [GAMI], para. 94. But see Gallus ((n 1407) 714) who suggests that the level of development of the host State could lead to a finding that investor had no protection.

[1416] Muchlinski (n 40) 553.

[1417] UNCTAD, *Transparency: UNCTAD Series on Issues in International Investment Agreements II: A sequel* (United Nations 2012) Sales No. E.11.II.D.16, pp. 52-55; Fietta (n 2) 389.

[1418] UNCTAD (n 1204) 51; Wälde (n 14) 387 and (n 199) 209; *Thunderbird*/Wälde, paras. 4-6 (ambiguous governmental communications should endanger expectations as the risk of lack of clarity burdens the host State); *Tecmed* tribunal (para. 154) suggested very broad obligation of transparency which was criticised (see e.g. UNCTAD (n 12) 52; Douglas (n 289) 28).

[1419] Dolzer & Schreuer (n 13) 133-134; Schreuer (n 12) 374.

[1420] UNCTAD (n 12) 63, 72.

[1421] Muchlinski (n 40) 546.

involve balancing of benefits the investor can gain from his investment with the risk he voluntarily undertakes when making the investment.[1422] The risk allocation will be influenced here by whether the host State induced the investor to invest.

3. Specific Considerations: Legitimacy of Expectations Arising from 'Commitments'

Reasonableness and legitimacy of investor's expectations arising from 'commitments' was influenced by the specific circumstances of the cases in which they were referred to. Tribunals found that the regulatory framework that included 'commitments' was designed and introduced with the specific purpose of inducing foreign investors to invest in Argentina.[1423] Argentina actively pursued potential investors[1424] and deliberately sought to create expectations of a stable regulatory framework capable of dealing with future economic crises.[1425] This framework was necessary because Argentina needed substantial capital, technology and know-how to upgrade its public utilities.[1426] To attract investors, due to its history of economic instability, Argentina needed to convince them that their investments are safe from such risks in the future.[1427] Moreover, the tribunals treated this regulatory framework as (re)presented[1428] or offered to the investors by the host State, rather than mutually negotiated.[1429]

As a result the 'commitment' approach did not require detailed assessment of legitimacy and reasonableness of investor's expectations. In the circumstances it was found reasonable for the investor to attach great importance to the host State's

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[1422] ibid 546-547, referring to the *Barcelona Traction case*, para. 99.

[1423] *Suez/Vivendi*, para. 227.

[1424] *CMS*, para. 134; *Enron*, para. 264; *Suez/Vivendi*, para. 30; *El Paso*, para. 84; *National Grid*, para. 177; *BG Group*, para. 175; *LG&E*, para. 49.

[1425] *Enron*, para. 264; *Suez/Vivendi*, para. 124, 227; *Suez/InterAgua*, paras. 112, 208; *EDF v Argentina*, para. 1008; *BG Group*, para. 304; *CMS*, para. 134; *LG&E*, para. 49; but see *El Paso* (paras. 392-404, 511-515, 517) where the tribunal found that Argentina's actions to attract investors were of political and commercial character and did not create expectations of immutability but, somewhat contradictorily, found the regulatory framework to constitute a commitment that the regulatory framework will not be totally altered by the host State.

[1426] *Suez/Vivendi*, paras. 30, 227; *Suez/InterAgua*, paras. 112, 208.

[1427] *Enron*, para. 264; *Suez/Vivendi*, paras. 124, 234; *Suez/InterAgua*, paras. 112, 214; *El Paso*, para. 82; *National Grid*, para. 176; *BG Group*, para. 304; *LG&E*, para. 133.

[1428] *Sempra*, para. 103; *BG Group*, para. 298.

[1429] *CMS*, para. 183; *LG&E*, paras. 52, 130; *Enron*, para. 262; *Suez/InterAgua*, para. 210; *Suez/Vivendi*, para. 231; *National Grid*, para. 174.

commitments and rely on them to make the investment.[1430] This reasonableness was justified by 'care and attention' Argentina took to establish the legal framework[1431] and by the statutory enshrinement of the 'commitments'.[1432] Moreover, tribunals assumed that without reliability of the 'commitments' no investor would have invested substantive funds in Argentina.[1433]

Therefore, the context of the 'commitments' cases was exceptional. They neutralised investors' risk of economic instability arising from historical experience of Argentina's economic crises. They 'created strong expectations of a long-term investment subject only to *de minimis* political or regulatory risk.'[1434] This meant that investors' due diligence obligations were low and tribunals refused to engage in their analysis.[1435]

4. Specific Considerations: Legitimacy of Expectations Arising from 'Representations'

When investor's expectations arise from representations, their legitimacy is influenced by that investor's unconscionable conduct vis-à-vis the host State.[1436] Legal relevance of unconscionability is not limited to the concept of legitimate expectations.[1437] An investor seeking representations from the host State is obliged, as a moving party, to disclose all relevant information. The scope of disclosure follows from his due diligence of the applicable law and the surrounding circumstances. If the information provided is incomplete and/or inaccurate and 'puts the reader on the wrong track', the host State's representations based on such

[1430] *Enron*, para. 265; *Suez/Vivendi*, para. 231; *Suez/InterAgua*, para. 212; *National Grid*, para. 178; *LG&E*, para. 133.

[1431] *Suez/Vivendi*, para. 231; *Suez/InterAgua*, para. 212.

[1432] *Enron*, para. 265; *BG Group*, para. 306.

[1433] *Suez/Vivendi*, para. 231; *Suez/InterAgua*, para. 212; *Sempra*, para. 148; *Enron*, para. 136. Pandya & Moody ((n 2) 18-19) criticise this approach as 'vague'.

[1434] *EDF v Argentina*, para. 1008.

[1435] ibid, para. 1009; *Suez/Vivendi*, para. 234; *Suez/InterAgua*, para. 214; *LG&E*, paras. 133, 139.

[1436] Muchlinski (n 40) 532) links this requirement of 'clean hands' with equitable character of the FET protection. See also Potestà (n 2) 120-121; Newcombe & Paradell (n 1) 282 and Section D.1.

[1437] *Plama*, paras. 133-146 (investor denied access to treaty protection due to misrepresentation of its investment capacity); *Azinian, Davitian, & Baca v The United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award of 1 November 1999 (for the same reasons host State's conduct not found to be in breach of IIA). See further Muchlinski (n 40) 536-542; Mairal (n 5) 441-442.

information are not procured in good faith and reliance on them is not reasonable.[1438] Investor's subjective interpretation of an agreement reached with the host State cannot give rise to legitimate expectations, if he behaved disingenuously during negotiations. Such investor cannot rely on his covert understanding of the agreement when he officially agreed with all the negotiating parties about the meaning of the relevant provision.[1439]

Repeated host State's conduct showing leniency vis-à-vis the investor may not create expectations of indefinite benevolence. When leniency in enforcement of tax law was based on investor's repeated but unfulfilled promises, the host State's repeated conduct does not create legitimate expectations of continued exemptions. Therefore, reversal of State conduct once the authorities' patience runs out does not frustrate any legitimate expectations.[1440] Aninvestor will also struggle to prove legitimacy of his expectations if the host State opposed his business activity 'every step of the way'.[1441]

Assessment of existence, reasonableness and legitimacy of expectations arising from 'representations' often forms part of the same analysis. The type of factors taken into account by tribunals to find whether investors' expectations were legitimate is illustrated by three examples.

In *Duke*, expectations of operational payment guarantees of a US investor and his subsidiary arose from letters issued by the relevant ministry of Ecuador. The guarantees were attached to power purchase agreements between the investor, his subsidiary and a State-owned power distribution company. The ministry undertook to pay for electricity in case the State-owned company defaulted on its payments. The guaranteed payments were to be secured by a trust-based mechanism. The ministry's representation was not merely contractual. It engaged the State's responsibility and the ministry, not being the investor's contractual partner, intervened for the sole purpose of providing the guarantees. The expectations were reasonable because the representations were a condition precedent of the

[1438] *Thunderbird*, paras. 151-159 (especially if it concerns activity that may be illegal under the host State's law).

[1439] *Chemtura*, para. 179.

[1440] *Oostergetel*, paras. 243-244, 248, 269-270.

[1441] *Feldman*, para. 149.

investment, requested by the investor because he knew of the previous problems with payment. The guarantees were also express and formulated in clear terms.[1442]

In *OKO* the tribunal found that investors' expectations of loan repayment arose from a letter from the relevant ministry in Estonia. The letter guaranteed the loan repayment and was attached to a loan restructuring agreement between the investors (commercial banks) and a state-controlled company. The expectations were reasonable even though the letter did not constitute a guarantee under Estonian law. The tribunal analysed in great detail circumstances justifying legitimacy of investor's expectations. They included: active participation of the ministry in long-term loan restructuring negotiations, its good faith willingness to secure payment of the loans, an analogous guarantee previously provided by the ministry and its *de facto* control over the debtor.[1443]

In *MTD* the tribunal found that a preliminary approval of a foreign investment gave rise to investor's legitimate expectations of feasibility of that investment's location. The case concerned construction of a city in Chile. The project was approved by the commission responsible for allowing foreign investments into the State. Investor's expectations did not arise from the facial reading of the approval but from two elements inherent in the approval process. First, the commission coordinated inflow of foreign investment at the highest ministerial levels. This implied 'minimum of diligence internally and externally' before it granted the approval. Secondly the approval process required the investor to specify location of the project which could only be changed by a renewed approval.[1444] Investor's expectation was limited to the feasibility of the investment's location and did not extend to its successful commencement or completion.[1445]

E. Protection of Investor's Legitimate Expectations

1. Expectations Arising from the State of the Law at the Time of Investment

As shown above [1446] although it was suggested that frustration of legitimate expectations based on the state of the law at the time of investment automatically

[1442] *Duke*, paras. 359-363.

[1443] *OKO,* paras. 39-40, 261-269.

[1444] *MTD,* paras. 162-163.

[1445] *MTD,* para. 163.

[1446] See section C.1.

breaches the FET standard, recent tribunals do not share this view, finding that investors are not immune from regulatory change.

Does the FET standard nevertheless protect certain expectations arising from the state of the law at the time of investment? Investors can expect that that law will apply to them.[1447] As a result, the regulatory framework at a given time creates expectations of treatment, either favourable or unfavourable to the investor. These law-based expectations must arise from law that is clear and not subject to controversy. When this is not the case investor's reliance on such law is not legitimate.[1448] In *Grand River* the relevant law was unclear and ambiguous. Its interpretation proposed by the investor was unsupported by judicial precedents and practice[1449] and therefore could not engender a reasonable expectation' of the alleged treatment under the law.[1450] In such cases investors should seek appropriate clarifications from the host State.[1451] Absent such clarifications, disputes concerning unclear and ambiguous law belong to the jurisdiction of the host State's courts.[1452]

To what extent are investors' expectations that the law will apply to them protected under the FET standard? Failure of the host State to apply it may, but does not have to, constitute a breach of the standard.[1453] This has to be assessed on a case-by-case basis. It is relevant whether the host State made good faith attempts to achieve the objectives of its laws and regulations[1454] or if, after discovering a misapplication of its own law, took no further action affecting the investor.[1455] Non-implementation of a policy does not frustrate investor's expectations if the failure to do so cannot be attributed exclusively to the State.[1456] However, the host State cannot excuse its failure to apply the law by a 'dearth of able administrators or a deficient compliance

[1447] See Section D.1.

[1448] See Section D.1.

[1449] *Grand River*, paras. 139-143.

[1450] ibid, para. 144.

[1451] *Unglaube*, para. 253; *Plama,* paras. 219-220, 270*; Metalclad,* paras. 80, 85, 88; *Grand River,* paras. 142-143; *Mobil,* para. 169. See also *Thunderbird/*Wälde, para. 26.

[1452] *EnCana*, para. 200; *Unglaube*, para. 253; *Grand River*, para. 142; *Feldman*, para. 134. But see *Metalclad* (paras. 81-86) and *Occidental* (paras. 117-143) where tribunals applied local law despite surrounding controversies.

[1453] *GAMI*, paras. 91, 97.

[1454] ibid para. 97.

[1455] *Unglaube*, para. 254.

[1456] *GAMI*, paras. 91, 110.

culture.'[1457] Most importantly, the assessment whether non-compliance with its own law breaches the FET standard is not guided by 'protection of legitimate expectations' but by an enquiry whether the host State's conduct is 'arbitrary, discriminatory or otherwise shocking to the conscience.'[1458] As a result, asking whether an investor had legitimate expectations in this context adds nothing to such enquiry.

The same applies to subsequent regulatory change. Protection against unfavourable regulatory changes is limited to situations when an investor obtained specific stabilization commitments to that effect.[1459] Absent such commitments, an investor is protected from regulatory changes it they are 'unfair and inequitable'[1460], 'unreasonable'[1461], 'arbitrary, grossly unfair or discriminatory, or otherwise inconsistent with the customary international law standard'.[1462] The host State enjoys here an 'acceptable margin of change'.[1463] If the investment is based on a contractual or quasi-contractual relationship between the investor and the host State, subsequent regulatory changes 'should be made fairly, consistently and predictably' and '[take] into account the circumstances of the investment.'[1464] In practice, such regulatory misconduct may be hard to prove.[1465] If the changes fall within such 'acceptable margin of change', they may even create 'unstable legal and business framework'.[1466] Tribunals may require the host States to provide them with an economic, social or other justification for the change.[1467] All in all, absent specific

[1457] ibid para. 94.

[1458] *Unglaube*, paras. 253, 258; *Toto*, para. 244.

[1459] *Mobil*, para. 169.

[1460] Muchlinski (n 40) 551-552.

[1461] *El Paso*, paras. 364, 370-371.

[1462] *Mobil*, para. 153. See also: *Parkerings*, para. 332; *Methanex*, Part IV, Chapter D, paras. 7, 15; *Glamis Gold*, paras. 761-762; *Suez/InterAgua/*Nikken and *Suez/Vivendi/*Nikken, para. 36; Schreuer (n 12) 374-275.

[1463] *El Paso*, para. 402.

[1464] *Electrabel*, para. 7.77. Muchlinski ((n 43) 552) suggests that the host State may breach this obligation by making 'significant, unforeseeable and unannounced changes in the law with the aim of 'trapping' an investor into giving up their investment as a result of non-compliance.'

[1465] Muchlinski (n 40) 552.

[1466] *Mobil*, para. 153 (but see *PSEG*, para. 254). See also *Glamis Gold*, paras. 761-762, 809-811 (any regulatory changes not covered by specific assurances were outside the tribunal's mandate).

[1467] *El Paso*, para. 372.

stabilisation commitments, 'expectations of stability', are also not 'protected legitimate expectations' engendered by the host State conduct.[1468]

Tribunals also found that the FET standard is breached when the legal framework under which the investment was made had been totally altered.[1469] This observation refers to expectations arising from 'commitments' or expectations inherent in the nature of long-term capital-intensive investments, whose profitability depends on fees and prices regulated by the host State.[1470] In the latter case 'legitimate expectations' of stability do not arise from the host State's conduct but are inherent in the investment's character.[1471]

Legitimate expectations based on general conditions in which an investment was made are merely an analytical tool, a starting point for the tribunal's assessment of facts, not a self-standing standard of review.[1472] Tribunals investigate the circumstances in which the investment was made, enquiring whether they reflect investor's alleged expectations.[1473] This methodology leads either to a finding of expectations arising from specific undertakings, i.e. representations or 'commitments', and to a subsequent analysis of their protection.[1474] Alternatively, it leads to a finding that investor's alleged expectations of stability, predictability or other specific treatment are not supported by the circumstances of the case.[1475] In the latter situation an assessment whether the host State's conduct was within the 'acceptable margin of change' is beyond the scope of the concept of legitimate

[1468] It may be based on normative 'legitimate expectations of fair and equitable treatment' but such approach only creates confusion.

[1469] *El Paso*, para. 374.

[1470] *Total,* para. 122.

[1471] This signals that to qualify for protection under the FET standard such total alteration must fall outside the 'acceptable margin of change'. This requires case-by-case assessment and has not been tested in practice. Even tribunals referring to such inherent normative expectation found that the host State's conduct gave rise to stabilising 'commitments'. (*Total*, paras. 167-168, 175; *El Paso,* para. 517).

[1472] Newcombe's observation in relation to expropriation is also relevant here: '[a] reference to the amorphous concept of legitimate expectation is the beginning of the expropriation analysis, not its conclusion'. (Newcombe (n 14) 48)

[1473] *Oostergetel*, paras. 235-236.

[1474] See sections b and c below.

[1475] *Oostergetel*, paras. 233-236; *Electrabel*, para. 7.140; *AES Summit*, paras. 9.3.17-18; *EDF v Romania*, para. 245; *Parkerings*, paras. 333-337; *Methanex*, Part IV, Chapter D, para. 10; *Mobil*, paras. 158-171. But see *El Paso* (paras. 397-400, 517), where absent specific representations the tribunal took the view that a number of provisions taken together constituted a specific stabilising commitment.

expectations. References to legitimate expectations in this context add nothing to the tribunals' methodology.[1476]

2. Expectations Arising from 'Commitments'[1477]

Some tribunals observe *in abstracto* that frustration of expectations arising from 'commitments' by the host State's non-compliance with its 'commitments' breaches the FET standard.[1478] However, their actual findings were more confined. They found that Argentina frustrated investor's expectations and breached the FET standard when it *completely* dismantled the regulatory framework, including the 'commitments' specifically designed to guarantee investment's stability and failed to offer viable alternative arrangements.[1479] Paparinskis argues that this is one of only two situations that shoud be regarded as covered by the concept of legitimate expectations.[1480]

3. Expectations Arising from 'Representations'

Some tribunals and commentators observe *in abstracto* that frustration of legitimate expectations based on representations *will* or *should* be protected.[1481] However, other tribunals point out that in assessing whether investor's expectations of stability have been frustrated, one needs to take into account if the measures were introduced in good faith, in a non-arbitrary and non-discriminatory fashion, and whether they were of general application.[1482] Moreover, it is important if the host State frustrated investor's expectations in pursuance of a public interest and

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[1476] See Section B.1.

[1477] The specific conditions of the Argentinean economic crisis and the issue whether it could have relied on the doctrine of necessity are outside the scope of our analysis.

[1478] *LG&E*, para. 130; *Sempra*, para. 299; *Suez/InterAgua*, para. 204; *Suez/Vivendi*, para. 223; *EDF v Argentina*, paras. 999, 1001; Potestà (n 2) 103.

[1479] *CMS*, para. 277; *LG&E*, paras. 134-139; *Enron*, paras. 264, 266; *BG Group*, paras. 307, 309-310; *El Paso*, para. 517; *National Grid*, para. 179; Newcombe & Paradell (n 1) 289. *Suez/InterAgua* (para. 227) and *Suez/Vivendi* (para. 247) found that expectations were frustrated by refusal to apply the framework, when it had not been dismantled.

[1480] Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (Oxford University Press 2013) 240 (the other are State contracts); see also Mairal (n 5) 439.

[1481] Schreuer (n 12) 374; Dolzer & Schreuer (n 13) 134; Fietta (n 2) 389; *Glamis Gold*, para. 22 (however, the tribunal added that the conclusion will depend on 'the type or nature of repudiation measures' frustrating expectations); Snodgrass (n 2) 56; Téllez (n 1272) 436; Voss (n 1215) 204; Tudor (n 1143) 168.

[1482] *Continental*, para. 261; *Frontier Petroleum*, para. 285.

employed 'measures to reduce the negative impact' of its conduct on the investment.[1483] Others still observe that frustration of legitimate expectations based on the host State's 'conduct' *may* be *relevant* for the finding of a breach of the FET standard[1484], or '*could'* give rise to the host State's obligation to compensate the investor[1485], but does not mandate protection.

Finding of a breach of the FET standard based on representations is not frequent.[1486] Tribunals that found such a breach took various approaches to the consequences of that frustration. In *OKO* a claim for invalidation of the loan restructuring agreement filed by the State-controlled company was 'an act of gross bad faith'. Its encouragement by the State constituted inconsistent, unfair and not even-handed conduct, frustrating investors' expectations and breaching the FET standard.[1487] In *MTD* the approval of investment location inconsistent with the host State's own policy was unfair and inequitable. However, the investor was partly to blame for his investment's failure as he did not perform due diligence of applicable law.[1488] In *Metalclad* the conduct in violation of host State's representation contributed to the breach the FET standard, resulting in expropriation of the investment.[1489]

Some commentators support the view that legitimate expectations based on the host State's conduct relied upon by the investor represent a 'self-standing subcategory and an independent basis for a claim.'[1490] This approach was followed in awards where legitimate expectations were found to arise from 'commitments'. However, these cases do not represent a general trend, since their circumstances were unique. Tribunals using a more general category of 'representations' do not always use legitimate expectations as a self-standing standard, and require that the host

[1483] *Continental*, para. 261.

[1484] *Waste Management*, para. 98; Newcombe & Paradell (n 1) 283.

[1485] *Thunderbird*, para. 147.

[1486] *Duke, OKO, MTD, RDC*. Earlier awards in which tribunals found a breach of the FET standard in relation to investor's reliance on representations but which did not refer to legitimate expectations (*CME*, *Tecmed* and *Metalclad*) are also regarded as belonging to this group. (Wälde (n 14) 387; Dolzer & Schreuer (n 13) 135-137).

[1487] *OKO*, paras. 282-283.

[1488] *MTD*, paras. 166, 242-243 (for this reason the tribunal decreased the damages by 50%).

[1489] *Metalclad*, para. 99.

[1490] *Thunderbird*/Wälde, para. 37; Snodgrass (n 2) 2; Fietta (n 2) 385.

State's conduct frustrating expectations is also arbitrary, inconsistent or results in an expropriation.[1491]

F. Balancing Private and Public Interest

Recognition that investment tribunals must balance investor's legitimate expectations and the host State's right to regulate in the public interest applies universally to expectations arising from all three sources of legitimate expectations[1492], namely the state of the law at the time of investment [1493], 'commitments' [1494] and 'representations'.[1495]

If the host State did not make any specific stabilising representations, investor's expectations arising from the state of the law at the time of investment do not outweigh the host State's right to regulate in the public interest. The host State's right to regulate has to be exercised within the 'acceptable margin of change', which may involve weighing of the public and private interests. Recent awards and commentary point in particular to proportionality and margin of appreciation in relation to such balancing.[1496] However, such standard of review is outside the concept of legitimate expectations.

Tribunals referring to legitimate expectations arising from 'commitments' were careful to stress that their mandate was limited to assessing whether the host State violated

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[1491] *Duke* is an exception.

[1492] UNCTAD (n 12) 72-77; McLachlan, Shore & Weniger (n 14) 239.

[1493] *El Paso*, para. 358; *Saluka*, para. 305; *Ulysseas*, para. 249; *Electrabel*, para. 7.77; *AES Summit*, para. 9.3.30; *Plama*, para. 177; *Parkerings*, para. 332.

[1494] *CMS*, para. 277; *BG Group*, para. 298; *Enron*, paras. 104, 143, 261; *Sempra*, para. 168; *Suez/InterAgua*, para. 216; *Suez/Vivendi*, para. 236; *EDF v Argentina*, para. 1005; *El Paso*, para. 358.

[1495] *Total*, para. 123.

[1496] e.g. Benedict Kingsbury, Stephan W Schill, 'Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law' (2009) 14 ICCA Congress Series: *50 Years of the New York Convention: ICCA International Arbitration Conference* (Kluwer Law International 2009) and 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality in Schill SW (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010); William W Burke-White, Andreas von Staden, 'The Need for Public Law Standards of Review in Investor-State Arbitrations' in Schill SW (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) and 'Private Litigation in a Public Sphere: The Standard of Review in Investor-State Arbitrations' (2010) 35 Yale J. Int'l L. 283; Stefan Schill, 'Deference in Investment Treaty Arbitration: Re-conceptualizing the Standard of Review' (2012) 3 JIDS 577; Henckels (n 13); Zeyl (n 48).

its legally binding commitments vis-à-vis the investor[1497] and did not cover the general economic policy measures adopted by Argentina during the crisis.[1498] The tribunals found that through the 'commitments' Argentina limited its right to regulate and it could only exercise it within the confines of the regulatory framework underlying the concessions and licenses.[1499] When it acted outside this framework, it either frustrated investor's expectations about the process applicable to the solving of the relevant problems[1500], or committed abuse of its regulatory discretion.[1501] For some tribunals the requirement to balance the public and private interests was eliminated by their narrow understanding of their mandate, the existence of 'commitments' and by deliberate inducement of investments by Argentina.[1502] In finding a breach of the FET standard the tribunals did not find that these measures were arbitrary or discriminatory.[1503] One tribunal even found that the measures resulted from host State's reasoned judgement, due consideration, a consultation process and a justified need to avoid 'full economic collapse'.[1504] The award does not reveal whether these findings were balanced with investor's legitimate expectations arising from 'commitments'. The tribunal found that protection of expectations was almost absolute, subject only to conditions of state of necessity.[1505]

[1497] *CMS*, para. 124; *CMS Gas Transmission Company v Argentina*, ICSID Case No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction of 17 July 2003 [*CMS*/Jurisdiction], paras. 27-29, 33; *Enron Corporation and Ponderosa Assets, L.P. v Argentina*, ICSID Case No. ARB/01/3, Decision on Jurisdiction of 14 January 2004, para. 30; *National Grid*, paras. 138-139.

[1498] *CMS*, para. 124; *CMS*/Jurisdiction, para. 33; *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v Argentine Republic*, ICSID Case No. ARB/02/1, Decision of the Arbitral Tribunal on Objections to Jurisdiction of 30 April 2004, para. 67.

[1499] *Suez/InterAgua*, para. 217; *Suez/Vivendi*, para. 237; *EDF v Argentina*, para. 1005.

[1500] *Suez/InterAgua*, paras. 222, 227; *Suez/Vivendi*, paras. 242, 247.

[1501] *Suez/InterAgua*, para. 217; *Suez/Vivendi*, para. 237.

[1502] Mairal (n 5) 445; *National Grid*, para. 179.

[1503] *CMS*, para. 295; *Enron*, para. 281; *Sempra*, paras. 318-319 (tribunals found that conduct was neither discriminatory nor arbitrary); *LG&E*, paras. 148, 162 (found discrimination but not arbitrariness); *BG Group*, paras. 346, 360 (found that measures unreasonable but not discriminatory).

[1504] *LG&E*, para. 162. See also *Enron*, para. 268 and *Sempra*, para. 318 (recognising that the measures were 'guided by best of intentions' but not enquiring into whether there were any 'good reasons' for those measures which could justify frustration of expectations).

[1505] *LG&E*, para. 130.

The need for such balancing was highlighted in recent awards concerning 'commitments'.[1506] It was important that the host State made reasonable attempts to respect its commitments vis-à-vis the investor, e.g. by cooperating with him and by restoring the contractual arrangements within a reasonable time after the crisis.[1507] Tribunals also observed that the measures adopted by Argentina were too rigid and restrictive**.** Less restrictive measures protecting the public and the private interests were proposed but rejected and the host State showed uncooperative attitude towards such proposals.[1508]

Some commentators suggest that protection of legitimate expectations arising from 'representations' should be weighed against the public interest represented by the host State's measures.[1509] However, tribunals dealing with this type of expectations do not engage in such balancing.[1510] In *Duke*, the non-implementation of the payment guarantees breached the FET standard, even though it was not arbitrary and the investor's invoices 'were paid, albeit late.'[1511] Of the tribunals who found a breach of legitimate expectations based on representations only the *Tecmed* tribunal balanced investor's expectation of continuation of his investment with the host State's measures that caused its permanent closure. It observed that the State conduct was not justified by public health or environmental concerns and, in case such concerns existed, the investor was not given an opportunity to address them.[1512]

Absence of such balancing may be explained similarly to the analogous problem under indirect expropriation. Tribunals might be unwilling to engage in politically sensitive delimitation of the host State's regulatory powers.[1513] They may also view 'representations' or 'commitments' as analogous to contractual commitments and their frustration akin to a breach of contract, and thus not requiring them to balance public and private interests. Moreover, the additional requirement that the host State

[1506] *EDF v Argentina*, para. 1005; *Suez/Vivendi*, para. 236; *Suez/InterAgua*, para. 216.

[1507] *EDF v Argentina*, para. 1001-1002.

[1508] *Suez/InterAgua*, para. 215; *Suez/Vivendi*, para. 235.

[1509] Montt (n 44) 264; Snodgrass (n 2) 48; Téllez (n 1272) 441-442; *Thunderbird/*Wälde, para. 30.

[1510] Montt (n 44) 365.

[1511] *Duke*, paras. 361, 364, 381, 448-449. However, no damages were awarded for this breach due to lack of evidence.

[1512] *Tecmed*, paras. 162, 173.

[1513] Mairal (n 5) 445.

conduct frustrating expectations cannot be arbitrary, inconsistent or otherwise unfair and inequitable or expropriatory, may be viewed as eliminating the need for additional balancing.

G. Conclusions

Legitimate expectations are perceived to be at the centre of the FET standard. As a result, the concept had been tried and tested in multiple ways, many of them controversial. A general rule emerging from these various applications is that the more specific the conduct identified as a source of legitimate expectations, the more acceptable it is that that subsequent frustration of such expectations may be worthy of protection.

The concept is most problematic when used in the abstract. The idea of 'legitimate expectations of FET' crosses the limit of the tribunals' mandate to interpret vague IIA provisions. It is based on a subjective and/or arbitrary identification of sub-standards of State conduct that should be legitimately expected by investors as part of ITL. This does not mean that the FET standard should not be understood as a standard of good governance. However, the development of its constituent standards would be less controversial if advanced on a case-by-case basis, allowing it to merge over time into a more abstract rule. In such case the references to legitimate expectations also would not add anything to such process.

The concept of legitimate expectations is less problematic when expectations arise from specific representations and commitments, including contractual and quasi-contractual ones. However, including formal State conduct such as licenses, permits and contracts as a source of legitimate expectations that can give rise to protection that differentiates ITL from the other legal systems analysed here. The latter do not subsume a formal State conduct under the concept of legitimate expectations. Apart from comparative questions, this broad catalogue of specific conduct giving rise to legitimate expectations also raises questions about overlaps between the FET standard and an umbrella clause, which is a standard designed for protecting State's compliance with its formal commitments.

By contrast, expectations arising from the state of the law at the time of investment are a different type of legitimate expectations. They give rise neither to investor's immunity from subsequent regulatory change nor to specific promises vis-à-vis such investor. They assist in identifying investor's legal and factual position based on the relevant circumstances. But this is only a starting point for a further analysis whether,

against this factual and legal background, the host State conduct was unfair and inequitable. Such breach of the FET standard would not be a frustration of legitimate expectations but e.g. an arbitrary treatment.

Such analytical function of legitimate expectations closely resembles the US concept of RIBE, where investor's proprietary expectations are established by looking at the factual and legal circumstances at the time the property was acquired. Both concepts attracted criticisms for supporting regulatory freezes and favouring interests of investors. This parallel reveals the conceptual door between indirect expropriation and the FET standard. Should the FET standard be used as an extension of the expropriation standard? Should the methodology used in an expropriation standard be available under the FET standard? Should legitimate expectations under the FET standard encompass expectations of property rather than, or in addition to, expectations of treatment? These questions will be addressed in the next chapter.

The question of balancing between private and public interests constitutes a grey area in investment treaty law. In theory, it is recognised that investors' legitimate expectations need to be balanced with the host States' exercise of their sovereign powers in the public interest. Such balancing, however, rarely happens in practice, although the tribunals' approach may be changing in this respect. The approach to balancing differs from the approach taken by other legal systems analysed in previous chapters. This disparity, as well as other comparative questions highlighted above, will be addressed in chapter 8, to which we now turn.

Chapter 8 The Legal Character of the Concept of Legitimate Expectations in Investment Treaty Law – A Comparative Analysis

A. Introduction

This chapter summarises the findings of chapters 3-7 and presents the comparative contribution of the concepts of reasonable investment-backed expectations and legitimate expectations to the development of the concept of legitimate expectations in ITL. It attempts a typology of approaches to legitimate expectations, identifying among them European and US approaches, legitimate expectations concerning legislative changes, expectations arising from representations and expectations arising in the context of invalidity of final administrative decisions. It further focuses on the the common elements of the concept of legitimate expectations, among others its rationale, protection, equitable character, legitimacy and balancing. The chapter concludes by answering the question whether, in the light of this discussion, the legal character of the concept of legitimate expectations is that of a general principle of law, a rule of investment treaty law, an analytical tool, or merely a relevant consideration in the tribunal's reasoning.

B. Summary of the Survey

Chapters 3 to 7 of this thesis presented a number of major legal systems that use the concept of legitimate expectations or RIBE. Viewed collectively, they do not present a single coherent principle or a doctrine. Each approaches the concept to reflect its own needs and purposes. Although the concept does not lend itself to generalisations[1514], this section highlights the specific aspects of the concept in these legal systems.

US law[1515] uses RIBE as one of the crucial factors in determining regulatory expropriation claims. RIBE represent owner's expectations of his property in the light of existing laws, regulations, usages and factual circumstances, and in the light of the socially acceptable and constantly changing dimension of property. RIBE reflect the tension between the property owner's expectations of stable property rights and the State's right to regulate. They are always balanced against other factors

[1514] *Deuka*/Trabucchi (n 725) 777.

[1515] See Chapter 3, Section B.

identified by the USSC on an *ad hoc* basis. They do not always feature in the Court's analysis and are usually not dispositive of the case result.

English law and Australian law[1516] use the concept of legitimate expectations as a manifestation of procedural fairness. Legitimate expectations give an individual procedural protection, i.e. the ability to present his case before the authorities take a decision that may negatively affect him. English law extends the concept to substantive protection, requiring fulfilment of expectations of a substantive benefit. Expectations can arise from specific as well as general conduct of the authorities, or even from the very nature of the individual's legal situation. However, substantive protection of expectations is limited to representations.

In EU law[1517] legitimate expectations are associated with three distinct areas of enquiry, namely expectations of immunity from regulatory or legislative changes; expectations as to the stability and legality of final administrative decisions; and expectations engendered by representations of the authorities. The first two types of expectations are attached to the very nature of the situation of change, namely a regulatory change or retroactive invalidation of final administrative decisions. Legitimate expectations arising from representations are similar to substantive protection of expectations under English law.

The ECtHR[1518] uses legitimate expectations in the context of deprivation of property to elucidate the concept of 'possessions'. Expectations arise here from situations which, were it not for the actions of the State, would have constituted an enforceable right or claim. Detrimental State actions consist of a retrospective invalidation of final formal decisions or a retrospective legislative change.

In general international law[1519] legitimate expectations support the scholarly analysis of the binding nature of rules of international law, including estoppel, unilateral declarations and Article 18 of the VCLT. It is also used in treaty interpretation, e.g. as a tool safeguarding benefits agreed under a treaty from being undermined by conduct consistent with the treaty's letter but not its spirit.

Against this background, the concept of legitimate expectations in ITL[1520] constitutes a patchwork of ideas that can be linked to the legal systems mentioned above. It

[1516] Chapter 3, Section C.

[1517] Chapter 4, Section B.

[1518] Chapter 4, Section C.

[1519] Chapter 5.

[1520] Chapters 6-7.

links legitimate expectations with the state of the law at the time of investment and with investor's expectations of his investment's stability. Further, it associates legitimate expectations with the host State's 'representations' and more vaguely understood 'commitments'. The concept operates predominantly under the FET standard but also plays a subsidiary role under indirect expropriation.

C. Concepts Based on Legitimate Expectations: Typology

The legal systems analysed in chapters 3-7 do not represent a single uniform concept of legitimate expectations. Based on this survey this section proposes a typology of approaches informing further sections of this chapter.

1. European and US Approaches

The legal systems analysed in the preceding chapters are dominated by two approaches that can be referred to as European and US. The European approach looks at the *conduct* of the State as a source of expectations. It recognises that the State does not operate in a vacuum and its conduct can create expectations in others, be it other States, the State's citizens, traders or foreign investors. Expectations arise from reliance on that conduct, which needs to be specific.[1521] Such reliance may have legal consequences when the State behaves inconsistently with what was expected and expectations are found to be worthy of legal protection. Protection may be justified because confidence manifested by reliance on the State conduct is necessary to safeguard conditions conducive to co-operation.

Against this background, the US law concept of RIBE represents another major approach to the concept of expectations. It roots them in the concept of *property*. Expectations are inherent in a proprietary title and represent the scope of that title vis-à-vis subsequent legislative and regulatory conduct of the State. These inherent expectations of property are derived from a broad range of sources, including legislation, administrative conduct and the factual background of a specific investment.

The European and the US approaches represent different directions of analysis. The former looks at a specific conduct of State authorities vis-à-vis an individual (or a State) or a group of individuals (or States). It focuses on State conduct creating and then frustrating legitimate expectations. The analysis under the US approach starts

[1521] Chapter 3, Section C.2.b; Chapter 4, Section B.2.c; Chapter 5, Section C.1; Chapter 5, Section C.2.

from an existing proprietary situation of an individual and tests his alleged proprietary expectations against a broad legislative, regulatory and factual background. It focuses on a proprietary situation of that individual and the social dimension of this situation in light of subsequent legislative conduct of the State.

Due to these differences the two approaches need to be clearly distinguished.[1522] Unfortunately, ITL conflates them, robbing the concept of legitimate expectations of clarity and persuasiveness.[1523] The concept of representations is narrow in the EU, England and Australia. ITL extended it to a broad spectrum of State 'conduct'. This 'conduct' may consist of any activity of the host State, from legislation, through regulation, formal administrative acts, contractual undertakings, to informal representations. This expansion is facilitated in at least three ways.

First, is the word 'conduct' can be interpreted broadly. In the narrow sense it encompasses specific State behaviour vis-à-vis a specific person or persons. In a broad sense it includes legislative or regulatory conduct vis-à-vis a broad or unlimited group of persons.

Secondly, the '*Tecmed* test', almost universally referred to by investment tribunals, facilitates such expansion by its broad formula of 'basic expectations that were taken into account by the foreign investor to make the investment'.[1524] No explanation was ever offered as to its meaning, making it one of the 'house-of-cards'-like developments in ITL.[1525] *Tecmed*'s approach to expectations is similar to the US approach (RIBE). It therefore potentially puts investment tribunals on the wrong track. It may direct them to engage in essentially proprietary analysis while applying the FET standard, which is generally associated with due process.[1526] The generally understood 'basic expectations' should not be linked with the stronger legal consequences attaching to expectations engendered by specific representations.

Lastly, the popular commentary by Dolzer & Schreuer merges the European and the US approaches into one. Schreuer is inspired by EU law, specifically by the requirement of legal certainty (transparency), traditionally linked with the concept of

[1522] Fietta (n 2) 378.

[1523] Chapter 7, Section C.2.

[1524] *Tecmed*, para. 154; Chapter 7, Section C.2; Chapter 2, Section D.

[1525] Chapter 2, Section D.

[1526] Such misconceived approach facilitates arguments that the FET standard is a standard of property protection protecting 'vested rights' (Chapter 6, Section D).

legitimate expectations.[1527] By contrast, Dolzer's view is rooted in the RIBE-related expectations arising from investor's reliance on the legal framework existing at the time of investment.[1528] By putting these two distinct ideas together they created a hybrid where expectations arise from the 'legal framework' consisting of 'legislation and treaties, of assurances contained in decrees, licenses and similar executive assurances as well as in contractual undertakings'.[1529] This catalogue is clearly reminiscent of the proprietary approach to expectations. Yet the commentators add that a 'reversal of assurances by the host state that have led to legitimate expectations will violate the principle of [FET].'[1530] Again, no explanation is offered as to how these two distinct concepts should work, risking confusion in practice.

Tribunals recognise the confused nature of this approach and try to remedy it by creating hierarchies of State conduct that can engender legitimate expectations.[1531] However, the comparative perspective emerging from this thesis shows that the differences are deeper than the type of conduct of the host State. They rest in the different aims and directions of the underlying analyses. As a result, expectations related to general legislative, regulatory or policy measures belong to a concept distinct from the one linking expectations with specific representations.

This does not mean that the two approaches are clinically isolated. In Australia and England legitimate expectations may arise 'from the very nature' of the individual's legal situation. In the EU and England protection of legitimate expectations covers substantive legal situation of an individual. These circumstances may not be easily distinguishable from the US proprietary analysis, except that the first offers only procedural protection while the latter is limited to expectations arising from specific representations. Similarly, sources of proprietary expectations in RIBE are not limited to general laws, regulations or surrounding factual circumstances. They can also be *informed* by specific formal and informal administrative actions. This creates potential for confusion because specific conduct can be mistaken for a specific representation, misdirecting the analysis from the US approach to the European approach. Such high potential for confusion further justifies the making of a clear distinction between the two approaches.

[1527] Chapter 4, Section B.1; Schreuer (n 12) 374-379.

[1528] Dolzer, 'FET: A Key Standard' (n 5) 100-104; Chapter 7, Section C.2.

[1529] Dolzer & Schreuer (n 13) 134.

[1530] ibid 134.

[1531] Chapter 7, Section C.4.

2. Legitimate Expectations and Representations

Legitimate expectations arising from representations are sometimes seen as the equivalent of the concept of legitimate expectations.[1532] It is also the most attractive type of expectations because of the attached strong (substantive) protection and thus its resemblance of a rule of law. This type can be found in the laws of the EU, England and Australia, and in ITL.

In all these legal systems the general understanding of the concept of representations is similar. They have no pre-defined form and there are no hard and fast rules defining what State conduct will be treated as engendering legitimate expectations.[1533] Although virtually any official conduct of the authorities can have such effect, certain hierarchy of conduct exists, reflecting the fact that unrecorded oral representations are harder to prove (easy to deny).[1534] Representations have to be clear, precise and specific[1535] and thus cannot be conditional, qualified or general.[1536] They also need to be directed to an individual or a group of recipients.[1537] ITL formulates analogous requirements.[1538]

The threshold of clarity and specificity is hard to pass and many cases fail on this basis.[1539] This is the case in ITL, too.[1540] The English law observation that the more specific the representation, the easier it is to find a legitimate expectation[1541] was echoed by investment tribunals.[1542]

An important feature of a representation is that it arises from informal, if official, conduct of State administration. ITL demonstrates a clear tendency to expand beyond this limitation. It primarily seeks to include *contractual* commitments among expectations-engendering representations.[1543] General *legislative* statements were

[1532] E.g. Snodgrass (n 2); Pandya & Moody (n 2) 3; Fietta (n 2) 397.

[1533] Chapter 4, Section B.2.c; Chapter 3, Section C.2.b.

[1534] Chapter 4, Section B.2.c.

[1535] Chapter 4, Section B.2.c; Chapter 3, Section C.2.b.

[1536] Chapter 4, Section B.2.c; Chapter 3, Section C.2.b.

[1537] Chapter 3, Section C.2.b.

[1538] Chapter 7, Section C.d.

[1539] Chapter 3, Section C.2.b.

[1540] Chapter 7, Section C.4.

[1541] Chapter 3, Section C.2.b.

[1542] *Total*, para. 121; Chapter 7, Section C.d.

[1543] Chapter 7, Section C.d.

also viewed earlier as equivalent to representations.[1544] Additionally, claimants and commentators attempted to subsume public international law concepts of *estoppel* and *unilateral declarations* under the strong protection of legitimate expectations.[1545]

This trend of extending the strong legal protections to as broad a spectrum of State conduct as possible goes beyond what is accepted in other legal systems. Since no explanation is offered, it can result in the concept's abuse. Alternatively, this approach may be viewed as an attempt to utilise an existing public law concept in the specific legal circumstances of a foreign investment, where there are no clearly defined international law mechanisms of protection. An investment project usually consists of intertwined contractual, administrative, regulatory and legislative arrangements, i.e. of different types of host State conduct.[1546] It is a complex legal structure usually governed by the host State's law. The concept of legitimate expectations may provide legal meaning under IIAs to situations when some State conduct upsets the bargain between the investor and the State reflected in this complex legal structure.

Legislative arrangements as well as the international law estoppel and unilateral declarations are distinguishable from the public law legitimate expectations based on representations.[1547] Although international law estoppel and unilateral declarations cover State conduct corresponding to public law representations, they have their own mechanism of application. Unilateral declarations refer to legitimate expectations only as one of the factors that need to be balanced with State intent and approach State conduct restrictively.[1548] Estoppel is generally reserved to relationships between equals[1549], while in a relationship between the State and an individual the court needs to weigh the public and private interests when assessing State conduct.[1550]

Thus, the key difference between ITL and other legal systems lies in including contractual commitments among (informal administrative) representations. One

[1544] Chapter 7, Section C.b, Chapter 7, Section C.d.

[1545] Chapter 7, Section C.d; Mahnoush H Arsanjani, W Michael Reisman, 'The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes', (2004) 19 ICSID Rev. 328.

[1546] Wälde & Kolo (n 13).

[1547] Section C.3.

[1548] Chapter 5, Section C.1.

[1549] Chapter 5, Section C.2; Chapter 3, Section C.3; Brown (n 5) 9-10.

[1550] Chapter 3, Section C.3.

approach to this purported expansion is *not to apply* the public law concept of legitimate expectations to contractual obligations.[1551] An alternative approach is to apply it, respecting the general conditions of application of the public law concept of legitimate expectations.[1552] Tribunals would therefore need to consider and balance all relevant circumstances of a particular case on an equitable basis, including existence of an overriding public interest justifying frustration of expectations. The contractual context is an important circumstance of this assessment. It means that tribunals cannot use legitimate expectations 'as a substitute for the actual arrangements agreed between the parties, or as a supervening and overriding source of the applicable law.'[1553]

This last comment ties with the Australian criticism of substantive protection of legitimate expectations. Commentators pointed out that a court or tribunal cannot usurp executive powers and has to act with restraint when assessing the substance of representations.[1554] An investment tribunal needs to consider this criticism when applying the public law concept of legitimate expectations. In the contractual context it highlights a prohibition of re-vising and re-writing of the bargain between the investor and the State. This caution echoes the restraint towards the concept of legitimate expectations by the WTO AB. It criticised the WTO panels for their readiness to protect expectations of one party to a treaty arising from its subjective reading of the treaty or its revisiting of treaty negotiations.[1555]

The expanded concept of representations triggers the question of potential conflicts and overlaps within an IIA. First, an umbrella clause provides for observance of commitments, including contractual ones, the State has entered into with the investor.[1556] Traditionally, contract-based legitimate expectations were linked with such clauses, not with the FET standard.[1557] If a tribunal uses legitimate expectations

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[1551] Montt (n 44) 363.

[1552] See Section D.

[1553] James Crawford, 'Treaty and Contract in Investment Arbitration' (2008) 24 Arb. Int'l 351, 374.

[1554] See Chapter 3, Section C.4.b; Chapter 3, Section C.5.

[1555] See Chapter 5, Section B.2.

[1556] On umbrella clauses see e.g. Hege Elisabeth Kjos, *Applicable Law in Investor-State Arbitration. The Interplay between National and International Law* (Oxford University Press 2013) 247-253; Anthony C Sinclair, 'The Origins of the Umbrella Clause in the International Law of Investment Protection' (2004) 20 Arb. Int'l 411.

[1557] See e.g. Verhoosel (n 13) 463; Thomas Wälde, George Ndi, 'Stabilizing International Investment Commitments: International Law Versus Contract Interpretation' (1996) 31 Tex.Int'l L.J. 215, 247 et seq; Wälde & Kolo (n 13) 843.

extending an FET standard to overlap with an umbrella clause, it creates uncertainty that could affect the legitimacy of the tribunal's interpretative exercise.[1558] The question is equally valid if an umbrella clause of this type is absent from the relevant IIA. Any decision has to be persuasively explained.[1559] Secondly, the tribunal needs to consider on what terms such an extension should subsume contractual analysis under its treaty-based mandate. Caution is required not to allow legitimate expectations to form a covert method of importing contractual claims under the mechanism reserved for treaty-circumscribed claims. So far there is no clear method of distinguishing whether a contract-related claim falls in or outside the tribunal's mandate.[1560]

3. Legitimate Expectations and Legislative Change

Another type of legitimate expectations concerns legislative measures. This type of expectations is addressed in the US[1561], the EU[1562], the ECHR regime[1563], and in ITL.[1564]

As a rule, individuals do not have an expectation that the law in force at a given time will not change, but rather an expectation that the law *will* change. It is generally not unfair for a State to change its laws, and arguments based on reliance on existing law represent only one side of the argument about change.[1565] Certain stability of law is embedded in the very idea of a legal system and the rule of law.[1566] As a result, expectations of some stability of law need to be balanced with the State's need to change it. This rule had not been obvious to the early investment tribunals, but the current state of ITL is in agreement with the other legal systems on this point.[1567]

[1558] Franck (n 193) Chapter 4.

[1559] Orakhelashvili (n 24) 196.

[1560] For a cautious approach see e.g. *Parkerings*, para. 344 and *Impregilo*, para. 294.

[1561] Chapter 3, Section B.

[1562] Chapter 4, Section 2.a.

[1563] Chapter 4, Section C.2.b.

[1564] Chapter 7, Section C.b, E.a.

[1565] Chapter 4, Section B.2; Chapter 4, Section B.3.c; Chapter 4, Section B.2.a; Chapter 7, Section C.2; Dolzer, 'FET: A Key Standard' (n 5) 100-104.

[1566] Chapter 3, Section C.1; Chapter 4, B.1, p.2; Chapter 5, Section A; Chapter 7, Section B.

[1567] Chapter 7, Section C.2.

Legitimate expectations tied to legislative changes concern prospective and retrospective changes, including those that are immediate, sudden and unexpected.[1568]

The comparative perspective shows general acceptance that law can always change prospectively, including to the detriment of an individual. Such expectations are particularly inherent in the business environment.[1569] Legislation enables existence of a complex market, at a national[1570] and an international level.[1571] Access to that market is a benefit granted by the authorities in return for which an entrepreneur accepts that the underlying laws[1572] and policies[1573] may change in response to economic, scientific, social, political or other developments.[1574] Courts give deference here to the discretionary powers of the regulators to choose appropriate solutions to address changing circumstances.[1575] Entrepreneurs are expected to be aware of this context and thus capable of foreseeing some legislative changes.[1576]

In certain cases prospective legislative change may frustrate expectations worthy of protection. This may happen when a State expressly shields the individual's beneficial position from such change. Such protection may be derived from formal decisions, specific assurances and formal approvals[1577], as well as from specific shielding legislation[1578] or special regulation-based arrangements with the authorities.[1579] To determine whether such protection should be granted, courts need to take into account all relevant circumstances. In the EU such expectations can be overridden by public interest.[1580] US law will determine protection by balancing of a

[1568] Chapter 4, Section B.2.a.

[1569] Chapter 3, Section B.4.a.

[1570] Chapter 3, Section B.4.a; Section Chapter 3, B.4.b.

[1571] Chapter 4, Section B.1.

[1572] Chapter 3, Section B.4.b; Chapter 4, Section B.2.a.

[1573] Chapter 3, Section C.2.b.

[1574] Analogies with RIBE must be treated with caution here, since *gros* concern real property which is not subject to this access-to-market benefit assumption. (Chapter 3, Section B.4.a)

[1575] Section D.5.

[1576] Chapter 4, Section B.2.a; Chapter 3, Section B.4.b.

[1577] Chapter 3, Section B.3.b.

[1578] Chapter 4, Section B.2.a.

[1579] Chapter 4, Section B.2.a.

[1580] Chapter 4, Section B.2.a.

number of different factors as part of the *Penn Central* test.[1581] Such shielding is never absolute.

Investment tribunals demand specific stabilising commitments as a protection from legislative or policy changes.[1582] The comparative exercise shows that tribunals need to make clear that such commitments are not the same as 'representations'[1583], as these two concepts are distinct. Stabilising commitments usually take a form of contractual stabilisation clauses, a phenomenon the other legal systems do not address. In ITL the question is whether stabilisation commitments should be analysed under an umbrella clause or under the FET standard. So far investment tribunals have been finding that it is unfair and inequitable to completely renege on stabilisation commitments by dismantling entirely the contractual structure of investment.[1584]

Recent ITA practice shows acceptance of a greater deference towards host States.[1585] Such developments are strongly supported by commentators.[1586] A clear approach is particularly needed when the tribunals' decision would endorse a result effecting a regulatory freeze. US law shows that such clarity is required to avoid suspicion of judicial activism or imposing personal ideological predilections about the role of the State in shaping the market.[1587]

The comparative perspective also shows that it is generally unfair to change laws retrospectively, unexpectedly and with immediate effect.[1588] EU law stresses that a legislative change is generally not unfair if it provides for transitional measures. To excuse retroactivity changes must be *necessary* for achieving the public policy goal sought by the regulator. However, the requirement to employ transitional measures may be overridden by public policy concerns.[1589] The practice of ECtHR also shows that retroactive laws cannot be used by the State to extinguish established claims

[1581] Chapter 3, Section B.4.a.

[1582] Chapter 7, Section E.1.

[1583] Chapter 7, Section C.2.

[1584] Chapter 7, Section E.1.

[1585] Chapter 7, Section E.1.

[1586] See e.g. Zeyl (n 48), Pandya & Moody (n 2).

[1587] Chapter 3, Section B.1.b; Chapter 3, Section B.5.b.

[1588] Chapter 4, Section B.2.a.

[1589] Chapter 4, Section B.2.a.

pending against it. Only in such situations claimants have legitimate expectations based on reliance of the law existing at the time when their claim arose.[1590]

Investment tribunals often refer to legitimate expectations as arising from the law in force at a given point of time.[1591] Absent special shielding arrangements, these are 'expectations-weak sense'[1592] – a mere delineation of the factual and legal scope of the investment. They resemble the static concept of legal certainty rather than dynamic expectations. Such references are superfluous[1593] and may be misleading by suggesting existence of a factual situation worthy of some special protection.[1594] They create a ground for manufacturing 'vested rights' deserving such protection[1595], while in fact no special legal consequences are attached to them.[1596] If ITL aims at developing clear and persuasive concept of legitimate expectations, the use of the term in these circumstances may be incorrect. In case of frustration of such 'expectations' the standard applicable should be that of arbitrariness and discrimination.[1597]

4. Legitimate Expectations and *Ultra Vires*

Protection of expectations arising from informal representations made *ultra vires* or from formal administrative acts that are subsequently invalidated represents another type of legitimate expectations spanning a number of jurisdictions.[1598] These expectations are not connected with the content of a specific act, but rather with its legality. They concern formal administrative decisions and informal representations. With regard to revocation of final administrative decisions EU law refers to *legitimate expectations of legality and stability* of a situation created when such decision is made.[1599] This reveals that legitimate expectations do not arise from any particular source but are inherent in this type of situation.

[1590] Chapter 4, Section C.2.b.

[1591] Chapter 7, Section C.2.

[1592] Montt (n 44) 222.

[1593] Snodgrass (n 2) 56.

[1594] Chapter 7, Section C.2.

[1595] Chapter 6, Section D.

[1596] Montt (n 44) 222, 362; Schill (n 1221) 28.

[1597] Chapter 7, Section E.1.

[1598] Chapter 3, Section C.3; Chapter 4, Section B.2.b; Chapter 4, Section B.2.c.

[1599] Chapter 4, Section B.2.b.

Invalidity of a formal administrative decision or an informal representation can occur when the State authorities exceed their powers. The policy reason for not upholding expectations in such a situation is to prevent the authorities from extending their statutory powers through their own actions.[1600] This approach is the expression of the rule of law.[1601] It corresponds with the requirement that representations must be made by an authorised person properly applying applicable law.[1602]

Informal representations that are *ultra vires* cannot give rise to legitimate expectations.[1603] Formal administrative decisions that are *ultra vires* may engender legitimate expectations. This is illustrated by the rules applying to revocation of final administrative decisions in EU law[1604] and the ECtHR jurisprudence concerning situations tainted with nullity, voidness or illegality.[1605] Foreseeability and reliance are the key components of the test here.

Formal acts that are subsequently invalidated can give rise to legitimate expectations if its addressee did not contribute to their illegality and could not have foreseen it at the time when these acts took place.[1606] The assessment is made on a case-by-case basis considering a number of factors.[1607] The EU Courts observe that individuals are generally not best placed to foresee the invalidity. However, the 'prudent trader' standard does not exempt the courts from scrutinising whether the individual was aware of the illegality.[1608]

The conduct of State authorities after issuing and before the invalidation of the formal act may be relevant for the finding that the act gave rise to legitimate expectations worthy of protection. Detrimental reliance is an important element here[1609] and the analysis is similar to estoppel. It may therefore be relevant that between the formal act's issuance and its invalidation the individual exercised his

[1600] Chapter 4, Section B.2.b; Chapter 3, Section C.3.

[1601] Chapter 4, Section B.2.b; Chapter 3, Section C.3. English law refers here to 'illegal legitimate expectations' preferring to view protection through the prism of fairness rather than legal certainty.

[1602] Chapter 4, Section B.2.c; Chapter 3, Section C.3.

[1603] Chapter 3, Section C.3; Chapter 4, Section B.2.c.

[1604] Chapter 4, Section B.2.b.

[1605] Chapter 4, Section C.2.a.

[1606] Chapter 4, Section B.2.b; Chapter 4, Section C.2.a.

[1607] Chapter 4, Section B.2.b.

[1608] Chapter 4, Section B.2.b.

[1609] Chapter 4, Section B.2.c; Chapter 4, C.2.a.

rights and obligations arising from that formal act, and that the State authorities benefited from that exercise e.g. by way of rents or taxes. In other words, it is relevant that the individual relied on the formal act to his detriment and/or to the benefit of the State. Moreover, it is relevant if both of the parties were entitled to assume that the formal act is legally binding.[1610] This approach is well established in international law.[1611]

The question of *ultra vires* is problematic in ITL. It spans expropriation and FET claims, although it originates in the former.[1612] Tribunals are not clear about the extent to which the requirement of investor's due diligence should contribute to the assessment of whether he could have foreseen the future invalidation of the formal act.[1613] The concept of legitimate expectations places strong emphasis on the expectations existing at the time of investment and requires diligent analysis of that law.[1614] However, tribunals facing the question of retrospective invalidations rarely analyse these elements. They rely on Article 32 of the Articles on State Responsibility[1615] and Article 27 of the VCLT[1616] that prohibit the State from relying on its own law to excuse violation of its international law obligations.[1617] They also refer to *SPP v Egypt*, where the tribunal stated that actions 'cloaked with the mantle of Governmental authority' give rise to legitimate expectations. These expectations are protected under international law and relevant when the underlying actions are later retrospectively invalidated.[1618] These references do not explain why the national law context and the investor's presumed awareness of it should be completely ignored in such cases. National law forms part of the State's international obligation

[1610] Chapter 4, Section C.3.

[1611] *Shufeldt claim*, pp. 1079-1102. Chapter 6, Section D.

[1612] Chapter 6, Section D.

[1613] Chapter 7, Section C.4.

[1614] Chapter 7, Section D.

[1615] 'The responsible State may not rely on the provision of its internal law as a justification for failure to comply with its obligations under this part.' (*Responsibility of States for Internationally Wrongful Act, Draft Articles adopted by the International Law Commission in 2001*, 2001 U.N.Y.B.I.L.C. Vol. II.2).

[1616] 'A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.'

[1617] Compare e.g. *Kardassopoulos*/Jurisdiction, paras. 195-194; *RDC*, paras 116-123, 222-236 and *Arif*, paras. 539-549.

[1618] *SPP*, paras. 82-85. The tribunal did not clarify whether the protected expectations concern legality of the State acts or success of the investment.

under IIAs and therefore its role goes beyond being a source of excuses of international liability.

The comparative exercise shows that the responsibility for the invalidity of a formal administrative act does not rest entirely on the shoulders of the State authorities. Considering this approach investment tribunals should therefore ask whether the investor should have foreseen the invalidity of the formal act at the time when it was issued and whether such invalidation, if pronounced by a competent State organ, was not arbitrary, abusive or in denial of justice. Such an approach is in line with the view that the FET standard reflects the standard of good governance[1619] or the rule of law.[1620] An approach *de facto* exempting investors from any responsibility for the host State's acts that are *ultra vires*, regardless of the circumstances that gave rise to such illegality, could legitimise negligent, abusive or corrupt conduct by foreign investors.[1621] This would contradict the equitable nature of legitimate expectations.

The comparative exercise shows that tribunals should be wary to attach legal consequences to illegal informal representations. Their assessment of legitimate expectations in *ultra vires* situations must consider investor's due diligence, his contribution to the situation of illegality and his ability to foresee it. If the competent State organs found a State act to be invalid, investment tribunals should investigate whether the actions leading to the invalidation were arbitrary, abusive or in denial of justice.[1622]

D. Common Elements

1. General Observations

The differences discussed in the preceding section do not mean that the concepts of RIBE and legitimate expectations do not share any characteristics. This section identifies three common elements, while sections 2-5 concentrate on those meriting broader analysis, namely: rationale, equitable character, legitimacy and balancing.

[1619] Muchlinski (n 164) 48; *Suez/InterAgua/*Nikken and *Suez/Vivendi/*Nikken, para. 20; Wälde (n 14) 385-386.

[1620] Schill (n 1221); Vandevelde (n 165).

[1621] Jan Paulsson, 'The Power of States to Make Meaningful Promises to Foreigners' (2010) 1 JIDS 341, 351. Montt (n 44) 364.

[1622] The approach of the *RDC* tribunal should be preferred here over the one's applied by the *Arif* tribunal.

First, in all of the legal systems the expectations-related concepts are judge-made. Although in general international law the concept of legitimate expectations was mainly developed by scholars[1623], courts and tribunals also play a role in its development.[1624]

Secondly, all approaches highlight expectations of the expectations-holder. They do not concentrate, sometimes deliberately, on the intention of the State undertaking the conduct that is being relied upon. This poses a risk of an undue concentration on one side of the legal relationship. In practice, as shown below, the courts approach the alleged expectations in an objective way.

Thirdly, the concepts are related to the question of risk allocation. Courts and tribunals applying RIBE and legitimate expectations face a challenge of deciding how the regulatory risk is allocated between the individual and the State in particular circumstances.[1625] Relevant considerations may include how much risk was inherent in a given context[1626], whether the State interfered in the entrepreneur's decision-making process to induce him to take greater risk, or whether the risk was voluntarily undertaken.[1627]

2. Rationale

The rationale for the protection of legitimate expectations results largely from scholarly elaboration.

In explaining the rationale of extending legal protection to legitimate expectations, the European approach focuses on the protection of trust or confidence of members of a given society or community in the consistency, certainty or predictability of State conduct.[1628]

There are at least three dimensions to this rationale. First, that interactions giving rise to expectations worthy of protection occur in a context of a given society or

[1623] Chapter 5, Sections A-B.1.

[1624] Chapter 5, Section B.2; Chapter 5, Section C.1.

[1625] Chapter 3, Section B.2.

[1626] Chapter 3, Section B.4.a; Chapter 4, Section B.2.a; Chapter 4, Section C.3; Chapter 7, Section D.1.

[1627] Chapter 3, Section B.4.b; Chapter 4, B.2.a; Chapter 4, Section B.5.2.c; Chapter 6, Section D; Chapter 7, Section D.2.

[1628] Chapter 3, Section C.1; Chapter 4, Section B.1.

community bound by the law giving protection to expectations, be it international, supranational or national law.[1629]

Secondly, the protection of expectations aims at facilitating cooperation between the members of that community, be it a community of equals[1630] or a relationship between citizens and public administration.[1631] That protection preserves conditions of good administration or good governance, enabling operation of the law in a cooperative, non-abusive and non-coercive manner.[1632]

Thirdly, the European approach ties protection of expectations with legal certainty by highlighting consistency and predictability of State conduct. However, while legal certainty is a static concept, addressing the clarity of law at a given point of time, it does not address the question of State conduct over time, which is inherent to the concept of expectations. As a result, although the concept of legitimate expectations acknowledges the need for legal certainty, predictability and stability of law, it requires them to be balanced with the inevitable changes over time, related to the operation of the State.[1633]

The concepts related to deprivation of property are less useful here because they subsume the concept of legitimate expectations within the broader rationale of property protection. However, they also take into account the social context of property rights, ability of the citizens to rely with confidence on specific State conduct, and the need for balancing of expectations with the State's right to regulate.[1634]

ITL recognises the protection of trust and confidence as a broad rationale for protection.[1635] However, tribunals prefer to tie legitimate expectations to good faith, an aspect discussed in the next section. The comparative exercise shows the potential for exploration of the social dimension of investment protection. It poses the question of what 'community' or 'society' should be taken into account as the scope

[1629] See e.g. Chapter 5, Section A.

[1630] Chapter 5.

[1631] Chapter 4, Section B.1; Chapter 3, Section C.1.

[1632] Chapter 3, Section C.1; Chapter 4, B.1, Chapter 4, Section B.2.a; Chapter 5, Section C.1.

[1633] Chapter 3, Section C.1, p. 25; Chapter 4, Section B.1; Chapter 5, Section A; Chapter 5, Section B.

[1634] Chapter 3, Section B.3.b; Chapter 3, Sections B.4.a-b; Chapter 3, Sections C.1-C.2.b.

[1635] Chapter 7, Section B.

of this protection: the 'community' of a host State and all foreign investors it admitted and regulates; the society governed by the State, which includes foreign investors, or the international community of States and foreign investors? The answer to this background question will influence the persuasiveness of the specific protection granted by tribunals on a case-by-case basis.

The rationale for protecting expectations does not go as far as to provide a test of application of the concept of legitimate expectations.[1636] The way in which it should be applied can be glimpsed from the concepts' essentially equitable character, to which we now turn.

3. Equitable Character

The concept of legitimate expectations is equitable in character. Equity refers to fairness[1637] in judicial decision-making and concerns application of principles that allow for achieving justice where existing rules and principles are inadequate.[1638] Equity in international law may be understood as the application of general principles of justice[1639] or principles representing the values of the system.[1640]

A number of features reflect the equitable character of legitimate expectations. First, the concept answers to the calls for fairness and justice. In England and Australia it developed as a concept of fairness in public administration.[1641] The substantive protection in English law targets situations where frustration of expectations 'is so unfair as to be a misuse of the authority's power'.[1642] EU law associates it with the principles of fairness and justice[1643] and its Courts use legitimate expectations when 'going one way in a particular case would be inequitable, or economically unsound'. [1644] RIBE apply when the change of the law affecting proprietary expectations is unfair[1645], and its role is to serve fairness and justice in the relations

[1636] Chapter 3, Section C.1; Chapter 5, Section A.

[1637] *The Law Dictionary* (Anderson Publishing 2002).

[1638] *Ballentine's Law Dictionary* (Lexis Nexis 2010) (online edn).

[1639] As distinct from application of law (Vaughan Lowe, 'The Role of Equity in International Law' (1988-1989) 12 Aust YBIL 54, 54)

[1640] Shaw (n 1089)106.

[1641] Chapter 3, Section C.1.

[1642] *Couglan*, p. 251; Chapter 3, Section C.4.b.

[1643] Chapter 4, Section B.1.

[1644] Sharpston (n 728) 160 and (n 853) 103.

[1645] Chapter 3, Section B.3.c.

between the State and property owners.[1646] In ITL the concept of legitimate expectations operates within the broader concept of the FET standard, perceived as a general standard of justice.[1647] Its application is subsumed under the general requirement of fairness in international law.[1648]

Secondly, the concept is applied to situations not recognised by law as clearly established rights[1649], formal administrative acts[1650] or obligations[1651], to which there is a remedy under law. It applies where the existing law or doctrine is too rigid, uncertain or unclear.[1652] In the Anglo-Saxon legal systems the concepts developed in response to overly rigid doctrinal divisions that left some situations worthy of protection without remedies in law.[1653]

Thirdly, application of the concepts does not follow any prescribed tests and depends on the circumstances of a particular case. As a result, it is often referred to as an approach based on common sense, pragmatism and logic.[1654] It gives courts and tribunals broad discretion.

Fourthly, use of the concept of legitimate expectations requires that the individual acts fairly and in good faith vis-à-vis the authorities. He must fully disclose any information relevant for an informed and valid representation[1655] and cannot act in a misleading, fraudulent or deceptive way.[1656] Legitimate expectations cannot arise if the individual contributed to illegality of the formal act.[1657] In ITL the requirement of investor's good faith is included in the 'caveat investor' rule.[1658] The requirement of good faith and conscionable conduct applies also to the State.[1659] It is relevant that it tries in a reasonable time and in good faith to remedy the situation caused by

[1646] Chapter 3, Section B.4.c and Section B.5.b.

[1647] Chapter 7, Section B.

[1648] Chapter 7. Section F.

[1649] Chapter 3, Section C.1; Chapter 4, Section B.1; Chapter 4, Section C.2.a.

[1650] Chapter 4, Section B.2.c.

[1651] Chapter 5, Section B.2.

[1652] Chapter 4, Section C.1.

[1653] Chapter 3, Section C.1; Chapter 3, B.1.b.

[1654] Chapter 3, Section B.5.b; Chapter 3, B.5.c; Chapter 4, B.5.

[1655] Chapter 3, Section C.3.

[1656] Chapter 4, Section B.2.b; Chapter 4, Section B.3.

[1657] Chapter 4, Section B.2.b; Section C.4 of this Chapter.

[1658] Chapter 8, Section D.a; Chapter 8, Section D.4.

[1659] Chapter 4, Section C.2.b.

frustration of expectations e.g. by offering alternative arrangements or correcting illegality.[1660] ITL follows a similar path.[1661]

Application of this equitable concept brings problems with its predictability and vagueness.[1662] The Anglo-Saxon commentators complain that it is too uncertain and may encourage arbitrariness, judicial activism or ideological bias.[1663] Because there is no authoritative indication of the point of balance, the concept can easily veer into circularities, favouring either the expectations-holder or the State.[1664] For these reasons some see it as superfluous[1665] and meriting abandonment.[1666]

However, because the concepts are inherently flexible and prone to controversy courts apply them with caution. They strive to weigh and balance all relevant circumstances and interests and assess expectations in an objective way. Thus, although many claims are based on the concept of legitimate expectations, not many succeed.[1667]

Commentators also monitor the borders of the concept. They criticise the uses that add nothing to the established rules and that compromise the concepts' own clarity and integrity.[1668] A second instance of judicial scrutiny also adds to such monitoring.[1669] It can correct developments that corrupt the concepts' equitable nature, veer into judicial activism and overly favour one of the sides of the expectations-related relationship. Absence of such a mechanism in ITA[1670] places a great burden on investment tribunals to self-monitor their use of legitimate

[1660] Chapter 4, Section B.2.b.

[1661] Chapter 7, Sections E.1 and E.2-3.

[1662] e.g. Chapter 4, Section B.4; Chapter 5, Section A.

[1663] Chapter 3, Section B.1.b; Chapter 3, Section B.5.b and Section B.5.c; Chapter 3, Sections C.1 and C.4.b; Chapter 5, Section B.2.

[1664] Chapter 3, Sections B.3.c and B.4.c.

[1665] Chapter 5, Section A.

[1666] Chapter 3, Section B.5.c.

[1667] Chapter. 3, Section B.5.c; Chapter 3, Section C.1, Chapter 3, Section C.4; Chapter 4, Section B.4.

[1668] Chapter 3, Section C.2.b; Chapter 4, Section C.2.b.

[1669] Chapter 3, Section B.4.c; Chapter 5, Section B.2.

[1670] Use of the concept of legitimate expectations will not be a reason for annulment. The *ad hoc* Committee can offer critique 'for posterity' (Christoph Schreuer et al, *The ICSID Convention. A Commentary* (Cambridge University Press 2009) 1040) and thus has moral rather than factual power in the control of the concept's use. See e.g. *MTD Annulment* (paras. 67-71).

expectations. Failure to do so may cause tensions among system participants and may take longer to correct.

The equitable character of the concept of legitimate expectations indicates that tribunals should use it cautiously, in particular in situations where there is a clearer alternative. Marking clear boundaries of the concept would contribute to its persuasive development. This is particularly desirable because ITL is developing in many directions which often overlap, creating inconsistencies, uncertainty, unpredictability and a risk for abuse.

4. Legitimacy of Expectations

Legitimacy of expectations concerns the question whether expectations are legitimate and/or reasonable and therefore possibly worthy of protection. There is no general test for the assessment of legitimacy or reasonableness but certain factors are commonly taken into account.

Legitimacy of expectations depends the context and all relevant circumstances surrounding the State conduct allegedly giving rise to expectations, as well as the State conduct that allegedly frustrates them.[1671] In the business context, these circumstances concern regulatory, political, economic and social conditions of doing business and of dealing with the authorities.[1672] As a rule, legitimate expectation can only arise from conduct of an authorised person acting in accordance with relevant law.[1673]

A court assesses legitimacy of expectations through an objective interpretation of the State's conduct that allegedly gave rise to those expectations. It analyses it in light of all relevant circumstances.[1674] The courts stress that legitimate expectations must be well-founded[1675] and must be something more than a 'unilateral hope' or an 'abstract need or belief'.[1676]

To assess the ways in which an individual could have reasonably understood the conduct allegedly giving rise to his expectations, the courts consider the level of

[1671] Chapter 3, Section C.3.

[1672] Chapter 4, Section B.1; Chapter 4, Section B.2.a; Chapter 5, Section B.2.c.

[1673] Chapter 3, Section C.3; Chapter 4, Section B.2.c; But see Section C.4 of this Chapter.

[1674] Chapter 3, Section C.3; Chapter 4, Section B.2.c.

[1675] Chapter 4, Section B.2.c.

[1676] Chapter 3, Section B.3.a.

knowledge, prudence or sophistication expected of a person of a given kind. With regard to professional entities, such as traders or business people, the courts usually set a relatively high standard of awareness of their area of operation.[1677] The EU law 'prudent trader' standard sets a particularly high bar for traders.[1678]

Seen through this prism, the courts assess whether the expectations-holder was able to realise that the conduct allegedly giving rise to expectations was not so intended or illegal; whether he could foresee the subsequent conduct frustrating his expectations[1679]; or whether he could obtain relevant assurances or clarifications from the authorities[1680] or legal advice. It is relevant that the individual acted fairly and in good faith vis-à-vis the authorities[1681], and that he relied on the conduct engendering his legitimate expectations.[1682]

Investment tribunals generally follow this course in assessing legitimacy of investors' expectations.[1683] There is no mechanical test allowing for taking these factors into account in a consistent manner. Investment treaties mix and match factors from various legal systems, as attested by the US-law inspired argument concerning regulatory environment introduced in *Methanex*.[1684] The main problem appears to be the formulation of a standard of knowledge (standard of reasonableness) required from foreign investors. The existence of such a standard, akin to, but not necessarily as high as EU law 'prudent trader' standard, would allow for a more predictable assessment of how IIAs allocate risk between foreign investors and host States. The extreme side of this problem is shown by some of the Argentinean 'commitments' awards, where the question of investors' due diligence in entering and negotiating the investment projects was essentially dismissed.[1685] On the other hand, investment tribunals to not deal with a single investment area and the conditions of investing differ from case-to-case. The tribunals seem to be left with a case-by-case construction of the standard of prudence or reasonableness required from a foreign investor, based on the conditions in which that investor invested and his specific

[1677] Chapter 3. Section C.3; Chapter 4, Section B.2.c; Chapter 4, Section B.3.

[1678] Chapter 4, Section B.3.

[1679] Chapter 3, Section C.3; Chapter 4, Section B.2.b.

[1680] Chapter 3, Section C.3.

[1681] Chapter 3, Section C.3; Chapter 4, Section B.3.

[1682] Chapter 3, Section C.3; Chapter 4, Section B.2.b.

[1683] Chapter 6, Section D; Chapter 7, Section D.a.

[1684] Chapter 3, Section B.4.b; Chapter 7, Section D.1.

[1685] Chapter 7, Section D.3.

relations with the host State giving rise to the alleged expectations and their alleged frustration. That assessment must be clearly and persuasively presented in the award.

Assessment of legitimacy or reasonableness of expectations is linked with the balancing of the individual's interest with the public interest that is at stake in the circumstances. To this issue we turn now.

5. Balancing

Balancing is an important element of the operation of the concept of legitimate expectations. Legitimate expectations limit flexibility of the exercise of sovereign powers but do not eliminate it. The two interests cannot be fully satisfied at the same time and their relation is a matter of degree influenced by the circumstances of a particular case.

Public interest underlying the State conduct frustrating legitimate expectations can override or outweigh the private interest behind legitimate expectations. A concern with such overriding public interest is an inherent element of the concept of legitimate expectations as well as RIBE. Existence of this factor is a permanent feature of analysis in the expropriatory and non-expropriatory contexts and it applies to all types of expectations in public law.[1686]

In balancing the two interests, courts at a national, supranational and international level leave a broad margin of discretion to the authorities.[1687] They admit to not being best suited to second-guess the substantive administrative decision-making based on broader policy considerations. The authorities need to retain flexibility in exercising their discretion.[1688] Concerns with discretion may follow from constitutional constrains of a separation of powers[1689], from the character and the organisation of the regional market[1690] or from the general policy of the court.[1691] The less 'dense' and more general the regulation, the less willing the courts are to interfere with State's discretion. This may be the result of greater willingness to avoid judicial

[1686] Chapter 3, Section C.5; Chapter 4, B.2.a; Chapter 4, Section B.2.b; Chapter 4, Section B.4; Chapter 4, Section C.3.

[1687] Chapter 4, Section B.4; Chapter 4, Section C.3.

[1688] Chapter 3, Section C.4.b; Chapter 3, Section C.5; Chapter 5, Section B.4; Chapter 4, Section C.3.

[1689] Chapter 3, Section C.4.b, Chapter 3, Section C.5.

[1690] Chapter 4, Section B.4.

[1691] Chapter 4, Section C.3.

activism at an international level, resulting in a more reserved approach.[1692] Courts essentially limit their role to monitoring whether the authorities acted legally, did not act abusively or arbitrarily or did not manifestly exceed their discretion.[1693]

As aptly observed by Australian commentators, there is probably no objective balancing test to reconcile the protection of legitimate expectations and the protection of the public interest underlying State conduct frustrating those expectations.[1694] Courts and tribunals are therefore exposed to the suspicion of arbitrariness, unpredictability or judicial activism.[1695] Except for the ECHR regime, none of the courts use a single balancing test and often uses no identifiable consistent mechanism, preferring instead an *ad hoc* balancing of relevant factors and values.[1696] The absence of such a single standard leaves the courts with broad discretion as to how to balance these interests in a particular case. Scholarly proposals of various standards of review, in particular proportionality, have not been followed in practice.[1697] The *ad hoc* case-by-case approach reflects the flexible and amorphous nature of legitimate expectations and an equitable and pragmatic approach of the courts. The courts' cautious approach allays fears that concentration on expectations tilts the balance towards the interests of an individual.[1698] Although the ECtHR employs the proportionality test, it does it in a lenient way, without requiring the least restrictive method to balance individual and public interests.[1699]

The mechanism of the concept of legitimate expectations sets a low jurisdictional threshold. This gives the courts broad jurisdiction over claims based on legitimate expectations. In the course of their review the authorities are required to explain and justify the conduct that frustrated legitimate expectations. However, the justification provided is usually sufficient to show that the authorities acted within the margin of their discretion.[1700]

[1692] Chapter 4, Section C.3; Chapter 5, Section B.2.

[1693] Chapter 4, Section B.4; Chapter 3, Section C.4.b (*Coughlan* (n 564)); Chapter 4, Section C.2.b (*Kopecký* (n 885)); Chapter 4, Section C.3.

[1694] Chapter 3, Section C.4.b.

[1695] Chapter 3, Section B.5.c; Chapter 3, Section C.4.b; Chapter 4, Section B.4.

[1696] Chapter 3, Section B.1.a; Chapter 3, Section B.5.b; Chapter 3, Section C.5; Chapter 4, Section B.4.

[1697] Chapter 3, Section B.5.b; Chapter 3, Section C.5; Chapter 4, Section B.4.

[1698] See Section C.3 of this Chapter.

[1699] Chapter 4, Section C.3; *Pine Valley* (n 880).

[1700] Chapter 3, Section C.5; Chapter 4, Section B.4; Chapter 4, Section C.3.

This contrasts with ITL, where the dominant view is that frustration of legitimate expectations arising from 'representations' and 'commitments' constitutes a breach of the FET standard.[1701] This approach makes no reference to the overriding public interest or balancing. It leaves little or no space for the assessment of the host State's conduct affecting legitimate expectations and thus no margin for deference and no need for a standard of review. Such an approach is out of line with the other legal systems analysed here.

However, some recognition that investigation of the public interest behind the measures frustrating legitimate expectations needs to be included appears to be slowly emerging in ITL.[1702] The standards proposed by scholars are those of proportionality, margin of appreciation, fairness and reasonableness.[1703] Snodgrass argues that they should involve an enquiry whether the State could have adopted measures less impinging on investor's legitimate expectations, at the same time also accommodating the public interest.[1704] Such investigation may be more intrusive than the approaches taken in the other legal systems. As illustrated by *Coughlan,* tribunals should avoid the illusion of easy alternatives.[1705] Taking the course suggested by Snodgrass requires tribunals to establish alternatives available to and feasible for the host State from the financial, policy and other relevant points of view and to analyse the substantive and policy issues underlying their application.

Other legal systems suggest alternative factors for this balancing process, for example: whether the measure frustrating legitimate expectations was a misuse of power, was arbitrary or in excess of discretion[1706]; whether the authorities took good faith measures to mitigate the effects of the frustration of expectations by way of 'practical means eliminating unfairness'[1707]; whether there was an 'average reciprocity of advantage' in constraining public and private interests.[1708] Moreover, tribunals could tap into the intensifying discussion on the appropriate level of scrutiny

[1701] Chapter 7, Sections E.2-3.

[1702] Chapter 7, Section F.

[1703] Snodgrass (n 2) 48, 57; Montt (n 44) 366; *Total,* para. 120. See Chapter 7, Section F.

[1704] Snodgrass (n 2) 48.

[1705] Chapter 3, Section C.4.b and Section C.5.

[1706] Chapter 4, Section B.4. Tribunals must avoid here the circularity of equating frustration of expectations with arbitrariness. (Montt (n 44) 222-223).

[1707] Chapter 3, Section C.5.

[1708] Chapter 4, Section B.5.b.

to be applied in ITA.[1709] The experience of other legal systems shows that this balancing process is rather opaque, based on a low threshold of scrutiny and a low level of interference with the decisions by the authorities. ITL commentators propose that tribunals should employ the balancing process in a way not *overly* deferential to national authorities.[1710] There is no explanation for such modelling of the balancing approach. Tribunals would have to be clear why they prefer the interest of investor over that of the host State and *vice versa*. However, in the current situation the key step for the tribunals is to cement the recognition of the need for balancing. The test applied to it will probably be an *ad hoc* one and will develop on a case-by-case basis. This will affect the persuasiveness and predictability of the concept.

The reluctance of investment tribunals to recognise the need for balancing exposes yet another frontier of resistance to the public dimension of ITA, that was prominent at the early stages of its development.[1711] The reasons for such resistance may also reflect a commercial rather than public law approach to ITL/ITA.[1712] Such a commercial approach sees legitimate expectations as 'transactional' or contractual in nature.[1713] This context of assessment is outside the scope of this thesis. However, it shows that an analysis of a contractual context of protection of legitimate expectations would be useful to complete the comparative picture. If undertaken, it should concentrate on economic relations between entrepreneurs and States in public law, i.e. not in purely commercial, context.

E. The Loose Ends: Expropriation, Public International Law and Commitments

This section concerns three 'loose ends' remaining from the comparative assessment of chapters 3-7. These are legitimate expectations associated with expropriation, commitments and public international law.

In the context of expropriation legitimate expectations cover factual situations at a 'property rights' periphery'[1714] that are considered worthy of protection from a regulatory taking[1715] or a deprivation of possession.[1716] Proprietary expectations arise

[1709]. Chapter 7, Section F.

[1710] Snodgrass (n 2) 57.

[1711] Chapter 6, Section C; Chapter 6, Section E.

[1712] Schill (n 1499) 587-588.

[1713] Alvik (n 2) 160; Schreuer (n 1290) 89; Wälde & Kolo (n 13) 844.

[1714] Montt (n 44) 222.

[1715] Chapter 3, Section B.

from existing laws, regulations or formal administrative acts and are protected ether from too great, unfair and unjust constraint[1717] or from unfair and disproportionate extinguishing or invalidation.[1718] The assessment whether such expectations should be protected from impending State measures requires taking into account public interest as well as other relevant factors.[1719]

ITL takes an entirely different approach to such 'lesser' expropriations. It does not allow for partial takings or deprivations of individual components of an investment, which it approaches as a whole.[1720] It recognises that expropriation can be indirect, but not partial. Legitimate expectations feature in the application of the standard of indirect expropriation. However, they do not follow the path of RIBE. Tribunals set the standard of indirect expropriation very high, leaving no space there for the concept of legitimate expectations as understood in the expropriation contexts of US law.

These developments in ITL cannot mean that less acute deprivations of property should shift under the FET standard. At least, this should not be facilitated though the incorrect use of the concept of legitimate expectations. The attempt to follow such a path combines strong legal consequences attached to substantive protection of legitimate expectations under EU law and English law with the legal sources of proprietary expectations, namely laws, regulations and formal decisions.[1721] This approach is incorrect because substantive protection attaches only to specific informal representations and does so on an exceptional basis.[1722]

Tribunals should be wary of endorsing such intellectual hybrids. Such caution follows from the need for the concept of legitimate expectations to be predictable and persuasive. The legitimacy of ITL would increase if treaty interpretation differentiated between the treaty standards, here between expropriation and FET, to make them clearer to the addressees.[1723]

[1716] Chapter 4, Section C.

[1717] Chapter 3, Section B.5.b.

[1718] Chapter 4, Section C.2.a-b.

[1719] Chapter 3, Section B.5; Chapter 4, Section C.3.

[1720] Chapter 5, Section D.

[1721] See Section C.1 of this Chapter.

[1722] Chapter 3, Section C.2.b; Chapter 3, Section C.4; Chapter 4, Section B.2.c; Chapter 4, Section B.2.a.

[1723] Franck (n 193).

By contrast, the practice of investment tribunals to derive legitimate expectations from commitments[1724] has no equivalent in the legal systems analysed in this comparative exercise. From the comparative perspective 'commitments' purport to use the protection mechanism attached to legitimate expectations reserved to representations to a cluster of different and not clearly distinguishable sources. The comments made above on the extension of the concept of representations beyond informal, if official, conduct of State administration are equally applicable to 'commitments'.[1725]

The last 'loose end' in this analysis of the comparative contributions concerns legitimate expectations and public international law.[1726] At first glance the concepts of legitimate expectations in ITL and general international law are different. The former uses the concept to elucidate the meaning of indeterminate treaty standard, while the latter refers to legitimate expectations in its attempts to explain the binding nature of international law rules. They therefore address two different questions: existence, as opposed to content, of binding international law rules.

However, as shown above, public international law also helps to elucidate the elements common to the concept of legitimate expectations and to distinguish specific representations from similar specific conduct of States on an international plane.

Its independent contribution to this comparative exercise concerns treaty interpretation. Application of the concept of legitimate expectations in the WTO shows clearly the perils of endorsing treaty interpretations based on subjective 'legitimate expectations' of one treaty party.[1727] This supports the critics of Weiler & Laird's approach to interpreting IIAs through the prism of investor's 'legitimate expectations' arising from his reliance on the treaty.[1728] It is an example of judicial activism and risks abusing the concept of legitimate expectations. As a result, tribunals should be cautious when endorsing interpretations arising from 'legitimate expectations of fair and equitable treatment'.

[1724] Chapter 7, Section C.3.

[1725] See Section C.2 of this Chapter.

[1726] Chapter 5.

[1727] Chapter 5, Section B.2.

[1728] Chapter 7, Section C.1.

F. Conclusions

How, in the light of the comparative exercise presented in this chapter, can we answer the question posed in the introduction? Is the concept of legitimate expectations a general principle of law, a rule of ITL, an analytical tool or merely a relevant factor?

As mentioned in Chapter 1[1729] some commentators argue that the principle of protection of legitimate expectations is a general principle of law. However, the comparative exercise shows that such a narrow approach does not allow for an understanding of the various other uses of the concept of legitimate expectations and its potential interactions with a proposed general principle. If any general principle of law of legitimate expectations exists, it is not a principle of 'protection'. Rather, it is a principle that

> if an individual or a State relies on the conduct of a State in certain circumstances, expectations arising from such reliance may be protected by law in case a subsequent State conduct frustrates these expectations, if refusing such protection would be unfair or unjust.

Specific factors will attach to the assessment of the factual circumstances underlying such a scenario. These factors do not lend themselves to a formulaic summary and can be derived from the legal systems analysed in the preceding chapters.

Legitimate expectations do not constitute a rule of ITL. References to legitimate expectations are certainly ubiquitous, as is their application by the tribunals. However, from the comparative perspective, the concept of legitimate expectations in ITL is still in formation. Many questions still need to be answered to delineate a predictable and persuasively constructed concept. It is also not certain whether that concept will be a rule in the sense of a rule of law. Investment tribunals clearly endorse arguments to this effect, accepting that frustration of expectations based on broadly understood State conduct, in particular commitments and undertakings, is a breach of the FET standard. However, such an unqualified approach is not in line with the public law concept of legitimate expectations, which requires taking into account public policy concerns in assessing whether expectations were frustrated unfairly. Moreover, such a rule is dangerously close to a contractual clause, which may take the concept outside the intended scope of a specific IIA.

[1729] Section D.

Can the concept of legitimate expectations be characterised as an analytical tool? It certainly has some characteristics of this kind in relation to expectations arising from the laws and regulations existing at the time of investment. These expectations are not 'protected' in the sense ascribed by commentators to the general principle of law. They merely help to establish a status quo. However, tribunals must be careful not to attach any specific legal consequences to it merely because they refer to 'legitimate expectations'. Moreover, using legitimate expectations as an analytical tool cannot lead to ascribing proprietary rights as protected under FET standard in the same sense as they would have been protected from expropriation. The FET standard is a standard of due process and such an approach would create confusion.

Lastly, legitimate expectations are often merely a factor in the process of applying investment treaties. They may indicate situations when the investor's position might merit greater consideration but will not be dispositive of the question whether there had been a breach of an IIA.[1730]

Thus, the short answer to the above question is that in some senses the concept of legitimate expectations is all of the above because it is still a work in progress. The comparative approach can shape its development in the future. How this may occur is the subject of the next, and last, chapter of this thesis.

[1730] See e.g. Patrick Dumberry, 'The Protection of Investors' Legitimate Expectations and the Fair and Equitable Treatment Standard under NAFTA Article 1105' (2014) 31 J.Int'l Arb. 47.

Chapter 9 Conclusions and recommendations

A. Introduction

This chapter summarizes the findings of this thesis by way of conclusions on how to address and apply the concept of legitimate expectations. It identifies the fundamental concerns about which tribunals need to be clear when referring to legitimate expectations. It also identifies themes meriting further research and comments on an express reference to the concept of legitimate expectations in a recent draft IIA.

B. How to Apply the Concept of Legitimate Expectations in Practice

1. Three Types of Legitimate Expectations

One can identify three main types of legitimate expectations:

- type 1: general expectations related to the legal and factual situation of the investor at the time he makes the investment;
- type 2: legitimate expectations arising from specific representations of the host State;
- type 3: legitimate expectations related to the invalidation of State acts.

Investment tribunals need to distinguish between these different types.[1731] Treating them as a single concept diminishes the persuasiveness and coherence of ITL. Accordingly, tribunals should first identify which of the three types is being argued before them and adjust their methodology accordingly.

These types of legitimate expectations should not be confused with two others. First, the concept of legitimate expectations should not be used as a tool of treaty interpretation. The idea of 'legitimate expectations of fair and equitable treatment' misdirects the tribunal into enforcing investors' subjective expectations about the content the FET standard.[1732] Secondly, the concept of legitimate expectations should not be used as an expression of acquired rights. Such argument has no place in the analysis under the FET standard. It concerns proprietary protection while the FET standard focuses on the treatment accorded to investors.[1733] Impact on the

[1731] *Arif*, para. 534.

[1732] Chapter 5, Section B.2; Chapter 7. Section C.1.

[1733] See Section C below.

investment is of secondary importance for the finding of a breach, although it is relevant for the assessment of damages. Such proprietary expectations also have no place under the indirect expropriation standard due to the high threshold for the finding of indirect expropriation.

2. Considerations Applicable to All Three Types of Expectations

Considering any type of legitimate expectations an investment tribunal needs to be mindful of the general considerations applicable to all three types of expectations.[1734] It should apply the concept in accordance with its equitable character and respect its focus on safeguarding the trust in the State authorities and the conditions for non-coercive governance. The tribunal needs to treat the concept according to its risk-allocating function. It must analyse legitimacy of investor's reliance on the alleged sources of expectations. Further, it should balance the investor's interest in fulfilment of those expectations with the public interest justifying the measures that frustrate them. The role, content and scope of each of these elements will depend on the type of expectations and the circumstances of a particular case. However, the tribunal should remember of its responsibility to self-monitor and prevent an abusive application of the concept.[1735]

3. Type 1: General Expectations Related to Legal and Factual Circumstances

Legitimate expectations type 1 embody *Tecmed's* 'basic expectations'. They should be used to analyse the relevant facts of the case to establish the situation of the investor at the time when he made the investment.[1736] They do not require the tribunal to attach any specific legal consequences to the situation of the foreign investor.

Type 1 expectations are not 'frustrated'. Unfavourable administrative or legislative changes should not be associated with such 'frustration'. These changes can breach the FET standard, but such breach will not constitute a frustration of this type of expectations. In such case the tribunal will be asked to assess if the host State applied its laws fairly and equitably. Nothing is gained by re-labelling it as a 'frustration of legitimate expectations'.

[1734] See Chapter 8, Section D.

[1735] Chapter 8, Section D.3.

[1736] Chapter 7, Section C.2; Chapter 8, Section C.3.

An exception from this rule is a specific arrangement between the investor and the host State, shielding the former from subsequent administrative or legislative changes. This will usually be a stabilisation clause, i.e. arrangements whereby the host State undertakes to stabilise certain aspects of its investment relationship with the foreign investor. It is unclear to what extent stabilisation clauses shield investors from future changes in ITL. The comparative approach shows that they are interpreted restrictively and may be outweighed by an overriding public interest.[1737] It is also unclear whether such arrangements should be classified as expectations type 1 or type 2. Further research may help to clarify these questions.

Another exception is provided by retroactive legislative changes that need to protect legitimate expectations by way of transitional measures. EU law provides useful safeguards in relation to both exceptions.

When applying this type of legitimate expectations the tribunal should reject express or implicit arguments that frustration of expectations is *per se* an arbitrary conduct of the host State and thus a breach of the FET standard. Such arguments are circular and expand the FET standard to any State conduct inconsistent with investor's subjective perceptions about the host State's legal, administrative or judicial system.

4. Type 2: Legitimate Expectations Arising from Representations

Legitimate expectations type 2 are engendered by specific representations of the host State vis-à-vis a foreign investor. Frustration of those expectations can merit legal protection if the expectations are legitimate and there is no overriding public interest behind the State measures that frustrate them.[1738] They analysis here can benefit greatly from analogies with EU law and English law.[1739] These analogies may help in the identification of State conduct that could give rise to legitimate expectations; in elucidation of the circumstances in which State conduct frustrates these expectations; and identification of situations when such frustration is not justified by any overriding public interest and thus gives rise to an obligation to remedy the situation.

An aspect immediately apparent from the comparative analysis is the subsumption by investment tribunals of contractual and other formal State conduct within the meaning and the legal consequences of specific representations. In public law, this

[1737] Chapter 4, Section B.2.a; Chapter 4, Section B.4.

[1738] Chapter 7, Section C.d; Chapter 8, Section C.2.

[1739] Chapter 3, Section C.2.b, C.3; Chapter 4, Sections B.2.c and B.3.

category of State conduct is outside the scope of this type of expectations.[1740] An investment tribunal extending this type of legitimate expectations beyond the scope firmly established in national laws is likely to meet with criticism. As a result, it needs to explain this extension. Moreover, such extension should be subject to same methodology as the other types of conduct constituting representations. This means, first, an objective assessment of the contractual context. Legitimate expectations cannot be used as a substitute for the actual contractual arrangements.[1741] Secondly, the general requirement of balancing will also be applied to the extended representations.[1742]

As mentioned above, stabilisation clauses will pose an additional challenge for the tribunal. Such clauses can be treated as specific representations giving rise to legitimate expectations type 2[1743] or as special shielding arrangements under expectations type 1.[1744] A stabilisation clause treated as engendering type 2 expectations will trigger the question of overlap between the FET standard and the umbrella clause, discussed in Section E.2.

Moving to the assessment of the State conduct that frustrates type 2 legitimate expectations, the tribunal needs to consider the public interest behind such conduct.[1745] Existence of an overriding public interest will influence the tribunal's decision whether investor's legitimate expectations are worthy of protection. The tribunal will engage in weighing the private interests of the investor related to his investment project with the public interest underlying the measures that negatively impacted on investor's expectations.

This element of type 2 legitimate expectations may be disappointing to those who regard IIAs as excluding any detrimental impact by the State's sovereign powers on an investment project agreed between that State and the foreign investor.[1746] Further research into approach of national laws to contracts between States and individuals could be of assistance here. However, a more realistic course is to find an acceptable formula for the balancing of both interests.

[1740] Chapter 8, Section C.2.

[1741] Crawford (n 1553) 374.

[1742] Chapter 8, Section D.5.

[1743] Chapter 7, Section C.d; Chapter 8, C.2.

[1744] Chapter 7, Section C.b; Chapter 8, D.3.

[1745] Chapter 8, Section D.5.

[1746] See Section C below.

The comparative perspective is of little assistance with regard to a specific test that could be applied to the balancing between the interests of investors and host States. There is no set balancing test, and the balancing is generally left to a case-by-case determination.[1747] Investment tribunals should be aided in such case-by-case *ad hoc* assessment by the general characteristics of the concept of legitimate expectations. They will be guided by the need to protect confidence and trust of foreign investors vis-à-vis host States in order to facilitate cooperation between them and to secure non-coercive economic governance.[1748] They should also bear in mind that the concept is equitable, i.e. demanding good faith and fair dealings from both parties, and is employed on an exceptional basis. Tribunals need to be guided here by common sense, pragmatism and logic and be mindful not to abuse the broad discretion that the concept affords them.

5. Type 3: Legitimate Expectations and *Ultra Vires*

Legitimate expectations type 3 concern the retrospective invalidation of formal administrative acts. The tribunal is faced with a question whether a retrospective invalidation of a legal instrument underlying a foreign investment that had a negative impact on that investment is a breach of an IIA and should be compensated. The expectations here are expectations that the final administrative act will not be invalidated rather than expectations of a successful investment project.

This type of expectations may be particularly relevant in the context of indirect expropriation, if the invalidation neutralises the foreign investment. It also raises certain fundamental questions discussed in Sections C.2-3.

An assessment of this type of claims involves two major sets of questions. First, the tribunal needs to consider the interactions between the State and the investor from the time when the relevant legal instrument was issued to when it was invalidated. The relevant factors include: the duration of the 'illegal' situation, the State's awareness of, lack of reaction to and/or benefit from that situation. Secondly, the tribunal needs to consider whether the investor should have been aware of the illegality, whether he relied on the measure in good faith, and whether he contributed

[1747] Chapter 7, Section F; Chapter 8, Section D.5.

[1748] The crucial question here concerns the scope of social interactions in which this co-operation will be assessed. (Chapter 8, Section D.2).

to the illegality.[1749] The experience of ECtHR, English and EU law may be of assistance here, as well as the CIL *Shufeldt* case.

C. Fundamental Questions Underlying Application of Legitimate Expectations

To be persuasive, the application of the concept of legitimate expectations has to be 'objectively justifiable and explainable'. [1750] The decision whether legitimate expectations are worthy of protection depends on the tribunal's perceptions of how the investment treaty system operates. Therefore, when giving reasons to its decision, the tribunal needs to be clear about the following four fundamental issues underlying application of the concept of legitimate expectations.[1751]

1. The Character of Protection Offered by IIAs

First, the tribunal needs to be clear about the character of protection offered by the IIAs, in particular whether they favour the protection of investments over the host State's right to regulate.

Public law shows that the private interests rarely prevail over the public interest. The State's frustration of legitimate expectations triggers the need for remedies only exceptionally.[1752]

The tribunal does not need follow this course. Its approach should reflect the nature of protection offered by the IIA in question, and ITL as a whole. Some commentators called for tipping the scales here in favour of investors.[1753] To prevent suspicion of abusing their mandate, investment tribunals should adopt solutions that do not unduly favour the investor or the host State.

Whichever way it proceeds, the tribunal will have to explain the way in which it balanced the interests of the investor with the interests of the host State.

[1749] Chapter 8, Section C.4.

[1750] Orakhelashvili (n 24) 196.

[1751] Chapter 2, Section B.

[1752] Chapter 8, Section D.4.

[1753] Snodgrass (n 2) 57; Mairal (n 5) 451.

2. The Character of the FET Standard

Secondly, the tribunal needs to be clear about the character of the FET standard. Is it a standard of treatment, commensurate with the standard of due process and fair procedure, or is it also a standard of proprietary protection?

Although most commentators appear to associate the FET standard with the former, there is no clear and unambiguous answer here. Two more approaches are possible.

The tribunal may view the FET standard as a gap-filling device applicable to situations requiring protection that the other standards do not address.[1754] This gives the tribunal an almost unlimited power to expand the scope of an IIA. It also thwarts the development of other treaty standards, facilitating the decision-maker's 'escape' into a more general and unstructured FET standard. Adopting this approach, the tribunal will have to consider potential overlaps of the concept of legitimate expectations with an umbrella clause and/or the indirect expropriation standard.

Moreover, the tribunal may view the FET standard as a standard of property protection, protecting rights acquired as a result of making the investment. Any diminution of these rights would constitute unfair and inequitable treatment. This approach also raises the question of an overlap with the standard of indirect expropriation.

As mentioned at the outset of this chapter, in our view there is no place for this type of expectations in ITL at its current level of development. The tribunal's use the concept of legitimate expectations in a proprietary sense would require elaboration of the concept of indirect expropriation, e.g. through the *Penn Central* test. Recognising that legitimate expectations could be expropriated would also require acceptance of partial expropriation, a step the tribunals have been unwilling to take so far.[1755]

Equating the FET standard with the standard of due process does not mean that, unlike in England and Australia, it should only allow for procedural remedies.[1756] Investment tribunals have a limited ability to order such remedies[1757] and the main available ones are damages. However, given the equitable character of the concept

[1754] FA Mann, 'British Treaties for the Promotion and Protection of Investments' (1981) 52 BYIL 241, 243; Dolzer, 'FET: A Key Standard (n 5) 90; *Sempra*, para. 297.

[1755] Chapter 6, Section B..

[1756] Chapter 3, Section C.4.a.

[1757] OECD, *Investor-State Disputes Settlement. A Scoping Paper for the Investment Policy Community* (prepared by Gaukrodger D, Gordon K), OECD Working Papers on International Investment 2012/2013, pp. 24-29.

of legitimate expectations, tribunals may order a non-pecuniary remedy as an option.[1758]

3. A Standard of Prudent or Reasonable Investor

Thirdly, the tribunal needs to reveal its approach to the relationship between the standard of due diligence required from the investor and the assessment of host State's conduct. This question goes to the heart of the possible future development of the ITL's standard of reasonable or prudent investor.

This is of particular importance for the assessment of legitimacy of investor's expectations and with regard to type 3 expectations (retroactive invalidation of formal State acts).[1759]

In the latter case the tribunal should ask whether the investor could have foreseen the subsequent invalidation of the act. Such enquiry balances two important values. First, it considers the host State's obligation to act fairly and equitably towards the investor by not invalidating final formal acts, especially if the investor relied on them in good faith to its detriment and/or to the benefit of the host State. Secondly, it takes into account that investors are required to conduct due diligence in making the investment and act in good faith when relying on such formal State conduct.[1760] In particular, an investor cannot legitimately expect that an illegal measure is not going to be invalidated if he was aware of its illegality or, in an extreme situation, when he contributed its illegality. Detaching assessment of invalidation from such concerns[1761] could undermine the rule of law in the host State by giving investors a license to put pressure, including undue pressure, on host State's officials to illegally extend their statutory powers. An important factor in this assessment is a question of time: the longer the State knowingly overlooks the illegality and fails to correct it, the more it is estopped from raising violation of its own law as a defence.[1762]

4. Does the Concept of Legitimate Expectations Apply to Contracts?

Fourthly, the tribunal needs to be clear about its approach to the question whether expectations type 3 apply to contractual commitments.

[1758] But see e.g. *Arif*, para. 573.

[1759] Chapter 8, Section C.4.

[1760] *RDC,* para. 116.

[1761] *Arif*, para. 539.

[1762] *RDC,* para. 234; *Kardassopoulos*/Jurisdiction*,* para. 194.

This question is closely connected to an umbrella clause. The tribunal may decide that contractual commitments should be subsumed under an umbrella clause rather than evaluated through the concept of legitimate expectations type 2 under the FET standard. This would limit the application of the concept of legitimate expectations to expectations engendered by specific informal representations, bringing it to line with other legal systems, notably EU law and English law.[1763] Alternatively, the tribunal can expand the concept of legitimate expectations to cover contractual commitments. Implications of this approach are discussed in Section B.4.

Extending the concept of legitimate expectations type 2 to contractual commitments could hamper the development of an umbrella clause as an independent element of IIAs. It would expand the meaning of the FET standard to blur the boundaries between these two types of provisions, to potentially expand the intended scope of an IIA and diminish the legitimacy of the tribunal's interpretative exercise.

One unarticulated assumption underlying the concept of legitimate expectations concerns the perennial problem of foreign investment, namely that of credible State commitments. It is sometimes assumed that IIAs support investor-State contracts that are 'binding under international law' and eliminate the host State's ability to change its laws in a way detrimentally affecting such a contract. This view arises from the disappointment with the internationalisation of investment contracts that failed to produce such result. The disappointment was in the fact the host State as party to such internationalised contracts retained its sovereign ability to change the law and thus was thought unable 'to make its commitment fully credible'.[1764]

The approach ascribing a more powerful effect to an IIA stems from the reading of its definition of 'investment' as providing that 'any breach of an agreement between the host country and the investor [is] a violation of an international treaty'.[1765] This conclusion is clearly erroneous since a *definition* of 'investment' *per se* says nothing about what State could constitute a breach of an IIA. However, in a more generalised version, this assumption underpins the approach to treaty obligations of some commentators.[1766]

[1763] Chapter 8, Section C.2.

[1764] Guzman (n 39) 660.

[1765] ibid 655-656, 658-660.

[1766] Daniel J Blake, 'Thinking Ahead: Government Time Horizons and the Legalization of International Investment Agreements' (2013) 67 International Organization 797; Paulsson (n 1622).

IIAs do not support such an assumption, which is a policy-like belief of some arbitrators and commentators as to how ITL should operate. The comparative analysis also shows that the need for credible commitments should be corrected by the consideration of the host State's need for flexibility to regulate in the public interest. This requires balancing of all relevant factors, rather than focusing on finding ways to justify the view that investment commitments are entirely unconstrained by the host State's sovereign regulatory powers.

As mentioned above, a comparative research into the question of contractual State commitments could help in developing an alternative methodology. However, this disappointment may also be an indication of an unsolvable clash of interests that pre-dates ITA. It is embedded in the very foundation of the system of investment protection and was not remedied by the tailor-made structure of ICSID arbitration.[1767]

D. Considerations for Treaty Drafters

How can the treaty drafters benefit from this comparative analysis? The analysis shows that the concept of legitimate expectations is flexible and as yet unsettled. Its regulation in an IIA at this stage would be premature for at least three reasons:

First, the concept cannot be succinctly presented and thus it is difficult to regulate without the risk of creating unintended consequences.

Secondly, once regulated, it may create inconsistency in ITA/ITL, if such regulation is introduced only by one or a limited number of States, or if the States introduce diverging formulations of the concept in their respective IIAs.

Thirdly, as illustrated by the *Penn Central* test and the concept of 'investment-backed expectations', such regulation does not mean that the concept will be applied or that such application will follow the intentions of the treaty drafters.[1768]

Regardless of these general comments, one needs to confront the reality of treaty-making. The recent CETA is the first IIA with an express provision attempting to influence the existing practice on legitimate expectations. The European Commission described it as limiting the breach of legitimate expectations 'to situations where the investment took place only because of a promise made by the

[1767] M Sornarajah, *International Commercial Arbitration: The Problem of State Contracts* (Longman 1990) 99-101.

[1768] Chapter 6, Section D.

State that was subsequently not honoured'.[1769] According to unofficial information (the text is not yet publicly available) CETA provides that a tribunal, when applying the FET standard, may take into account

> whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated.[1770]

How would a tribunal apply this provision in light of our comparative analysis? The reference to a 'specific representation' points to legitimate expectations type 2. The IIA does not clarify the scope of such 'specific representation', in particular whether it includes conduct that is formal or informal, contractual, administrative, legislative or otherwise. It may also cover formal acts that induced the investor to invest but were subsequently invalidated, i.e. legitimate expectations type 3. The clause potentially covers contractual commitments as well as other specific statements. It is not clear whether the Commission's reference to a 'promise' could narrow the scope of potential State acts that could give rise to legitimate expectations.

In applying this provision a tribunal will have to establish whether the particular representation interfered with the investor's decision to make, or maintain, the investment. It appears to allude to situations similar to *Embassy Limousines, CNTA* or *Mulder*. In these cases the EU institutions caused traders to take upon themselves greater risk than they would otherwise have and the consequences of that reliance were later frustrated.[1771]

The provision gives the tribunal broad discretion to apply it. This may lead to problems similar those caused by the concept of 'commitments', when tribunals *de facto* exempted investors from any due diligence obligations by assuming that investors were induced to invest .[1772]

To summarise, CETA limits the scope of State conduct that could give rise to legitimate expectations to specific conduct that was instrumental in inducing the investor to make or maintain his investment. It does not include legitimate expectations type 1 within the scope of the concept. It requires tribunals to enquire

[1769] 'Investment Provisions in the EU-Canada free trade agreement (CETA)', European Commission <http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf> (accessed 16 April 2014).

[1770] CETA, Section 4, Article X.9.5.

[1771] Chapter 4, Sections B.2.a and B.2.c.

[1772] Chapter 7, Section D.c.

whether, but for the inducement, the investor would not have invested in the host State. However, it does not elucidate the mechanism of assessing such inducement.

E. Suggestions for Further Research

The comparative analysis identifies at least three areas meriting additional research. Such research could benefit further elucidation and consolidation of the concept of legitimate expectations and its peripheries.

1. The Contractual Dimension of Legitimate Expectations

The first such area concerns interactions between the host State's exercise of its sovereign powers and their negative impact on the investment contract between the investor and the State.

The comparative analysis shows that extension of the concept of legitimate expectations type 2 to contractual commitments must involve balancing of private and public interests. However, the answer to the question about the limits of State sovereign powers with regard to its contractual relations with a private business party does not need to be informed by the public law concept of legitimate expectations. The comparative approach of this thesis does not pretend to be the only possible solution to the problem of credible (contractual) commitments.

The old research did not bring conclusions satisfactory to the interests of foreign investors on the perennial problem of reinforcement contractual commitments of a host State vis-à-vis a foreign investor.[1773] It is possible that a renewed research into this area could arrive at different conclusions. The law might have changed over the last decades. Such research would also contribute to further elucidation of the concept of legitimate expectations. An alternative solution is to accept that exercise of sovereign powers of a host State impacting negatively on an investment contract cannot be entirely eliminated by an IIA. This could allow the system participants to focus on developing rules applying to the interaction and balancing of the two interests, private and public.

2. The Role of Stabilisation Clauses

The second area that would benefit from further research concerns stabilisation clauses. The classic function of a stabilisation clause is to freeze specific legislation from subsequent unfavourable change, usually for the duration of an investment

[1773] Chapter 1, Section B.

project. Another type of a stabilisation clause, an economic equilibrium clause, aims to maintain the economic equilibrium of such a project. It does not freeze the applicable law but obliges the parties to negotiate in good faith to restore the project's equilibrium.[1774]

Stabilisation clauses raise a number of important questions. Should they be subsumed under legitimate expectations type 1 (as shielding arrangements) or type 2 (as contractual commitments)? They are contractual in nature and therefore raise concerns whether they should be subsumed under the FET standard (and the concept of legitimate expectations) or an umbrella clause. Given their repeated use in investment projects, a set of guidelines concerning stabilisation clauses in the context of IIAs would be a welcome assistance to the development of ITL. So far the approach of investment tribunals to these clauses has been inconsistent. They sometimes treat them as contractual and thereby outside the scope of their mandate[1775] and sometimes as commitments protected under the FET standard.[1776] Economic equilibrium clauses signed by Argentina gave rise to the rule according to which an investor can legitimately expect that his contractual arrangements with the host State will not be completely dismantled.[1777] The question whether this rule is universal or is confined to stabilisation clauses has not yet been tested in practice.

3. The Standards of Review/Balancing

The third area inviting further research concerns the standard according to which States and tribunals should balance the private interests of investors and the public interest represented by the State. The comparative analysis shows a general absence of a set balancing test in the more developed legal systems.[1778] As a result, any detailed research of this issue will not be coming from the research on legitimate expectations.

[1774] See generally: Lorenzo Cotula, 'Regulatory Takings, Stabilization Clauses and Sustainable Development', OECD Global Forum on International Investment VII, 27-28 March 2008 <http://www.oecd.org/investment/globalforum/40311122.pdf>; Andrea Schemberg, 'Stabilisation Clauses and Human Rights', OECD Global Forum on International Investment VII, 27-28 March 2008 <http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/publications/publications_loe_stabilization__wci__1319577941106> (both accessed 16 April 2014).

[1775] *Parkerings,* paras. 344-345; *Impregilo*, para. 305.

[1776] E.g. *Total,* para. 175.

[1777] See e.g. *EDF v Argentina*, para. 999; *El Paso*, paras. 513-515.

[1778] Chapter 8, Section D.5.

However, the need for and interest in the standard of review appears to be growing in ITL in general.[1779] An investment tribunal applying the concept of legitimate expectations should tap onto an on-going research and discussion about such standard.

An investment tribunal applying the results of such research to legitimate expectations should be mindful of the level of intrusion into the host State's administrative decision-making allowed by such test. Australian law comments are instructive here. They remind us that one should generally not allow a tribunal to interfere with the policy-making of the host State. Tribunals do not have the capacity or means to make such assessments. It is also instructive that other international or supranational legal regimes, namely the EU and ECHR, do not apply intrusive balancing tests and leave the State authorities with a broad margin of discretion.

F. Final Remarks

This thesis explored the concept of legitimate expectations by way of a comparative analysis. The comparative perspective proved to be an effective way to elucidate the incoherent concept of legitimate expectations in ITL. Its conclusions can be instantaneously applied in practice and can contribute to a more coherent and persuasive development of the concept of legitimate expectations in this nascent legal regime.

The foregoing analysis greatly assists in understanding the practice of investment tribunals so far. It clearly shows where ITL is developing in the same direction as the other legal systems; where it combines distinct elements of the concept from different legal systems to expand the reach of investment protection; where it ignores universally established elements of the concept; and where it develops it in an entirely distinct way.

The comparative perspective identifies a general approach to the concept of legitimate expectations that goes beyond individual needs of a specific legal system. As a result, it creates an important point of reference for justification of approaches taken by investment tribunals. Using this point of reference in future disputes will contribute to the development of the legal argument in ITL.

The points of convergence can help to discipline the concept's development. It is applied in three core areas, which are: situations of changes to existing factual and

[1779] Chapter 7, Section F.

legal situation of a person; situations created by specific representations of a State; and situations of invalidity of State action. The concept's application by investment tribunals can be made more coherent at once if they use this typology to classify arguments made before them by the parties. They can further strengthen the persuasiveness of their reasoning by borrowing from methodologies and factors applied in these areas by the other legal systems where the concept is more established.

The comparative perspective is also a good point of reference where the tribunals apply the concept inconsistently with other legal systems. Explaining their methodology used for the concept of legitimate expectations investment tribunals can justify their position by reference the boundaries of the concept set by other legal systems. This will add to the system's credibility and provide a foundation for an in-depth doctrinal engagement with the concept by all participants of the validation process.

The comparative analysis identifies two urgent points to address. First, the question of using the concept of legitimate expectations to contractual commitments and, secondly, incorporation of public interest into the concept of legitimate expectations. It also shows that the comparative perspective cannot be of assistance with regard to basic values that should inform the concept's application. However, it highlights that those values have a crucial role in the tribunals' equitable determination whether legitimate expectations are worthy of protection in the circumstances of a particular case.

Other legal regimes could also benefit from a similar comparative perspective. It is an important tool of development of any international law regime that applies to individuals and has an independent enforcement mechanism.

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