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INVESTOR DILIGENCE IN INVESTMENT ARBITRATION: SOURCES AND ARGUMENTS

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1. Introduction

Most contemporary observers of international investment law will likely share with the author of these lines the impression that the criticism expressed by many commentators over the last decade with respect to the operation of investor-State arbitration is no longer of merely theoretical interest.[1] Practice, broadly understood so as to encompass more circumspect stances taken by arbitration tribunals, more carefully reflected treaty negotiation and design, and even the

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[1] See, among several others, Gus van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007); Pierre-Marie Dupuy, Francesco Francioni, Ernst-Ullrich Petersmann (eds.), *Human Rights in International Investment Law and Arbitration* (Oxford University Press, 2009); Claire Balchin, Liz Kyo-Hwa Chung, Asha Kaushal and Michael Waibel (eds.), *The Backlash Against Investment Arbitration* (Boston: Kluwer, 2010); Jorge E. Viñuales, *Foreign Investment and the Environment in International Law* (Cambridge University Press, 2012); M. Sornarajah, *Resistance and Change in the International Law of Foreign Investment* (Cambridge University Press, 2015); Steffan Hindelang and Markus Krajewski, *Shifting Paradigms in International Investment Law* (Oxford University Press, 2016).

wide variety of events, discussions and writings through which a certain idea of the state of investment arbitration is formed, is indeed changing. And the drivers are not confined to stigmatised countries (and authors) but also include an increasing number of developed countries and even the European Commission. In academic and practitioner circles, the initial polarisation between pro-investor and pro-State views is no longer a useful discourse, if it ever was. This is not – and should not be – the time to point fingers at people for rapacious or hypocritical practices or to do entirely away with a system of investment arbitration that, despite its many flaws, has also many advantages. Rather, the time is ripe to formulate specific suggestions as to how to adjust the international legal framework relating to investment transactions. It is in this context that the concept of investor diligence in investment arbitration is starting to be discussed in more detail, not just as a matter of activism but as one of law, positive law.

Requiring a certain level of diligence from foreign investors is not a new idea. For decades, there have been initiatives to subject multinational enterprises and financial institutions to some standards of conduct, giving rise to the vast body of 'Corporate Social Responsibility' (CSR)[2] and 'Socially Responsible Investment' (SRI)[3] standards. What is more recent is the attempt at fleshing out such diligence in legal terms and, more specifically, in the context of foreign investment disputes decided by arbitral tribunals.

In this context, this article has one simple goal. It seeks to conceptualise the main sources of investor diligence or, in other words, of ways of defining standards and making them operate legally in an investment arbitration context. I identify three approaches, namely (i) the usual soft-law standards addressed directly to companies (CSR) or indirectly to financial institutions (SRI), (ii) legal anchors that make standards actionable and enforceable as well as other forms of international obligations imposed on investors, and (iii) more prosaically, the limitation of the scope of investment protection provisions with legal consequences for the jurisdictional, admissibility, merits and quantum phases of investment proceedings. Each approach is analysed in turn by reference to some prominent examples. The article concludes with some observations regarding the conceptual as well as very practical implications of mainstreaming investor diligence in investment arbitration.

My hope in bringing these different approaches to bear at once on the question of investor diligence is that their articulation may appear more clearly. The wealth of standards governing the behaviour of investors (CSR, SRI and others) can be legally anchored through certain techniques (e.g. enhanced voluntary standards, compliance requirements, formal international obligations on investors, or treaty clauses referring to CSR). These duties can in turn operate in an investment dispute by virtue of several legal concepts intervening at different

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2 See Jennifer Zerk, *Multinationals and Corporate Social Responsibility* (Cambridge University Press, 2006).

3 See Benjamin Richardson, *Socially Responsible Investment Law* (Oxford University Press, 2008).

stages of investment proceedings: jurisdiction (illegality arguments); admissibility (illegality arguments, unclean hands doctrine, and transnational public policy); merits/liability (causation, contributory fault, making expectations unreasonable or providing the basis for a counterclaim); and quantum (causation/contributory fault or the duty to mitigate damages).

2. Sources of investor diligence[4]

2.1. *Sources as analytical vantage points*

Before proceeding to the analysis of the sources of investor diligence, some additional comments on what this term encompasses appear useful. Often, lawyers refer to the source of a norm as the place where the norm is 'found' or has been formulated (the *locus* of the norm). From this basic perspective, the sources of investor diligence are all those instruments, whether binding or not, international or domestic, top-down (regulation) or bottom-up (self-regulation), direct or indirect, where one can find norms or standards of behaviour addressed to investors.

A second meaning of the term is more technical and refers to the legal grounding of a given norm. In international law, we use the term 'formal source' to specify whether a norm is 'law' as a result of its treaty or customary nature and, less frequently, of its constituting a general principle of law. In the context of this article, this meaning is relevant to understand whether a given norm or standard of behaviour is binding or not. This raises profound questions of theory that I can only mention in passing here. One is the extent to which formal sources of law not recognised as such in international law (as is the case of domestic law, which is often viewed as facts) can nevertheless provide the basis for an international obligation imposed directly on investors (e.g. through incorporation by an applicable law clause). Another one is whether an entity which is not clearly acknowledged as a subject of international law can have binding obligations under international law (grounded in one formal source). Whereas the latter question is circular and could be expressly solved (an entity that has obligations directly imposed by international law – e.g. individuals have the obligation not to commit certain international crimes – has some measure of international subjectivity), the former is in practice left unaddressed or handled through a choice-of-law (e.g. Article 42 of the ICSID Convention) or some other 'anchor' clause that incorporates domestic law or some other instrument.[5]

A third way in which this article uses the term source is as an 'entry point' or an 'argument'. Whether a standard is binding or not on an investor, it is still necessary to identify how it may become operative in an investment arbitration proceeding. As this article will show, norms or standards can be used to argue that

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4 See generally Viñuales, above n. 1, chapter 4.

5 See Jorge E. Viñuales, 'The Sources of International Investment Law', in S. Besson, J. d'Aspremont (eds.), *The Oxford Handbook of the Sources of International Law* (Oxford University Press, 2016), chapter 24.

an investment is not protected as a result of its illegality (mostly viewed as a matter of jurisdiction) or that, even if the tribunal had jurisdiction, it should not exercise it (e.g. in cases of corruption or breaches of international public policy), or that much more diligence would have been expected from a sophisticated investor in a regulated industry (and, as a result, it cannot claim to have a reasonable or legitimate expectation) or, still, that the lack of diligence warrants a reduction of the compensation due (e.g. because such lack of diligence was a contributing factor to or concurring cause of the damage suffered).

When commentators, negotiators and practitioners refer to the term sources, these different meanings are not always disentangled. The distinction is, however, useful for two main purposes. Firstly, it provides three different analytical angles of the same reality, which is each time considered from a different vantage point in order to reach different conclusions (What are the main standards? What is their legal grounding? How can they operate in investment arbitration?). Secondly, the distinction helps identify the areas that have received sufficient attention and analysis (the first meaning of the 'sources' of investor diligence) and those that have not (the second and third meanings).

2.2. *Sources as* 'loci'

The initial approach in the development of a body of investor diligence norms was to adopt standards of conduct directly applicable to the operations of multinational companies. Over time, another body of standards has also emerged affecting such operations only indirectly, by targeting financial intermediaries.[6]

2.2.1. *The OECD Guidelines on Multinational Enterprises* – The most prominent illustrations of direct standards are the efforts undertaken within the framework of the United Nations and the Organisation for Economic Co-operation and Development (OECD). Historically, the two processes were linked because the OECD initiative was undertaken by developed countries at a time where a UN draft Code of Conduct on Transnational Corporations was the object of vivid debates between developed and developing countries.[7] Whereas the main results of the OECD process were the 'Guidelines for Multinational Enterprises'[8], the UN process has led over time to the elaboration of a series of documents and frameworks,[9] including the 'UN Global Compact'.[10] Here, the discussion will

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6 B. J. Richardson, 'Financing Sustainability: The New Transnational Governance of Socially Responsible Investment' (2006) 17 *Yearbook of International Environmental Law* 73, at 74.

7 *Ibid*., 102.

8 OECD, Guidelines for Multinational Enterprises, Annex I to the Declaration on International Investment and Multinational Enterprises, 25 May 2011 ('OECD Guidelines').

9 See E. Morgera, *Corporate Accountability in International Environmental Law* (Oxford University Press, 2009), pp. 77-101.

10 UN Global Compact, at www.globalcompact.org (accessed on 31 May 2016). On the operation of the Global Compact *see* UN Global Compact Office, *United Nations Guide to the Global Compact: A Practical Understanding of the Vision and the Nine Principles*; B. King, 'The UN Global Compact: Responsibility for Human Rights, Labour Relations, and the Environment in Developing Nations' (2001) 34 *Cornell International Law Journal* 481.

focus on the OECD Guidelines, which are arguably the main CSR instrument of its kind.

The Guidelines were adopted in 1976 and subsequently updated five times, most recently in May 2011. The approach followed in the Guidelines is that of 'recommendations jointly addressed by governments to multinational enterprises'. [11] They cover a variety of areas including human rights, environmental protection, social rights, corruption and consumer interests, and they apply to multinational companies (broadly defined to include both parent companies and/or local entities[12]) operating 'in or from' the territories of adhering countries.[13] Their observance by covered enterprises is 'voluntary and not legally enforceable', [14] but their enforcement, organised by Part II of the OECD Guidelines, is based on a rather sophisticated system of accountability. States adhering to the guidelines are required to establish 'national contact points' (NCPs),[15] the function of which is *inter alia* to receive complaints from civil society groups relating to the implementation of the guidelines by multinational corporations ('Specific instances').[16] Upon receipt of a complaint, NCPs '[m]ake an initial assessment of whether the issues raised merit further examination'[17] and, if so, they 'offer good offices to help the parties involved to resolve the issues'.[18] If no agreement is reached, NCPs 'issue a statement, and make recommendations as appropriate, on the implementation of the Guidelines'.[19] In some cases, the NCP procedures have been combined with other – potentially more powerful – mechanisms, such as judicial means of dispute settlement.[20]

2.2.2. *The IFC Performance Standards* – Indirect standards encompass a number of principles and policy instruments aimed at regulating the activities of financial intermediaries, including the World Bank's International Finance Corporation (IFC) and private financial institutions (commercial banks,

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11 OECD Guidelines, above n. 8, chapter I, para 1.

12 *Ibid*., chapter I, para 4.

13 OECD, Declaration on International Investment and Multinational Enterprises, 25 May 2011 ('OECD Declaration'), para I, available at www.oecd.org (accessed on 31 May 2016).

14 OECD Guidelines, above n. 8, chapter I, para 1.

15 OECD, Part II: Implementation Procedures of the OECD Guidelines for Multinational Enterprises, 'Decision of the OECD Council on the OECD Guidelines on Multinational Enterprises' ('Council Decision'), para I.1.

16 OECD, Part II: Implementation Procedures of the OECD Guidelines for Multinational Enterprises, 'Procedural Guidance' document ('Procedural Guidance'), para I.C.

17 *Ibid*., para I.C.1.

18 *Ibid*., para I.C.2.

19 *Ibid*., para I.C.3.

20 *See* e.g. *Press release by the Finnish NCP on Metsä-Botnia in Uruguay* (22 December 2006) ('*Botnia case*'), which is related to the dispute before the International Court of Justice in the *Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, Judgment, ICJ Reports 2010, p. 14. See also the 2009 Vedanta case before the UK National Contact Point (*Final statement by the UK NCP on the complaint from Survival International against Vedanta Resources plc*, 25 September 2009) and the subsequent decisions of the India Supreme Court regarding the conflict between, on the one hand, Vedanta and the local government and, on the other hand, the Dongria Kondh people who oppose bauxite mining in their sacred land: *Orissa Mining Corporation Ltd. v. Ministry of Environment & Forest & Others*, in the Supreme Court of India Civil Original Jurisdiction, Writ Petition (Civil) no. 180 of 2011, Judgment of 19 April 2013 ('Vedanta case').

investment banks, insurance companies and pension funds).[21] Among the numerous instruments falling under this category, one may mention the IFC's Performance Standards on Social and Environmental Sustainability,[22] the Equator Principles,[23] the UNEPFI-led Statement by Financial Institutions on the Environment and Sustainable Development,[24] the UN Principles of Responsible Investment,[25] and many others. Despite some variation from one instrument to another, they all operate by setting social and environmental standards for project financing by public, institutional or private financiers. Thus, access to funding by promoters of infrastructure or other projects with potentially harmful implications is subject to the respect of a number of sustainability standards.

A major example of an indirect (SRI) instrument is given by the IFC's Performance Standards. The standards were developed through a process that lasted some fifteen years as a means to ensure that both the IFC and its clients ('IFC-funded projects') conduct their activities in a manner that is socially and environmentally responsible. Initially limited to a vague reference to 'appropriate World Bank environmental policies and guidelines',[26] the policy was expanded in 1998, 2003 and 2006, before taking its present form in January 2012. The operation of the Performance Standards is based on a combination of (i) eight standards focusing on social and environmental protection and (ii) a rather sophisticated enforcement mechanism through the Compliance Advisor Ombudsman ('CAO'). Regarding the latter, those affected by an IFC-financed project can bring a complaint before the CAO for breach of the IFC Performance Standards. In case of breach, sanctions may go as far as the suspension of the funding of the project. The CAO has handled several dozens of cases so far, either in its capacity of ombudsman (disputes between the IFC's 'client' and complaining stakeholders) and/or in its compliance role (audits of the IFC itself).

These direct and indirect sources of investor diligence standards are well known examples of CSR and SRI instruments. In most cases, they are of a soft-law nature, although they can be 'hardened' through a variety of mechanisms that provide them with a legal anchor.

2.3. *Sources as* 'anchors'

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21 *See* Richardson, *Financing Sustainability*, above n. 6; Richardson, *Socially Responsible Investment Law*, above n. 3.

22 International Finance Corporation (IFC), *Performance Standards on Social and Environmental Sustainability*, available at www.ifc.org/sustainability (accessed on 31 May 2016).

23 Equator Principles, available at www.equator-principles.com (accessed on 31 May 2016).

24 UNEP Finance Initiative, *Statement by Financial Institutions on the Environment and Sustainable Development*, available at www.unepfi.org (accessed on 31 May 2016).

25 United Nations Principles of Responsible Investment, available at www.unpri.org/principles (accessed on 31 May 2016).

26 IFC, Environmental Analysis and Review of International Finance Corporation Projects. Procedure for Environmental Review of the International Finance Corporation (8 September 1993), reproduced in Morgera, above n. 9, at 147.

An anchor provision can be understood as a provision (in domestic or international law) that incorporates or in some other way gives legal effect between certain parties to standards or norms that would not otherwise be binding upon such parties. More broadly, it may refer to the legal grounding (the source) that makes certain standards or norms binding. As far as investor diligence is concerned, and particularly the degree of diligence that can be taken into account in the context of an investment dispute, four main types of anchors can be identified.

2.3.1. *Enhanced voluntary standards* – The first example refers to anchors that may give voluntary standards (addressing the question of investor diligence) an enhanced normative value. To continue with the example of the OECD Guidelines, although the standards are voluntary, their implementation may be strengthened through at least three avenues. First, the standards set out in the Guidelines 'may also be regulated by national law or international commitments',[27] in which case their observance may be required by law. Second, adhering States 'make a binding commitment to implement them in accordance with the *Decision of the OECD Council on the OECD Guidelines for Multinational Enterprises*'.[28] This decision requires adhering States to implement into their domestic legislation the system of accountability described in Part II of the Guidelines (national contact points) discussed earlier.[29] Third, when the domestic laws and regulations of the host States where covered enterprises operate are inconsistent with the Guidelines, enterprises 'should seek ways to honour such principles and standards to the fullest extent which does not place them in violation of domestic law'.[30]

Of course, except for the first hypothesis (where standards are incorporated as law), this remains an example of strengthened CSR. But, aside from the potentially far-reaching effects of such an enhanced form of CSR,[31] the strengthening may itself operate as an anchor when articulated with other relevant processes. By way of illustration of the latter point, some complaints were brought before NCPs in connection with the exploitation of natural resources in the Democratic Republic of Congo,[32] which in turn triggered the establishment, in 2000, of a 'Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth of the Democratic Republic of the Congo' by the United

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27 *Ibid.*, chapter I, para 1.
28 *Ibid*., preface, para 1.
29 *See* section 4.3. below.
30 OECD Guidelines, above n. 8, chapter I, para 2.
31 See *Michelin Group in India - Statement of the French National Contact Point for the OECD Guidelines for Multinational Enterprises*, 27 September 2013, available at: http://www.tresor.economie.gouv.fr/File/397224 (accessed on 31 May 2016). In this case, the Michelin group agreed to develop a specific policy not only for the case for which the specific instance had been brought but also applicable to other foreign operations of Michelin.
32 O. K. Fauchald, 'International Investment Law and Environmental Protection' (2006) 17 *Yearbook of International Environmental Law* 3, at 43ff.

Nations Security Council.[33] The Panel issued its first final report in 2002, finding that 85 named enterprises were in violation of the guidelines.[34] Eventually, however, the follow-up of these cases was mostly[35] left to the NCPs of the relevant home countries, and very few cases were actually continued, apparently for lack of sufficiently detailed information.[36]

2.3.2. *Compliance* – To cross the line and enter into law proper, one has to move from 'CSR' to what is usually referred to as 'compliance', namely specific reporting obligations imposed by domestic law (often following international initiatives) in areas such as the fight against money laundering,[37] corruption[38] or natural resource extraction in conflict areas.[39] In the context of investment proceedings, there are many examples of cases where corruption and/or money laundering on the investor's part have been alleged[40] and, when proven, the allegation has been dispositive of the case.

A well-known illustration is the case *World Duty Free v. Kenya*,[41] where the investor sought to enforce a contract obtained by means of a payment made to the then Kenyan president. The agreement referred, in its arbitration and choice-of-law clauses, to English and Kenyan law. The tribunal dismissed the claim under both international law (relying on the concept of *ordre public international*) and domestic English and Kenyan law. It noted that bribery was a criminal offense under the applicable Kenyan laws and that contracts obtained by bribery were

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33 UN Doc S/PRST/2000/20.

34 Final Report (1) of the Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth of the Democratic Republic of the Congo, S/2002/1146 (2002), para 170-8 and Annex III, referred to by Fauchald, above n. 32, 43.

35 The UN Security Council followed up on those cases where the illegal resource exploitation was closely linked to illegal import of arms into the Congo. *See* UN Doc S/RES/1533 (2004) establishing a Committee to examine such cases. This committee took a number of measures, but none of the multinational enterprises subject to the OECD Guidelines seems to have been targeted. *See Ibid*., 44, at footnote 180.

36 Fauchald, above n. 32, 44-45.

37 See the knowledge platform devoted to this question by the International Bar Association: http://www.anti-moneylaundering.org/ (accessed on 31 May 2016).

38 See e.g. the UK 2010 Bribery Act, available at: http://www.legislation.gov.uk/ukpga/2010/23/contents (accessed on 31 May 2016), or the US 1977 Foreign Corrupt Practices Act, available at: https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2012/11/14/fcpa-english.pdf (accessed on 31 May 2016).

39 See e.g. title XV of the US 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, under which the US Securities and Exchange Commission issued regulations requiring specific disclosure by certain companies of their use of conflict minerals, available at https://www.sec.gov/spotlight/dodd-frank/speccorpdisclosure.shtml (accessed on 31 May 2016).

40 See e.g. *Wena Hotels LTD. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award (8 December 2000), para 111; *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Award on Jurisdiction (6 August 2003), para 141-143; *TSA Spectrum de Argentina S.A. v. Argentine Republic*, ICSID Case No. ARB/05/5, Award (19 December 2008), para 175-176; *African Holding Company of America, Inc. and Société Africaine de Construction au Congo S.A.R.L. v. Democratic Republic of the Congo*, ICSID Case No. ARB/05/21, Decision on Jurisdiction and Admissibility (29 July 2008), para 52; *Sistem Muhendislik Insaat Sanayi ve Ticaret A.S. v. Kyrgyz Republic*, ICSID Case No. ARB(AF)/06/1, Award (9 September 2009), para 42-45 ; *Hesham Talaat M. Al-Warraq v. Republic of Indonesia*, UNCITRAL, Award on Respondent Preliminary Objections to Jurisdiction and Admissibility of the Claims (21 June 2012) ('*Al-Warraq v. Indonesia*'), para 99 ; *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines [II]*, ICSID Case No. ARB/11/12, Award (10 December 2014), para 479 ; *Valeri Belokon v. Kyrgyz Republic*, UNCITRAL, Award (24 October 2014), para 158.

41 *World Duty Free Company Limited v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award (4 October 2006).

deemed unenforceable in the common law authorities relevant to the case. Interestingly, the investor sought to mitigate the consequences of its illegal act highlighting the illegal conduct of the Kenyan president, and it asked the tribunal to achieve a balance between both. However, the tribunal firmly dismissed this argument noting that, even if there had been a rule allowing such exercise of equitable judgment, its use would have been of no help to the claimant. Indeed, the apparent unfairness of letting Kenya benefit from the illegal act of its president missed the point that the public policy concepts applicable in this case were intended to protect the public as well as to deprive any claimant (including Kenya, had it been the claimant in the case) from relying on a court of law to enforce an act executed against basic public policy principles.[42]

A similar stance has been taken by the tribunal in *Metal-Tech v. Uzbekistan*, which noted that the condemnation of corruption in Uzbek law was consistent with international law and the laws of most countries and, after finding that there had been indeed corruption, declined jurisdiction to hear the claim.[43] At that point, the tribunal also acknowledged the unbalanced effects of a finding of corruption but it added, in the same line as the tribunal in *World Duty Free v. Kenya*, that 'the idea […] is not to punish one party at the cost of the other, but rather to ensure the promotion of the rule of law, which entails that a court or tribunal cannot grant assistance to a party that has engaged in a corrupt act.'[44] While corruption and money laundering acts are clearly a matter of compliance, some other norms may also become a matter of compliance in time. Indeed, the boundary between CSR and compliance is not set in stone and it may be moving to include areas such as human rights. A significant development in this regard is the adoption by the International Bar Association of Guidance on Business and Human Rights[45] that should be followed, as a matter of deontology and professional practice, by lawyers advising companies around the world.

2.3.3. *International obligations of investors* – Another approach is the creation of a system of investor due diligence obligations directly at the international level. This approach is theoretically much simpler but practically and politically much more controversial. Unsurprisingly, there are very few examples of instruments that have introduced such obligations.

One oft-quoted example may be provided by the potential outcome of the process initiated in 2014 by the Human Rights Council,[46] on the initiative of Ecuador, and entrusted to an Open-ended Intergovernmental Working Group on transnational corporations and other business enterprises with respect to human

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42 *Ibid*., para 176-178.

43 Another example is *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award, 4 October 2013, para 290-291, 389.

44 *Ibid*., para 389.

45 *IBA Business and Human Rights Guidance for Bar Associations, with commentaries*, 8 October 2015, available at: www.ibanet.org (visited on 15 May 2016).

46 'Elaboration of an international legally binding instrument on transnational corporations and other business enterprises with respect to human rights', Human Rights Council, Resolution 26/9, 14 July 2014.

rights (Open-ended Group). It is unclear whether, if the negotiations were to reach a successful outcome, such outcome would take the form, at least partly, of direct international obligations imposed on transnational corporations. At the first session of the Open-ended Group, the Ecuadorian chair of the group proposed a concept note[47] where this approach is suggested as one possibility, albeit not the main one. Indeed, paragraph 2 of the concept note recalls that:

'Resolution 26/9 stresses that the *obligation and primary responsibility to promote and protect human rights and fundamental freedoms lies with the State, and that States must protect against human rights abuse within their territory and/or jurisdiction by third parties, including transnational corporations*. While the obligation of States to regulate business activities within their territorial jurisdiction is clear, on the other hand States' obligations regarding corporate conduct acting abroad remain unclear' (italics added)

But then, in paragraph 4, the note stresses that:

'the international legal system reflects an asymmetry between rights and obligations of TNCs. While TNCs are granted rights through hard law instruments, such as bilateral investment treaties and investment rules in free trade agreements, and have access to a system of investor-state dispute settlement, there are no hard law instruments that address the obligations of corporations to respect human rights.'

In fairness, however, this cannot be considered as a clear example of an instrument or a process aiming at imposing direct international obligations on investors, at least not at present.

A clearer illustration[48] is provided by the 2016 Draft Pan-African Investment Code, prepared under the aegis of the African Union,[49] which devotes a full chapter (chapter 4) to 'Investor Obligations'. Of particular note is the use of the terms 'Investors shall' before the formulation of a series of standards regarding corporate governance (Article 19), socio-political obligations (Article 20), bribery (Article 21), corporate social responsibility (Article 22) and the use of natural resources (Article 23). The provision devoted to 'Business Ethics and Human Rights' (Article 24) is instead preceded by the word 'should' and sets a number of principles that should govern the conduct of investors. If the code becomes binding, these provisions would have direct effect, operating as a set of uniform domestic law (droit uniforme) adopted by treaty and adding a regulatory layer to the relevant legal frameworks of States parties.

2.3.4. *Treaty references to CSR* – Given the practical difficulties involved in developing a treaty providing for specific and clear obligations directly imposed

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47 Concept note proposed under the responsibility of the designated Chair, Amb. María Fernanda Espinosa, Permanent Representative of Ecuador to the United Nations in Geneva, July 6th-10th 2015.

48 I am indebted to Professor Makane Mbengue, from the University of Geneva, for having drawn my attention to this example.

49 Draft Pan-African Investment Code, ECOSOC/African Union E/ECA/COE/35/18, AU/STC/FMEPI/EXP/18(II), 26 March 2016 ('Draft Pan-African Code'). Another example that has been referred to as providing for direct international obligations on investor is the Investment Agreement for the COMESA Common Investment Area, 23 May 2007. However, on closer inspection, this Agreement only contains one clear provision (Article 13, entitled 'Investor Obligation'), which, in fact, is a fairly recurrent clause also found in many other investment agreements according to which investors must comply with domestic law (the term used in Article 13 is 'domestic measures').

on investors, a midway 'anchor' provision referring generally to corporate social responsibility may be a useful compromise. An UNCTAD Report[50] analysing 18 international investment agreements or IIAs (11 BITs and 7 FTAs) that were concluded in 2013 shows that some of these treaties (5 out of 18) contain a reference to CSR standards in the form of either a separate clause or preambular language.[51]

A good example of this trend is provided by the 2009 Canada-Peru FTA, which contains both types of references.[52] Indeed, in the preamble both parties agree to 'encourage entreprises operating within their territory or subject to their jurisdiction, to respect internationally recognized corporate social responsibility standards and principles and pursue best practices'. Subsequently, in the investment chapter of the agreement, Article 810 entitled 'Corporate Social Responsibility' provides that:

'Each Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies, such as statements of principle that have been endorsed or are supported by the Parties. These principles address issues such as labor, the environment, human rights, community relations and anti-corruption. The Parties therefore remind those enterprises of the importance of incorporating such corporate social responsibility standards in their internal policies'

From the perspective of 'anchor' provisions, the language used is clearly a best efforts one ('encourage', 'should', 'voluntarily incorporate').

Similar language is used in some so-called mega-regional trade and investment agreements, such as the recently negotiated Trans-Pacific Partnership (TPP).[53] Article 9.17 of the investment chapter, entitled 'Corporate Social Responsibility', provides that:

'The Parties reaffirm the importance of each Party encouraging enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate into their internal policies those internationally recognised standards, guidelines and principles of corporate social responsibility that have been endorsed or are supported by that Party.'

The normative value of such clauses and, particularly, their ability to operate as anchors is unclear both because of the hortatory language used and, more importantly, because the exhortation is addressed to State parties rather than to companies. However, an investor seeking the protection of such treaties is thereby made aware that all States parties expect the host State (and potentially the home State) to ensure that the operations of investors abide by certain internationally

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50 UNCTAD, *World Investment Report 2014. Investing in the SDGs* (2014) ('UNCTAD 2014'), available at: www.unctad.org (visited on 15 May 2016).

51 *Ibid*., p. 117.

52 See Canada-Peru Free Trade Agreement, signed on 29 May 2008, available at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/peru-perou/peru-toc-perou-tdm.aspx?lang=eng (accessed on 31 May 2016). A 2011 UNEP Report on CSR in FTAs presents the Canada-Peru FTA as groundbreaking in its treatment of CSR. See UNEP, *Corporate Social Responsibility and Regional Trade and Investment Agreements* (2011), p. 25.

53 Trans-Pacific Partnership (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, Vietnam), 4 February 2016 ('TPP').

recognised CSR standards. As a result, investors could reasonably expect that they will be able to operate under lower standards, which in turn limits the range of what they can reasonably claim (and obtain) in investment proceedings.

2.4. *Sources as* 'entry points'

So far, I have discussed some sources where standards of investor diligence can be found as well as some legal mechanisms through which they can be legally grounded. This section focuses on how such norms and standards may operate in investment arbitration. To avoid speculations, I analyse only those 'entry points' or uses for which specific and realistic examples can be identified. This is in my view important, to disentangle law from mere hope. There are examples in the investment jurisprudence to support the proposition that the degree of investor diligence can play a role at different stages of investment proceedings: jurisdiction, admissibility, merits, and quantum. The discussion follows this order.

2.4.1. *Investor diligence and jurisdictional matters* – Regarding the jurisdictional phase, the degree of investor diligence may be relevant to assess whether an investment is 'covered' or 'protected' by an IIA. From a technical perspective, investor negligence is captured at this stage to the extent that it constitutes a *material breach of domestic law*. Some IIAs include provisions according to which they provide protection only to investments 'made in accordance with the law of the host State'[54] and there is authority to consider that even in the absence of such a clause, the legality requirement must be read as an implicit term of the treaty.[55] The interpretation and application of such clauses has encountered some challenges, particularly in connection with the determination of when an investment is 'made' (a distinction between 'initial' and 'subsequent' illegality is often drawn[56]) and what are the laws relevant for the assessment of the initial (il)legality of the investment.

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[54] *See* e.g. Egypt—Pakistan BIT (2000), art 1(1); Bahrain—Thailand BIT (2002), art 2, reproduced in A. Joubin-Bret, 'Admission and Establishment in the Context of Investment Protection' in A. Reinisch (ed.) *Standards of Investment Protection* (2008) 17. Such a reference to the host State's laws concerns the validity of an investment and not the definition of the term investment itself, see e.g. *Salini Costruttori v. Morocco*, Decision on Jurisdiction (23 July 2003), para 46. However, in a growing number of cases, the legality of an investment has been considered as a jurisdictional obstacle.

[55] See *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Award (27 August 2008), 138-139; *Phoenix Action Ltd v. Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009), para 101; *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 226, Final Award (18 July 2014), para 1349-1352;*Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227, Final Award (18 July 2014), para 1349-1352; *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 228, Final Award (18 July 2014), para 1349-1352.

[56] *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, Award (16 August 2007), para 345; *Bernhard von Pezold and others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15, Award (28 July 2015), para 420; *Hulley v. Russia*, above n. 55, para 1354-1356; *Yukos v. Russia*, above n. 55, para 1354-1356; *Veteran Petroleum v. Russia*, above n. 55, para 1354-1356; *Copper Mesa Mining Corporation v. Republic of Ecuador*, UNCITRAL, PCA No. 2012-2, Award (15 March 2016), para 5.54 ff; *Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/5, Award (22 August 2016), para 289ff. Two specificities must be noted in this regard. Firstly, the illegality of a transaction or scheme that occurs even prior to the moment when the investment is made can be relevant. See e.g. *Alasdair Ross Anderson and others v. Costa Rica*, ICSID Case No ARB(AF)/07/3, Award (19 May 2010), para 51-61 (where the illegality of the 'ponzi' scheme in which the investors invested barred jurisdiction). *Hulley v. Russia*,

Importantly, this inquiry must be distinguished from that concerning the law applicable to settle an investment dispute over which a tribunal has already asserted jurisdiction. The laws governing the initial (il)legality will typically be a subset of the law applicable to settle the dispute. Over time, investment tribunals have tended to expand the scope of the laws governing initial (il)legality. A line can be drawn from some early cases such as *Inceysa v. El Salvador*, where the initial illegality is defined by some fundamental norms such as the prohibition of corruption,[57] to cases such as *Saba Fakes v. Turkey*, which define narrowly the domestic laws relevant for the determination of initial illegality,[58] to the more recent decision in *Mamidoil v. Albania*, where the laws relevant to define the initial illegality are more broadly understood.[59]

The latter case is significant for the impact of investor diligence on jurisdictional matters. The dispute concerned allegations of mistreatment of a Greek investor in connection with the construction and operation of an oil container terminal as well as petrol stations in Albania. The respondent argued, among others, that the investment had not been made in accordance with the host States' domestic laws. Specifically, it referred to the fact that the claimant had failed to conduct any due diligence assessment and had not sought the relevant (construction, environmental and exploitation) permits. Although the tribunal found that the lack of construction and exploitation permits amounted to a non-trivial illegality, it – debatably – asserted jurisdiction on the grounds that the respondent had been cooperative enough and stood ready to cure the illegality arising from the procedural irregularities. It thus moved the issue of illegality to the assessment of the merits of the dispute, where it eventually rejected the claim. For present purposes, however, what is worth noting is how the tribunal reached that conclusion.

Such reasoning can be summarised in four points. Firstly, the tribunal adhered to the increasingly well-established distinction between initial and subsequent illegality.[60] Secondly, and importantly, it noted that illegality can arise out of inconsistency with substantive and/or procedural domestic law, and it

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above n. 55, para 1369-1370; *Yukos v. Russia*, above n. 55, para 1369-1370; *Veteran Petroleum v. Russia*, above n. 55, para 1369-1370 ('The Tribunal agrees with Respondent that an examination of the legality of an investment should not be limited to verifying whether the last in a series of transactions leading up to the investment was in conformity with the law. The making of the investment will often consist of several consecutive acts and all of these must be legal and bona fide […] the alleged illegalities to which it refers are sufficiently connected with the final transaction by which the investment was made by Claimants.')

57 *Inceysa Vallisoletane, SL v. El Salvador*, ICSID No ARB/03/26, Award (2 August 2006), para 257, 264. For a recent iteration of this approach see *ECE Projektmanagement International GmbH and Kommanditgesellschaft PANTA Achtundsechzigste Grundstücksgesellschaft mbH & Co v. Czech Republic*, PCA Case No. 2010-5, Award (19 September 2013), para 3.170 – 3.171.

58 *Saba Fakes v. Turkey*, ICSID Case No. ARB/07/20, Award (12 July 2010), para 119 (according to the tribunal, only the illegality arising from a violation of the host State's law relating to the admission of investments would exclude jurisdiction). For an iteration of this approach see *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award (4 October 2013), para 165.

59 *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award (30 March 2015), para 372, 378.

60 *Ibid*., para 359.

understood both bodies of law broadly.[61] Investors are therefore expected to identify all necessary requirements and diligently comply with them. Thirdly, not any violation of domestic law can defeat jurisdiction. The rationale is indeed that States should not be expected to have forgone their immunity of jurisdiction – consenting to arbitration – for investments made illegally, but at the same time, allegations of illegality must be circumscribed to avoid abuse.[62] The level of investor negligence that is relevant for jurisdictional purposes is therefore one that amounts to material breaches of domestic law, not minor irregularities. Fourthly, the tribunal admitted the possibility that initial illegality may not defeat jurisdiction when the respondent has forgone the possibility of invoking it (e.g. because the deficiency was cured domestically or on the basis of estoppel) or when the State has stood ready to remedy the illegality.[63] The latter stance is debatable. It amounts to endorsing the view that a host State who behaves in a constructive manner – e.g. by not moving to demolish an installation built in breach of a construction permit – cannot avail itself of the argument that an investment has been made illegally and hence does not benefit from the protection of the treaty. In other words, at least for jurisdictional purposes, the State's good will and diligence are used to cure investors' negligence. That solution may have been warranted for factual reasons arising in this specific case, but it is misguided as a general principle.

2.4.2. *Investor diligence and admissibility matters* – The difference between jurisdiction and admissibility is well known, although not always clearly applied. A claim over which a tribunal 'can' exercise jurisdiction, may be such that the tribunal 'should not' exercise jurisdiction. Stated differently, the tribunal does not lack the power to hear a claim, but it should not use it.[64] The assessment of

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[61] On the scope of the relevant substantive law, the tribunal stated the following: '[t]he Tribunal finds that an investment can be illegal and as a consequence not protected by investment conventions when it contravenes substantive law, in other words when it does not comply with material norms regulating investments. Norms may prohibit certain business activities, such as the production of drugs, or they may reserve certain sectors to national entities or protect certain sectorial or geographical areas, for example, by making an investment in a national park illegal' (*ibid*., para 372). On the scope of the relevant procedural law, the tribunal noted that '[t]he second source of possible illegality concerns procedural rules. In the Tribunal's view, an investment can be found illegal for procedural reasons when the investor does not respect the norms regulating the process of investment. The investment may be legal in substance but still tainted by illegality when the investor violates procedural norms and regulations for setting up its investment' (*ibid*., para 378). It then went on to analyse consistency with construction, environmental and operation requirements. Although the scope of the relevant laws was challenged by the claimant-appointed arbitrator in a dissenting opinion (see Dissenting Opinion of Steven A. Hammond, 30 March 2015, para 128-131), the majority's stance is more accurate as a general principle. See the discussion in Viñuales, above n. 1, pp. 98-99.

[62] As noted by the tribunal: '[t]he Tribunal agrees with the view that not every trivial, minor contravention of the law should lead to a refusal of jurisdiction. It must strike a balance between two criteria. On the one hand, neither Claimant nor the Tribunal may presume that the host State waives its sovereignty and agrees to the arbitration of disputes when the investor made the investment in violation of its substantive or procedural legislation. On the other hand, States must not be allowed to abuse the process by scrutinizing the investment post festum with the intention of rooting out minor or trivial illegalities as a pretext to free themselves of an obligation. A State must act consistently with its obligations and not resist jurisdiction because it wants to escape the consequences of its standing agreement to arbitrate', *ibid*., para 483.

[63] *Ibid*., para 490-495.

[64] *Achmea B.V. v. Slovak Republic [II]*, PCA Case No. 2013-12, Award on Jurisdiction and Admissibility (20 May 2014), para 114-119. See also *Abaclat and Others (Case formerly known as Giovanna a Beccara and Others) v.*

whether it should or should not use such power is different from the assessment as to whether it has or not this power, as well as from the assessment of the actual claims (which assumes both the power and its use). There are a number of practical differences between characterising an issue as a matter of jurisdiction or one of admissibility, including the moment in the arbitration proceeding at which such an argument can be made,[65] the burden of proof,[66] and the scope for review of the decision.[67] But for present purposes, the main consideration is whether the degree of investor diligence can play a role in the assessment of admissibility. From a technical standpoint, three main legal concepts have been mobilised to assert the inadmissibility of a claim on the basis of investor's fault, namely the *illegality of the investment* (see previous section), the doctrine of *unclean hands*, and the concept of *transnational public policy* (or 'ordre public international').

Concerning the *unclean hands doctrine*, the matter has featured prominently in three investment claims brought against the Russian Federation over the expropriation of Yukos.[68] In the *Yukos* cases, after joining the objection to the discussion on the merits, the tribunal rejected it as such but took into account the tax avoidance actions of Yukos in its analysis of contributory fault. The sections of the awards relating to unclean hands as a preliminary objection are of particular relevance because the tribunal discusses the existence of 'unclean hands' as a general principle of law in the meaning of Article 38(1)(c) of the ICJ Statute.[69] The analysis is rigorous and considers many decisions from the ICJ and its predecessor, the Permanent Court of International Justice (PCIJ), before rejecting the existence of such a rule.[70] It may be noted however that, in reaching its conclusion, the tribunal seemed to overemphasise the lack of recognition of the unclean hands doctrine by a majority in a court or tribunal (by contrast with dissenting opinions) instead of focusing on the practice in *foro domestico* and the potential transposal of such a principle to the international plane, as the very concept of a general principle of law would require.[71] Thus, I do not believe that the conclusions of the tribunal on this point settle the principle. Another illustration is provided by the *Copper Mesa v. Ecuador* case, where the tribunal

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Argentine Republic, ICSID Case No. ARB/07/5, Dissenting Opinion, Georges Abi-Saab (28 October 2011), para 18.

65 *HOCHTIEF Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/07/31, Decision on Liability (29 December 2014), para 149.

66 *Hassan Awdi, Enterprise Business Consultants, Inc. and Alfa El Corporation v. Romania*, ICSID Case No. ARB/10/13, Award (2 March 2015), para 212.

67 See Z. Douglas, *The International Law of Investment Claims* (Cambridge University Press, 2009), para 307.

68 In the three cases, the tribunal considered the 'unclean hands' argument as part of the merits of the claim. See *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 226, Interim Award on Jurisdiction and Admissibility (30 November 2009), para 435 ; *Yukos Universal Limited (Isle of Man)* v. *The Russian Federation*, UNCITRAL, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility (30 November 2009), para 436 ; *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 228, Interim Award on Jurisdiction and Admissibility (30 November 2009), para 492.

69 Statute of the International Court of Justice, 26 June 1945, 33 UNTS 993.

70 See *Hulley v. Russia*, above n. 55, para 1358-1373; *Yukos v. Russia*, above n. 55, para 1358-1373; *Veteran Petroleum v. Russia*, above n. 55, para 1358-1373.

71 See J. Barberis, *Fuentes del derecho internacional* (La Plata: Editora Platense, 1973), pp. 3-30.

characterised the objection as one of inadmissibility (rather than lack of jurisdiction) and then, after considering that it was too late in the proceedings to raise such an objection, assimilated a number of different concepts (unclean hands, causation, contributory fault) as materially equivalent and left the matter for the discussion of liability/quantum.[72] The tribunal's approach will be discussed in connection with the entry points of investor's negligence at the merits level. It is noteworthy however that, despite a factual finding that the investor had 'resort[ed] to recruiting and using armed men, firing guns and spraying mace at civilians, not as an accidental or isolated incident but as part of premeditated, disguised and well-funded plans to take the law into its own hands'[73] nevertheless deemed the claim relating to that portion of the investment admissible. Investment decisions are always fact-sensitive and it is difficult to understand a given approach without the benefit of a full briefing of the facts. However, it is difficult not to be perplexed by this finding in the light of the very rationale of the concept of admissibility. A State is not only entitled but it has a duty to act, under international human rights law, to cease such deliberate misuse of private security forces by a foreign investor. Resort by an investor to such abusive and illegal practices is totally unacceptable and a claim based on the consequences of such action is clearly inadmissible.

As for the concept of *transnational public policy*, the most prominent illustration in this regard concerns investors' violations of what I have referred to earlier as norms or standards of compliance (e.g. anti-corruption and money laundering laws and principles). The case of *World Duty Free v. Kenya* discussed in the previous section is not necessarily a clear illustration, as the corruption allegation targeted the very existence of a contract, which in turn was a condition for the jurisdiction of the tribunal. But there may be cases in which the basis of jurisdiction is provided by a valid treaty and, yet, acts of corruption by the investor are deemed to make treaty protection unavailable. As with other issues, the treatment of this question in investment decisions has varied with tribunals considering such issues as a matter of jurisdiction (for lack of 'investment' or 'consent') or merits.[74] But there is no legal impediment to characterise such arguments as objections to the admissibility of a claim.[75] An investor may have acquired two public companies at different points in time, one of them legitimately and the other on the basis of a bribe. If these companies are targeted by an act of the host State, a treaty-based investment tribunal would have jurisdiction over the claims, but one of the claims (regarding the company acquired through the bribe) would be inadmissible. It is possible – but not necessary – that the corrupt act taints the entire action of the investor and leads the

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[72] See *Copper Mesa v. Ecuador*, above n. 56, para 5.62-5.66

[73] *Ibid*., para 6.99.

[74] See above n. 40.

[75] *Hesham Talaat M. Al-Warraq v. Republic of Indonesia*, UNCITRAL, Final Award (15 December 2014), para 646-648 (remarkably stating that although the claimant did not receive fair and equitable treatment, it is prevented from pursuing this claim because the 'clean hands' doctrine makes it inadmissible).

tribunal to dismiss the claims without reviewing the merits, but analytically the question of corruption in this case could be articulated as one of admissibility, with the ensuing practical consequences mentioned earlier.

2.4.3. *Investor diligence as a matter to be reviewed on the merits* – The usual stage at which the degree of investor diligence will be considered is in connection with the merits of the investor's claims or those of State counter-claims. There are several entry points for consideration of investor diligence or negligence at this stage but, for present purposes, I will organise the discussion from two main perspectives. The first perspective concerns references to the degree of investor diligence as part of a *State's defence against allegations for breach of an investment treaty*. The degree of investor diligence operates here as a factual or interpretive element in the light of which the appropriateness of State action is to be assessed or, relatedly, the scope of protection of investment protection standards is to be determined. The second perspective relates to the use of investor negligence as part of a State *counter-claim*.

The first perspective can be sub-divided into two main categories, namely (i) investor negligence *justifying intervention from State authorities*; (ii) investor's degree of diligence in forming *a reasonable expectation*. In the two cases, investor's negligence has provided grounds to conclude that measures from State authorities (whether general regulations or targeted measures) were consistent with investment protection standards or, in other words, that the protection claimed by the investor required some degree of diligence on its part to be fully enjoyed. The first category can be illustrated by reference to cases such as *Azinian v. Mexico*[76] or *Genin v. Estonia*[77]. In these two cases, the reckless or negligent conduct of the investor provided, to the eyes of the tribunal, justification for the adverse targeted action undertaken by the State. In some other cases, such as *Occidental v. Ecuador*[78] or the *Yukos* cases, tribunals have established a link between investors' negligence and the measures challenged. In both examples, the negligent conduct of the investor (e.g. not requiring the necessary authorisation before proceeding to a transfer of rights or embarking into an aggressive tax avoidance strategy) was deemed to be causally related to the wrongful act of the host State, although the latter deliberately took disproportionate measures (terminating an agreement or forcing a company into bankruptcy) that went beyond what was warranted by the investors' conduct. Negligence can be (and has been) argued in this context on the basis of arguments such as *causality* or *contributory fault*. Tribunals have relied on the rules stated in Articles 31 and 39

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[76] *Robert Azinian, Kenneth Davitian & Ellen Baca v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award (1 November 1999), para 103-105.

[77] *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia*, ICSID Case No. ARB/99/2, Award (25 June 2001), para 361.

[78] *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award (5 October 2012). This award has been subsequently annulled for manifest excess of powers in assuming jurisdiction, although not in connection with the specific point discussed here. See Decision on Annulment of the Award (2 November 2015).

of the ILC Articles,[79] but they have framed this issue as a matter of liability or quantum.[80] Given that these rules relate to the consequences of internationally wrongful acts, I will discuss them in connection with quantum.

The second category encompasses a larger number of examples. Importantly, investor diligence is a key consideration in assessing the *reasonableness* or *legitimacy* of the expectations that could potentially be protected by the fair and equitable treatment clause. This key point often remains implicit in the characterisation of reasonable expectations,[81] but in some cases it has indeed been spelt out. A line can be identified in this regard going from *Methanex v. United States*, where the tribunal stated that the investor could not ignore the conditions of the regulatory and political context prevailing in California and the United States,[82] to *Plama v. Bulgaria*, where the tribunal reasoned that a diligent investor should have been aware of the debates at the parliament relating to the potential changes of the relevant environmental law,[83] to *Chemtura v. Canada*[84] and, more recently, *Occidental v. Ecuador*,[85] *Unglaube v. Costa Rica*,[86] *Copper Mesa v. Ecuador*[87] and *Charanne v. Spain*,[88] where the tribunals reasoned that the claimants, as sophisticated investors in their respective industries, could not reasonably expect that no regulatory changes would intervene during the period relevant for their investment.

The overall import of this line of cases can be summarised in four points. Investors have a due diligence obligation, which covers not only (a) the basic regulations applicable to foreign investment transactions (e.g. licensing

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79 Responsibility of States for Internationally Wrongful Acts, G.A. Res. 56/83, U.N. Doc A/RES/56/83, 12 December 2001 ('ILC Articles'). See *Occidental v. Ecuador*, above n. 78, para 659ff; *Hulley v. Russia*, above n. 55, para 1274 (referring to chapters X.E and XII.C of the award); *Yukos v. Russia*, above n. 55, para 1274 (referring to chapters X.E and XII.C of the award); *Veteran Petroleum v. Russia*, above n. 55, para 1274 (referring to chapters X.E and XII.C of the award); *Copper Mesa v. Ecuador*, above n. 56, para 6.91 (considering Article 39 as 'declaratory' of customary international law).

80 *Occidental v. Ecuador*, above n. 78, para 678, 681, 687 (quantum); *Hulley v. Russia*, above n. 55, para 1274 (referring to chapters X.E and XII.C of the award); *Yukos v. Russia*, above n. 55, para 1274 (referring to chapters X.E and XII.C of the award); *Veteran Petroleum v. Russia*, above n. 55, para 1274 (referring to chapters X.E and XII.C of the award); *Copper Mesa v. Ecuador*, above n. 56, para 6.97 and 6.102 (liability)

81 *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability (13 October 2006) ('*LG&E v. Argentina*'), para 130; *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award (11 September 2007), para 331; *Duke Energy Electroquil Partners and Electroquil SA v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award (18 August 2008), para 340.

82 *Methanex Corporation v. United States of America*, UNCITRAL, Final Award (3 August 2005), part IV, chapter D, para 9-10.

83 *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Award (27 August 2008) ('*Plama v. Bulgaria*'), para 219-221.

84 *Chemtura Corporation (formerly Crompton Corporation) v. Government of Canada*, UNCITRAL, Award (2 August 2010), para 149.

85 *Occidental v. Ecuador*, above n. 78, para 383.

86 *Marion Unglaube v. Republic of Costa Rica,* ICSID Case No. ARB/08/1 and *Reinhard Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/09/20, Award (16 May 2012), para 258.

87 *Copper Mesa v. Ecuador*, above n. 56, para 6.60-6.71 (although the tribunal concludes that the police powers doctrine does not cover the measures challenged for lack of due process). See specifically para 6.61 ('[i]n the Tribunal's view, as a general matter, the Claimant took the risk of changes in the legal and regulatory regime upon making its long-term investments in Ecuador. There were in the present case no specific commitments, representations or assurances to the Claimant that the Respondent would refrain from such regulation.').

88 *Charanne BV and Construction Investments S.A.R.L. v. Kingdom of Spain*, ECT Arbitration 062/2012 (SCC Rules), Award (21 January 2016) [Spanish], para 507.

requirements and the like) but also (b) the entire legal framework potentially applicable to the investment as well as (c) the potential changes of such framework that are foreseeable at the time the investment is made. Investors may, of course, manage regulatory risk by introducing specific provisions in their contract with the host State, but this possibility is not without limits.[89] In addition, as noted by other investment tribunals, (d) 'reasonableness' would have to be assessed in the light of other broader circumstances, including 'business risk or industry's regular patterns'[90] or 'the political, socioeconomic, cultural and historical conditions prevailing in the host State'.[91] By way of illustration, it would not be reasonable for an investor investing in highly volatile political environment, whatever the assurances received, that the investment will no longer be affected by further disruptions.[92] In such a context, assumed political risk would become commercial risk.

Moving now to the second perspective, investors' negligence can be an important consideration in assessing a *counter-claim* brought by a State. A noteworthy case in this regard is the pending dispute *Perenco v. Ecuador*.[93] The case concerns the environmental impact of oil extraction activities by Perenco in the Ecuadorian part of the Amazonian rainforest. In an interim decision on a counter-claim brought by Ecuador, the tribunal has discussed Perenco's liability for damage caused to the environment under both strict liability and fault-based liability regimes laid out in Ecuadorian law and incorporated into the applicable contractual framework without, however, specifying the extent of liability.[94] The discussion of fault-liability is significant to assess the impact of an investor's 'duty of care', particularly in the light of best industry practice. In this case, Perenco took over the operation of two blocs from a previous operator without a proper environmental assessment (at least there was none recorded in writing) of the state of the blocs at the time of taking over. The conduct of such an assessment is, however, common industry practice because, in case of environmental liability, it allows to disentangle what damage is attributable to each operator. In assessing Perenco's liability for the environmental damage of the relevant blocs, the tribunal paid attention to this and other displays of negligence.[95] References to investor's negligence become even more pressing when assessing the investor's environmental practices. Before reviewing the different instances of deficient environmental management, the tribunal states

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89 OECD Guidelines, above n. 8, chapter II, para 5.

90 *LG&E v. Argentina*, above n. 81, para 130.

91 *Duke v. Ecuador*, above n. 81, para 340.

92 See *Bayindir Insaat Turizm Ticaret ve Sanayi A Ş v, Pakistan*, ICSID Case No ARB/03/29, Award (27 August 2009), para 193 ('the Tribunal is of the view that the Claimant could not reasonably have ignored the volatility of the political conditions prevailing in Pakistan at the time it agreed to the revival of the Contract. Indeed, the Claimant expressly acknowledges that it suffered severely from political changes in Pakistan during the preceding years').

93 *Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador)*, ICSID Case No. ARB/08/6, Interim Decision on the Environmental Counterclaim (11 August 2015).

94 See the ambiguous formulation of the operative part, ibid., para 611 (points 3 and 4).

95 *Ibid*., para 389-390.

indeed that 'given [its] view of Perenco's conduct […] it has decided not to dispose of this claim on a simple burden of proof approach'[96] and, later on, it notes that '[t]he number of non-conformities, including major non-conformities, is striking and tends to weaken Perenco's claim of strong environmental stewardship'.[97] Then, after reviewing several specific non-conformities, the tribunal concluded that '

> 'the company's failure to document the environmental condition of the two Blocks at the time of acquisition of its interests, its failures to conduct the statutorily required audits in 2004, its use of outdates environmental documents during the course of the operations, its failure to obtain necessary licenses, the increase in the incidence of nonconformities detected in the 2006 and 2008 audits, and [a witness'] unchallenged testimony as to the approach taken in the 2008 Block 7 audit do not paint a picture of a responsible environmental steward'[98]

The decision is peculiar in that it encourages the parties to reach a settlement on the basis of its factual findings. The liability of Perenco is strongly suggested but the operative part remains ambiguous. This said, the decision is important to identify the type of standards that investors are expected to follow, which arise not only from domestic law but also from best industry practice.

2.4.4. *Investor diligence and quantum* – Another way in which the degree of investor diligence has been taken into account is through an adjustment (reduction) of compensation. The rationale underlying this approach is that those damages arising from investor's negligence should not be compensated, either because such negligence would be (at least partially) their cause or because the overall damage could have been mitigated had the investor exercised the diligence that could be expected from it. Technically, there are two legal concepts mobilised in this regard, namely *contributory fault* (entailing causality between fault and a severable part of the injury suffered) and the *duty to mitigate damages*.

Regarding the first concept, *contributory fault* has been used to reduce compensation by 25,[99] 30[100] or even 50[101] per cent and, in one case, to suppress compensation altogether.[102] A line can be identified in this regard going from cases such as *MTD v. Chile*, to *Occidental v. Ecuador*, the *Yukos* cases and *Al-Warraq v. Indonesia* and, more recently, *Copper Mesa v. Ecuador*. *MTD v. Chile* is often referred to as a key precedent. In this case, the tribunal considered that the investor, which had acted negligently in assessing regulatory risks affecting the acquisition of a plot of land for further development, had to bear part of the damages that it had suffered. The tribunal reasoned that such damage was

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96 *Ibid*., para 407.
97 *Ibid*., para 411.
98 *Ibid*., para 447.
99 *Occidental v. Ecuador*, above n. 78, para 687; *Hulley v. Russia*, above n. 55, para 1637; *Yukos v. Russia*, above n. 55, para 1637; *Veteran Petroleum v. Russia*, above n. 55, para 1274.
100 *Copper Mesa v. Ecuador*, above n. 56, para 6.102.
101 *MTD Equity Sdn Bhd and MTD Chile SA v. Republic of Chile*, ICSID Case No. ARB/01/7, Award (25 May 2004), para 242-243.
102 *Al-Warraq v. Indonesia,* above n. 75, para 683, point 6 (for the claim relating to breach of fair and equitable treatment).

attributable to business risk because the investor could have mitigated it if it had deployed better business judgment:

'The Tribunal decided earlier that the Claimants incurred costs that were related to their business judgment irrespective of the breach of fair and equitable treatment under the BIT. As already noted, the Claimants, at the time of their contract with Mr. Fontaine, had made decisions that increased their risks in the transaction and for which they bear responsibility, regardless of the treatment given by Chile to the Claimants. They accepted to pay a price for the land with the Project without appropriate legal protection. A wise investor would not have paid full price up-front for land valued on the assumption of the realization of the Project; he would at least have staged future payments to project progress, including the issuance of the required development permits […] The Tribunal considers therefore that the Claimants should bear part of the damages suffered and the Tribunal estimates that share to be 50% after deduction of the residual value of their investment calculated on the basis of the following considerations.'[103]

Interestingly, the key consideration in the reasoning offered by the tribunal is the distinction between business judgement, which is a matter of commercial risk, and the compensable political risk. As discussed in the next section, this distinction, which remains underexplored despite the inflation in writings about investment law, is of great importance both theoretically and in practice. Another prominent illustration is *Occidental v. Ecuador*. In this case, the claimant had transferred its rights over a portion of an oil block without the required authorisation of the government officials. Such conduct enabled the operation of a clause authorising the rescinding of the governing contract. The tribunal found that, in the specific factual context, the exercise of such contractual right by the governmental authority had been disproportionate but it nevertheless reasoned that the investor had contributed to this measure as a result of its negligence. For present purposes, the main elements that can be derived from this decision are the conditions for the operation of Article 39 of the ILC Articles, which the tribunal read in conjunction with Article 31. Three main components of this test can be identified namely (i) negligence must be of some degree, (ii) it must bear a material or significant causal relationship with the challenged measure, and (iii) some part of the injury must be shown to be severable in causal terms from the injury caused by the host State.[104] The tribunal asserted 'discretion' as to the apportionment of the damage.[105] Subsequent decisions have added some further refinements. In the *Yukos* awards contributory fault was distinguished from the duty to mitigate damages[106] and in *Copper Mesa v. Ecuador* the tribunal suggested that when the investor's fault (component (i) of the abovementioned test) goes beyond negligence it may have 'much graver' consequences.[107]

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[103] *MTD v. Chile*, above n. 101, para 242-243. The damages assessment of the tribunal withstood an annulment challenge, *see MTD Equity Sdn Bhd and MTD Chile SA v Chile*, ICSID Case No ARB/01/7, Decision on Annulment (16 February 2007) ('*MTD v. Chile—Annulment*'), para 101.

[104] *Occidental v. Ecuador*, above n. 78, para 665-668.

[105] *Ibid*., para 670.

[106] *Hulley v. Russia*, above n. 55, para 1603; *Yukos v. Russia*, above n. 55, para 1603; *Veteran Petroleum v. Russia*, above n. 55, para 1603. Although the tribunal is not entirely clear on this point, the main dividing line seems to be the causal link between the investor's 'fault' and the State's wrongful act (para 1608) whereas the duty to mitigate damages intervenes in the absence of such causal link and after the State's wrongful act has occurred.

[107] *Copper Mesa v. Ecuador*, above n. 56, para 6.100.

The latter point can be illustrated by reference to the – perhaps exceptional – approach followed by the tribunal in *Al-Warraq v. Indonesia*. In this case, the tribunal found that the State had breached its fair and equitable treatment obligation under the applicable treaty (imported through an MFN clause) and even a provision (Article 14) of the International Covenant on Civil and Political Rights, although the tribunal did not assert jurisdiction over this instrument. However, because of the reckless financial practices of the investor, which the tribunal considered to be in breach of an unusual provision (Article 9) of the applicable treaty requiring the investor to comply with domestic regulations, a majority of the tribunal concluded that 'for this reason [the Claimant] is not entitled to any damages in respect of the Respondent's breaches of the fair and equitable treatment standard'.[108] This is a remarkable development because the treaty clause in question, however unusual, simply states what is in all events obvious, in essence that investors must respect the domestic laws and regulations for the protection of the public interest.[109]

Even in the absence of contributory fault, compensation may be reduced as a result of the investor's *duty to mitigate the damages suffered*. There is an abundant body of cases providing authority to the existence of such a duty.[110] The principle was suitably formulated a case against Slovenia where, discussing mitigation, the tribunal noted that 'general principles of international law applicable in this case require an innocent party to act reasonably in attempting to mitigate its losses' and buttressed this assertion with a reference to the commentary to Article 31 of the ILC Articles.[111] The negligence involved here (*rejected in casu*) relates to the conduct of the aggrieved party when facing the wrongful act. That conduct must remain reasonable[112] and the burden of proving negligence is on the respondent.[113] Of note is that the tribunal is assuming – quite reasonably – that a duty of mitigation normally applicable to States also applies to investors. This is an interesting indication that there may be many other duties

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[108] *Al-Warraq v. Indonesia,* above n. 75, para 683, point 6.

[109] Specifically, Article 9 of the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference, June 1981, states: 'The investor shall be bound by the laws and regulations in force in the host state and shall refrain from all acts that may disturb public order or morals or that may be prejudicial to the public interest. He is also to refrain from exercising restrictive practices and from trying to achieve gains through unlawful means'.

[110] See *Saar Papier Vertriebs GmbH v. Republic of Poland*, Award (16 October 1995), para 98-102; *Middle East Cement Shipping and Handling Co. S.A. v. Egypt*, ICSID Case No. ARB/99/6, Award (12 April 2002), para 166-171; *CME Czech Republic BV v. Czech Republic*, UNCITRAL, Award (14 March 2003), para 482-483; *EDF International SA, SAUR International SA and Leon Participaciones Argentinas SA v. Argentina*, ICSID Case No. ARB/03/23, Award (11 June 2012), para 1302-131; *Hulley v. Russia*, above n. 55, para 1776; *Yukos v. Russia*, above n. 55, para 1776; *Veteran Petroleum v. Russia*, above n. 55, para 1776; *Hrvatska Elektroprivreda D.D. v. Republic of Slovenia*, ICSID Case No. ARB/05/24, Award (17 December 2015), para 215.

[111] *Hrvatska v. Slovenia*, above n. 110, para 215, 386. See also *EDF v. Argentina*, above n. 110, para 1302 (referring to Article 31 of the ILC Articles); *Middle East Cement v. Egypt*, above n. 110, para 167.

[112] See also *Saar Papier v. Poland*, above n. 110, para 98 (implying a duty of due diligence on the investor); *CME v. Czech Republic*, above n. 110, para 482-483; *National Grid plc v Argentina*, ICSID Case No. ARB/[---], Award (3 November 2008), para 273*; EDF v. Argentina*, above n. 110, para 1306; *Achmea B.V. v. Slovak Republic*, PCA Case No. 2008-13, Award (7 December 2012), para 320.

[113] *Saar Papier v. Poland*, above n. 110, para 101.

that, through analogical reasoning, could be extended to govern the conduct of investors. One illustration of the effects of the duty to mitigate – and how far its effects can go – is provided by *EDF v. Argentina*. In this case, the tribunal considered that the investor (EDFI) had failed to its duty to mitigate damage because in selling its shares in the investment vehicle to another shareholder, it kept only its claims in the arbitration and left any possible benefit from a successful renegotiation of the tariff to the buyer of the shares.[114] As a result, the tribunal concluded that an amount equal to 50% of the value of EDFI participation in the vehicle had to be subtracted from the damages awarded.[115]

The concepts reviewed in the foregoing sections provide different entry points capable of integrating the degree of investor diligence or lack thereof in investment proceedings. These instruments have to be assessed in the broader light of the other sources discussed in prior sections. Their combined operation is relevant in both practical and more theoretical terms, as discussed next.

3. Concluding observations - Implications of analysing investor diligence in investment arbitration

The analytical exercise conducted in the preceding sections may strike some as descriptive 'black letter' analysis. That is correct, but precisely because of its technical grounding, some very practical implications can be derived; practical implications with deeper theoretical roots. These concluding observations look at these implications, organised at three levels, from the more theoretical to the more practical, namely the implications (i) for the investor-State asymmetry arising from international investment agreements, which only contemplate obligations for States, (ii) for the still underexplored legal distinction between commercial and political risk, particularly for regulated industries, and (iii) for the operation of an apparently narrow, yet practically fundamental, concept of international investment law, the much debated 'legitimate expectations' under the fair and equitable (FET) standard.

3.1. *Implications for investor-State asymmetry* – There is a body of policy – in some cases activist – literature decrying a system of investment protection where States only have obligations and investors only have rights. There is some truth in such criticism, although from a conceptual perspective it tends to be rather simplistic and not always accurate. One must make two important adjustments in this regard.

Firstly, it is not true that investors do not have any obligations. The sources of foreign investment regulation are not merely treaties but also a wide array of domestic norms, contractual arrangements and an evolving body of customary and treaty-based international norms concerning matters such as corruption, social

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[114] *EDF v. Argentina*, above n. 110, para 1307-1310.
[115] *Ibid*., para 1312.

rights, human (including collective) rights and environmental protection.[116] Overreliance on IIA in both commentary and – as a result – practice may be comfortable, as it allows to excluding significant parcels of knowledge from the analysis, but it comes at a price, even for those highly critical of the investment protection system. In fairness, if one takes into account at the very least domestic law and contractual arrangements, it is inaccurate to state that the investment protection system does not impose obligations on investors. In point of fact, it is the overreliance on IIA that has led to some 'practices' that, in turn, have tended to insulate, on thin legal grounds, investors from their obligations. Some of them include the distinction between treaty and contract claims, which opens the possibility for an investor to exclude its contractual obligations (including a forum selection clause) from an investment arbitration proceeding, or the still poorly articulated relationship between domestic law and international law (narrowly understood as investment treaties), which also serves to downplay the impact of the former to the benefit of the latter. It is therefore a practice, a mindset, shared even by those who criticise the system, which contributes to the impression that investors have no obligations under the system of investment protection.

The second adjustment is that, technically speaking, investors do not have 'rights'. The content of investment protection standards is similar to that of some human or constitutional rights, but technically such standards remain inter-State disciplines. This is not a merely academic point. To mention but one practical implication, a State may well suspend the advantages granted to the investors of the other contracting State on the basis of the *exceptio non adimplenti contractus* (Article 60 of the Vienna Convention on the Law of Treaties[117]). This is because investment treaties are inherently synallagmatic agreements.[118] If investment disciplines were to be analysed instead as human rights, then such suspension would not be lawful. Criticism of the investment protection system has hence

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[116] Viñuales, above n. 5.

[117] Vienna Convention on the Law of Treaties, 23 May 1969, 1155 UNTS 331 ('VCLT')

[118] See e.g. *Barcelona Traction, Light and Power Company, Limited*, Judgment, ICJ Reports 1970, p. 3, para 33 ('When a State admits into its territory foreign investments or foreign nationals, whether natural or juristic persons, it is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded them. These obligations, however, are neither absolute nor unqualified. In particular, an essential distinction should be drawn between the obligations of a State towards the international community as a whole, and *those arising vis-à-vis another State in the field of diplomatic protection*.'(italics added); *Sawhoyamaxa indigenous community c. Paraguay*, ICtHR Series C No 146 (29 March 2006), paras 136, 137, 140 ('The State has put forth three arguments: […] 3) that the owner's right "is protected under a bilateral agreement between Paraguay and Germany[,] which [...] has become part of the law of the land […] Lastly, with regard to the third argument put forth by the State, the Court has not been furnished with the aforementioned treaty between Germany and Paraguay, but, according to the State, said convention allows for capital investments made by a contracting party to be condemned or nationalized for a "public purpose or interest", which could justify land restitution to indigenous people. Moreover, the Court considers that *the enforcement of bilateral commercial treaties negates vindication of non-compliance with state obligations under the American Convention; on the contrary, their enforcement should always be compatible with the American Convention, which is a multilateral treaty on human rights that stands in a class of its own and that generates rights for individual human beings and does not depend entirely on reciprocity among States*'(italics added)).

been quite uncritical by implying, even conceding, that investors have 'rights' under current arrangements.

Once these two adjustments have been made, the unease does not dissipate entirely, however. The investment protection system, as it has operated in practice, may still appear unbalanced. The policy question that arises at this stage is whether introducing internationally imposed obligations on investors would be the best avenue to balance the system. In my view, such an approach would be not only politically very difficult, but in addition it would not provide an adequate response to the root cause of asymmetry, namely the simplistic overreliance on investment treaties. In fact, it would further emphasise such overreliance, as it would imply that any reform must take place at the IIA level. Instead, a change of mindset is necessary, one in which reliance on investment treaties is of course preserved but as part of a wider array of sources of foreign investment regulation; and one in which these different sources, including treaties, are interpreted in a more balanced manner, taking into account the degree of diligence displayed by foreign investors.

3.2. *Investor diligence and commercial/political risk* – The degree of diligence displayed by an investor is very important to determine what must be considered as part of its business or commercial risk and what belongs instead to political risk. I mentioned earlier the case of *MTD v. Chile*, where such a distinction led to a reduction of 50% in the compensation due to the investor.

But the distinction has far deeper implications. In a well known statement, an investment tribunal 'emphasize[d] that Bilateral Investment Treaties are not insurance policies against bad business judgments'.[119] Part of what could be characterised as 'bad' business judgment includes insufficiently informed decisions or negligently assumed risks. Even when the investor has done its utmost to behave diligently, part of its losses may still be due to the 'business risk inherent in any investment'.[120] *A fortiori*, when it has not displayed the necessary diligence, the consequences of its negligence are relevant to characterise loss as part of its commercial risk.

A particularly complex scenario arises in the context of regulated industries and, more specifically, of industries where the market in which the investor operates has been created or heavily relies on regulatory conditions. In such a case, the benefit of the investment is not generated by market conditions under the oversight of the host State but, instead, it is derived from the very regulatory framework. An illustration will help clarify this point. Much like an investor in the consumer goods industry is expected to assess and monitor consumer preferences and choices as part of its business model, an investor in the chemical sector would be expected to understand that the scientific understanding of the impact of different chemical compounds evolves and that such changes may also

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[119] *Maffezini v. Spain*, ICSID Case No. ARB/97/7, Award (13 November 2000), para. 64.
[120] *Ibid*., para 64 in fine.

entail regulatory changes. If any adverse change in the regulatory framework could be argued to be the compensable consequences of political risk, then there would be little or no place for the commercial risk of the investor in the chemical sector. Regulatory change must, however, take place within certain reasonable bounds to be an acceptable exercise of the States regulatory powers.[121] Egregious, arbitrary or unreasonable changes should remain actionable as a matter of political risk. But there is significant room for changes in the conditions of regulated markets that the investor is expected to assess and anticipate, as part of its business judgment, which includes the exercise of due diligence. Absent such diligence, the ability for an investor to invoke the impairment or frustration of its 'reasonable' or 'legitimate' expectations should be extremely limited. As discussed above, the connection between investors' diligence and legitimate expectations is of particular practical importance.

3.3. *Investor diligence and legitimate expectations*[122] - From a more concrete perspective, the degree of investor diligence is not just a question among many others. In order to understand this point it is important to recall what was mentioned in the previous sub-section as well as in sub-section 2.4.3 above, namely that the degree of investor diligence is very important to assess the 'reasonableness' or 'legitimacy' of investors' expectations.

The significance of this point must be appreciated in the light of the broader context of investment arbitration and particularly the relatively recent shift from the use of expropriation clauses as the main ground for investment claims to the use of other investment treatment standards.[123] Unlike expropriation measures, the compensation of which is governed by relatively well settled rules of international law, the shift towards claims based on standards other than expropriation raised the question of how to compensate them or, in other words, what norms govern the determination of compensation in such cases. The question is important because non-expropriatory breaches of international investment law may be more easily established than expropriation. One key requirement in this respect is the need to prove, in a claim for indirect expropriation, that the measure challenged has led to a substantial deprivation of the value of the investment. Absent substantial deprivation, there will be no expropriation. Yet, the measure may still be challenged as a breach of the FET standard, particularly as a measure frustrating reasonable or legitimate expectations.[124]

In the context of the NAFTA, the price for moving away from expropriation and to the international minimum standard of treatment (Article 1105) was that

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[121] See generally Viñuales, above n. 1, chapter 14.

[122] See generally *ibid*.

[123] M. Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press, 2nd edn. 2004), at 315.

[124] For examples of cases where the tribunals rejected the claim for expropriation and granted the claim for breach of the FET standard see P.-Y. Tschanz and Jorge E. Viñuales, 'Compensation for Non-Expropriatory Breaches of International Investment Law: The Contribution of the Argentine Awards' (2009) 26 *Journal of International Arbitration* 729, Appendix I.

the investor could no longer avail itself of the generous and comprehensive rules of compensation for expropriation.[125] The same point was made beyond the NAFTA context by the tribunal in *LG&E v. Argentina*, in connection with the assessment of compensation for a breach of the FET standard in the absence of expropriation.[126] However, in a stream of cases starting with *CMS v. Argentina*,[127] the rules of compensation for expropriation were extended to breaches of FET short of expropriation. In other words, breaches of an investment standard such as FET, which is not subject to the requirement of substantial deprivation of the value of the investment, could be compensated applying the rules of compensation for expropriation.

Against this background, it is easier to understand why the mainstreaming of investor diligence as a way of keeping the doctrine of legitimate expectations within reasonable bounds may be so significant in practice. If claims for breach of the FET standard and, specifically, under the doctrine of legitimate expectations can be more easily proved than expropriation (because they are not subject to the requirement of 'substantial deprivation') and yet be compensated in application of the rules normally applicable to expropriation, then taming such a doctrine through reference to investor diligence can close a critical loophole in the overall law of investment protection. Thus, from a very theoretical to a very practical level, it is important to understand the sources and arguments relating to investor diligence in international investment proceedings.

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[125] *Feldman (Marvin) v. Mexico*, ICSID Case No. ARB (AF)/99/1 (NAFTA), Award (16 December 2002), para 194.

[126] *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Damages Award (25 July 2007), para 35–36.

[127] *CMS Gas Transmission Co. v. Argentina*, ICSID Case No. ARB/01/08, Award (12 May 2005), para 410. The approach was thereafter followed by four other tribunals: *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, Award (14 July 2006), para 419–24; *Enron Corporation and Ponderosa Assets, L.P.* v. *Argentine Republic*, ICSID Case No. ARB/01/3, Award (22 May 2007), para 359–63; *Sempra Energy v. Argentina*, ICSID Case No. ARB/02/16, Award (28 September 2007), para 402–04.