

PART I

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Why Do We Need a Theory of Legitimate  
Expectations?

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Teerawat Wongkaew  
Excerpt  
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## 1

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## Introduction

‘Must a name mean something?’ Alice asked doubtfully.

‘Of course it must,’ Humpty Dumpty said with a short laugh; ‘my name means the shape I am – and a good handsome shape it is, too. With a name like yours, you might be any shape, almost.’

...

‘When I use a word,’ Humpty Dumpty said, in a rather scornful tone, ‘it means just what I choose it to mean – neither more nor less.’

‘The question is,’ said Alice, ‘*whether you can make words mean so many different things.*’

‘The question is,’ said Humpty Dumpty, ‘*which is to be master – that’s all.*’

Lewis Carroll, *Through the Looking Glass and What Alice Found There*<sup>1</sup>

### 1.1 Setting the Scene: Legitimate Expectations in Search of a Principled Justification

Since its inception in the decision of *Tecmed v. Mexico*,<sup>2</sup> the doctrine of legitimate expectations has been pervasively deployed as a legal tool to give legal protection to the investor’s expectations created by the host state’s representation or conduct in the assessment of the fair and equitable treatment standard. Despite the recognition that the doctrine of legitimate expectations has been embedded in investment treaty arbitration,<sup>3</sup> it has become part of international investment law without

<sup>1</sup> L. Carroll, *Through the Looking-Glass and What Alice Found There* (1941), 111–12 (emphasis added), cited in C. Brown, ‘A Comparative and Critical Assessment of Estoppel in International Law’ (1995) 50 *U Miami L Rev* 369.

<sup>2</sup> *Técnicas Medioambientales Tecmed, S.A. v. Mexico*, ICSID Additional Facility Case No ARB (AF)/00/02, Award (29 May 2003) 10 ICSID Rep 134.

<sup>3</sup> R. Dolzer and C. Schreuer, *Principles of International Investment Law* (Oxford: Oxford University Press, 2008) 134 (‘firmly rooted in arbitral practice’); *Electrabel S.A. v. Republic of Hungary*, ICSID Case No ARB/07/19, Decision on Jurisdiction, Applicable Law and

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understanding *why the law should protect legitimate expectations*.<sup>4</sup> What is meant by ‘legitimate expectations’ and what is the underlying rationale are the fundamental questions that have not been properly addressed by arbitral tribunals and legal scholars. It is pertinent to recall the acute observation on this point by F Dupuy and PM Dupuy that ‘after more than ten years of intensive use of this phrase, do we really know what the doctrine of “legitimate expectations” stands for and what purpose it serves?’<sup>5</sup>

It is unclear why there has been little discussion on the underlying rationale of protection of legitimate expectations on the part of arbitral tribunals and legal scholars.<sup>6</sup> Does it seek to protect the investor from the harm caused by its reliance on the state’s conduct to enforce sovereign commitments or to promote the rule of law or prevent abuse of regulatory power or arbitrary or inconsistent conduct? In the absence of such rationale, the tribunals have developed the jurisprudence in a conflicting and unstructured manner.

Nevertheless, one might suggest that the application of the principle seems *in vogue*<sup>7</sup> and so widely recognised in several municipal public laws<sup>8</sup> that it obviates the need for theoretical justification. After all, ‘who could be against the protection of legitimate expectations?’<sup>9</sup> In investment treaty arbitration, the doctrine of legitimate expectations

Liability (30 November 2012) para 7.75 (the ‘most important function’ of the FET standard); *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL Case, Final Award (26 January 2006) Separate Opinion of Professor Walde, para 37 (‘a self-standing subcategory and independent basis for a claim under the “fair and equitable standard” under Art. 1105 of the NAFTA’).

<sup>4</sup> Similar concern in English public law, CF Forsyth, ‘Legitimate Expectations Revisited’ (2011) 16(4) *JR* 429, 430 (‘[I]t seems to me that the time has come to return to fundamentals. So we should ask fundamental questions about the justification and the task of the concept of legitimate expectations.’).

<sup>5</sup> F Dupuy and PM Dupuy, ‘What to Expect from Legitimate Expectations? A Critical Appraisal and Look into the Future of the “Legitimate Expectations” Doctrine in International Investment Law’ in NG Ziadé (ed), *Festschrift Ahmed Sadek El-Koshi* (The Hague: Kluwer Law International 2015), 273.

<sup>6</sup> *AWG Group v. Argentina*, UNCITRAL Case, Decision on Liability (30 July 2010) para 222 (the tribunal discussed ‘the theoretical basis’ of legitimate expectations and cited the work of Max Weber); R Dolzer, ‘Fair and Equitable Treatment: Today’s Contours’ (2014) 12 *Santa Clara J Int’l L* 7, 17 (the author briefly discussed the rationale and justification for the recognition of legitimate expectations).

<sup>7</sup> *EB (Kosovo) v. Secretary of State for the Home Department* [2008] UKHL 41 [2009] 1 AC 1159 at [31], per Lord Scot.

<sup>8</sup> Dolzer, ‘Fair and Equitable Treatment’ (n 6).

<sup>9</sup> Forsyth, ‘Legitimate Expectations Revisited’ (n 4) 429.

can be used to maximise protection to the investor by circumventing the high threshold test of expropriation because it allows ‘a measure of subjective judgment’.<sup>10</sup> The tribunal in *Suez v. Argentina* considered legitimate expectations as ‘an *operational method* for determining the existence or non-existence of fair and equitable treatment’.<sup>11</sup> It is hard to see how an abstract term such as ‘legitimate expectations’ could define ‘fair’ or ‘unfair’ treatment.

It is unfortunate that such metalegal understanding of protection of legitimate expectations cannot be acquired purely from the formalist approach based on the sources of law framework or the use of comparative public laws. The legal question on protection of legitimate expectations has an inherently moral dimension – namely, why a state must keep its promise or else pay compensation for the harm caused by a broken promise. The tribunals have already implicitly engaged in ‘moral reasoning’ in interpreting the rules on legitimate expectations. The moral philosophy of promise would offer invaluable guidance on the doctrine of legitimate expectations. This book proposes to elucidate the core of legitimate expectations from philosophical perspectives with a view to developing a coherent understanding of the doctrine and a normative framework for adjudication of cases.

This introductory chapter explains why a theory of legitimate expectations is needed in investment treaty arbitration and how such theory would improve the current state of law. It sets out the argument of the book and how it will be developed in the chapters that follow.

## 1.2 Three Reasons for a Theory of Legitimate Expectations

First, the questions of what is meant by legitimate expectation and why legitimate expectations should be protected have received little attention. This has resulted in the application of different conceptions of legitimate expectations, which has caused uncertainty and unpredictability in the outcome. Several practical questions have been given conflicting answers. Inconsistencies and poor reasoning are the hallmarks of arbitral decisions dealing with legitimate expectations. Second, following the lack of conceptual clarity, the doctrine of legitimate expectations has seen the so-called grey areas in adjudication of cases and lacks a clear doctrinal

<sup>10</sup> *Thunderbird v. Mexico* (n 3), Separate Opinion of Arbitrator Waelde, para 37.

<sup>11</sup> *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No ARB/03/19, Decision on Liability, Final Award, 30 July 2010, para 203.

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structure. Third, inconsistent application of the principle of legitimate expectations has contributed to the level of legitimacy deficit in investment treaty regime. This problem is highlighted by the fact that arbitral tribunals have rarely engaged in the principled justification of protection of legitimate expectations.

### 1.2.1 *Lack of Conceptual Clarity*

The conceptual ambiguity of the doctrine of legitimate expectations can be illustrated with the following hypothetical situation based on the excerpt at the outset of the chapter.

Alice and Humpty Dumpty meet four distinguished investment treaty arbitrators at the International Centre for Settlement of Investment Disputes (ICSID) in Washington DC. Alice, who wants to reassure herself about Humpty Dumpty's answer from the previous conversation (in the excerpt), curiously asks the arbitrators, 'Must a word like "legitimate expectations" mean something, and can you make it mean so many different things?'

Upon reflection and recollection of the investment treaty jurisprudence, four arbitrators give four different answers. The first arbitrator tells her that 'legitimate expectations' means that the investor can expect the host state to act transparently and consistently,<sup>12</sup> as well as to ensure the stability of legal framework.<sup>13</sup> The second one explains that the doctrine of legitimate expectations is about the host state's acting in a non-arbitrary<sup>14</sup> or non-discriminatory<sup>15</sup> manner. The third displays the mastery of the obvious by suggesting that the investor can expect to be treated fairly and equitably.<sup>16</sup> The fourth one explains in a learned manner: 'yes, in real life, people have different expectations because they have different conceptions of present reality and the future; they are also influenced by different values, experiences and circumstances.

<sup>12</sup> *Tecmed v. Mexico* (n 2) para 154.

<sup>13</sup> *Frontier Petroleum Services Ltd v. Czech Republic*, UNCITRAL Case, Final Award (12 November 2010), para 285.

<sup>14</sup> *Alpha Projektholding GmbH v. Ukraine*, ICSID Case No ARB/07/16, Award (8 November 2010) para 420 ('this means, in part, that governments must avoid arbitrarily changing the rules of the game in a manner that undermines the legitimate expectations of, or the representations made to, an investor').

<sup>15</sup> *Saluka Investments BV (The Netherlands) v. Czech Republic*, UNCITRAL Rules, Partial Award (17 March 2006) para 321.

<sup>16</sup> *Ibid* para 446 ('the host State, in providing State aid, is clearly bound not to frustrate an investor's legitimate and reasonable expectation to be treated fairly and equitably').

The principle of legitimate expectations does not mean that every legitimate expectation should be protected. The challenge is how to decide which expectation should come under its protection. My view is that legitimate expectations must have a specific meaning – and in the context of investor–state dispute, legitimate expectations occur when the state has caused harm to the foreign investor by not keeping its promise made to that investor.<sup>17</sup> But I must leave the explanation for another time. Well done, Alice; you asked the question that even my colleagues or experts rarely address’. Alice is perplexed by these four answers. Humpty Dumpty comes and reminds her once more of the words of wisdom, ‘*which is to be master – that’s all*’. The doctrine of legitimate expectations has been applied to mean different things. This book simply seeks to identify the master meaning.

### 1.2.2 *Lack of Doctrinal Structure and the Adjudicative Problem*

The law of legitimate expectations lacks a clear doctrinal structure and conceptual guidance for resolving the ‘grey areas’.<sup>18</sup> Some issues can be mentioned: can a state create a legitimate expectation without explicit promise? Is detrimental reliance required? To what extent is the investor’s own conduct relevant in the assessment of its legitimate expectations? In what circumstances can investors legitimately expect legal stability? Let us take just the first issue to illustrate that we may get different answers depending on which decision we look at. It might not be an exaggeration to characterise the doctrine of legitimate expectations as ‘little more than a mechanism to dispense palm-tree justice’.<sup>19</sup>

Some arbitral decisions suggest that legitimate expectations can only arise where there is a specific promise or representation or certain conduct. However, even within this category, there are different views on whether expectations must derive from legal commitment or if it suffices to have a specific representation or consistent conduct.

<sup>17</sup> Some investment treaty decisions which suggest the reliance approach include *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL Case, Final Award (26 January 2006); *AWG Group v. Argentina*, UNCITRAL Case, Decision on Liability (30 July 2010); *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, SCC Case No V (064/2008), Final Award (8 June 2010).

<sup>18</sup> Dupuy and Dupuy, ‘What to Expect from Legitimate Expectations?’ (n 5) 290–93.

<sup>19</sup> J Watson, ‘Clarity and Ambiguity: A New Approach to the Test of Legitimacy in the Law of Legitimate Expectations’ (2010) 30(4) *LS* 633, 651.

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The other decisions suggest that legitimate expectations can arise without assurance or the state's conduct because the law should provide protection when the investor 'could reasonably expect' it.<sup>20</sup> Furthermore, there are tribunals who employ the term 'legitimate expectations' in a rhetorical or tautological manner,<sup>21</sup> which does not add much to the legal analysis.

Some scholars have argued that the doctrine of legitimate expectations as an 'essentially contested concept'<sup>22</sup> cannot adjudicate the case 'as an arbiter of the controversy'<sup>23</sup> because there are disagreements over the exact meaning of the concept.<sup>24</sup> It is claimed that 'the principle of protecting reasonable expectations provides a signpost that points down the right road, but it does not provide a map to the end'.<sup>25</sup> However, the important premise of the book is that the underlying principles will provide invaluable guidance to resolve difficult questions regarding the extent to which the law protects the investor's legitimate expectations.<sup>26</sup>

### 1.2.3 Legitimacy Deficit and Protection of Legitimate Expectations

Arbitral tribunals have never explained why fair and equitable treatment should embrace protection of the investor's legitimate expectations. In many instances the doctrine has been applied to challenge the exercise of sovereign powers. Therefore, the continued application of the doctrine of legitimate expectations, which has no clear juridical basis or principled justification, will undermine the legitimacy of investment treaty arbitration.<sup>27</sup> This is not least because protection of legitimate

<sup>20</sup> *Saluka v. Czech Republic* (n 15) para 329.

<sup>21</sup> *Franck Charles Arif v. Republic of Moldova*, ICSID Case No ARB/11/23, Award (8 April 2013) para 533 (noting 'a certain easy circularity of argument' based on legitimate expectations in that an investor can postulate an expectation to condemn the sovereign conduct without articulation of the origins and scope of expectations).

<sup>22</sup> W Connolly, *The Terms of Political Discourse* (Princeton, NJ: Princeton University Press, 3rd edn, 1993), 10.

<sup>23</sup> BH Kuklin, 'The Justification for Protecting Reasonable Expectations' (2001) 29(3) *Hofstra L Rev* 863, 865.

<sup>24</sup> BH Kuklin, 'The Plausibility of Legally Protecting Reasonable Expectations' (1997) 32 *Val U L Rev* 19, 21.

<sup>25</sup> *Ibid* 33.

<sup>26</sup> P Reynolds, 'Legitimate Expectations and the Protection of Trust in Public Officials' (2011) *PL* 330; Forsyth, 'Legitimate Expectations Revisited' (n 4) 429.

<sup>27</sup> M Sornarajah, *Resistance and Change in the International Law on Foreign Investment* (Cambridge: Cambridge University Press, 2015), 299 ('The tribunal ceases to have



expectations has featured in almost all claims concerning the fair and equitable treatment standard. Its prominent role in the investment treaty arbitration, if misused, contributes significantly to the criticism of the investment treaty regime. Furthermore, given that the investment treaty regime has been undergoing a period of reflection and reform,<sup>28</sup> it is timely to rethink about the proper role and function of the doctrine of legitimate expectations.

### 1.3 The Argument: Protection against Detrimental Reliance as the Core of Protection of Legitimate Expectations

This book aims to develop a theory for protection of legitimate expectations in investment treaty arbitration from the philosophical perspectives based on the moral philosophy of promise. It defends a reliance conception of legitimate expectations – namely, that the fundamental purpose of the principle is to protect the investor against the harm that it has suffered from reasonably relying on the expectations created by the state's promise. In other words, the principle of legitimate expectations seeks to protect reliance interests rather than expectation interests of the investor.

Prior to setting out the discourse towards the theory of legitimate expectations, the book critically assesses the current approaches to the doctrine of legitimate expectations adopted by arbitral tribunals and legal scholars, which mainly focus on the sources of international law framework in Article 38(1) of the Statute of the International Court of Justice. The continued justification of legitimate expectations based on a general principle of law or good faith does not offer useful guidance to solve difficult cases of legitimate expectations that raise moral and political dimensions. The scholars' works take the protection of legitimate expectations as a self-evident premise and promptly proceed to enquire into *what expectations* to protect, often with the aid of comparative public laws.<sup>29</sup> Scholars and tribunals overlook the wisdom of the theory of

legitimacy and the law it formulates itself is not founded in authority. It is this double illegitimacy that taints the use of the rule on legitimate expectations. Its continued use will undermine investment arbitration even further'.).

<sup>28</sup> UNCTAD IIA Issues Note, 'Reform of the IIA Regime: Four Paths of Action and A Way Forward' (No 3, June 2014) 2.

<sup>29</sup> Textbooks on the doctrine of legitimate expectations in English laws include Soren Schönberg, *Legitimate Expectations in Administrative Law* (Oxford: Oxford University Press, 2000); R Thomas, *Legitimate Expectations and Proportionality in Administrative Law* (Oxford: Hart Publishing, 2000); R Moules, *Actions against Public*

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judicial borrowing,<sup>30</sup> which cautions us that the purpose and rationale of rules should be identified before any meaningful borrowing of rules is possible. Dworkin's wisdom – 'analogy without theory is blind'<sup>31</sup> – confirms this.

Having set out the need for a theory of legitimate expectations and refuted the current approaches to legitimate expectations, the second part of the book develops a theory of legitimate expectations based on the alternative methodology in the moral philosophy of promise. The main argument is that protection of legitimate expectations should be based on a theory of detrimental reliance. The argument is substantiated in three steps.

First, Chapter 3 sets out the theoretical foundations for the use of moral philosophy in developing a theory of legitimate expectations. The important premise of this book is that understanding the phenomenon and reason for liability from the moral philosophy perspectives of promissory obligation will help us understand the doctrinal structure of an obligation to protect legitimate expectations. The underlying idea behind this chapter is that if we could understand how 'promise' or similar notions could create an obligation, we would be able to explain the mystery of how the state could incur an obligation from frustrating the investor's expectations.

The notion of 'promise' is at the heart of legitimate expectations cases. Investment treaty tribunals even employ the term 'promise' and other similar notions, such as 'assurance', 'commitment' and 'representation', as the 'legal' threshold for determining liability for breach of legitimate expectations, without explaining how those acts can generate an obligation. Why is an expectation based on a specific representation more 'legitimate' than a vague promise? It seems intuitively right that when the state makes a promise, which has created the expectation and is subsequently frustrated, there is something unfair or morally wrong about it. The use of these terms in laws without articulating the phenomenon of liability creates confusion and reveals ambiguity of thought.<sup>32</sup>

*Officials: Legitimate Expectations, Misstatements and Misconduct* (London: Sweet & Maxwell, 2009). One comparative law book which includes a discussion of French law is S Calmes, *Du principe de protection de la confiance légitime en droits allemand, communautaire et français* (Nouvelle bibliothèque de thèses) (Paris: Dalloz 2001).

<sup>30</sup> The issue of judicial borrowing is discussed in Chapter 2.

<sup>31</sup> R Dworkin, 'In Praise of Theory' (1997) 29 *Ariz St LJ* 353, 371 ('an analogy is a way of stating a conclusion, not a way of reaching one, and theory must do the real work').

<sup>32</sup> P Millett, 'Equity's Place in the Law of Commerce' (1998) 114 *LQR* 214, 225 ('misuse of language often conceals a confusion of thought').