

Original Paper

A Study on the Application of Investors' Reasonable Expectations in the Fair and Equitable Treatment Clause

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Received: March 4, 2026 Accepted: March 16, 2026 Online Published: March 18, 2026

doi:10.22158/elp.v9n1p237

URL: <http://dx.doi.org/10.22158/elp.v9n1p237>

Abstract

The fair and equitable treatment clause is a core provision of modern international investment agreements. As the central criterion for the interpretation and application of this clause, the concept of an investor's legitimate expectations originates from the principle of protection of legitimate expectations in domestic administrative law and has evolved through arbitration practice into a key basis for determining whether a host state has breached its obligations. Due to the absence of clear and uniform rules for its determination, its application faces challenges such as inconsistent standards, excessive expansion of scope, and an imbalance between the interests of investors and host states, thereby encroaching upon the host state's regulatory sovereignty. This paper examines the underlying theories and logical connections between the two concepts. Addressing the practical challenges, it proposes pathways including the clarification of constituent elements, the delineation of boundaries for application, the standardisation of interpretative methods, and China's response strategies. These aim to provide support for balancing investor rights with the host state's regulatory authority, contribute to the improvement of the international investment legal framework, and align with China's requirements for the development of its foreign-related legal system.

Keywords

fair and equitable treatment, legitimate expectations of investors, international investment arbitration, host state regulatory authority

1. Introduction

Against the backdrop of deepening economic globalisation and the liberalisation of international investment, the fair and equitable treatment clause—owing to its abstract and inclusive nature—has become one of the most frequently invoked provisions by foreign investors in asserting their rights and

by arbitral tribunals in adjudicating international investment disputes. The principle of the investor's legitimate expectations was not expressly created by international investment agreements, but was gradually developed through early international investment arbitration practice. Initially serving as an auxiliary tool for interpreting the fair and equitable treatment clause, it has progressively evolved into a core element of that clause, and in some arbitral awards has even been equated with the obligation of fair and equitable treatment itself. The original intent behind establishing the principle of legitimate expectations was to protect the legitimate reliance formed by foreign investors based on the host state's laws, policies and commitments, and to uphold the stability and predictability of the international investment environment. However, legitimate expectations are not an independent right expressly provided for in international investment agreements, but rather an implied obligation deduced by arbitral tribunals from the fair and equitable treatment clause through legal interpretation. This "judicial law-making" approach to rule-formation, whilst to some extent remedying the ambiguity of treaty texts and resolving adjudication dilemmas in certain practical disputes, has also given rise to numerous issues: some arbitral tribunals have unduly expanded the scope of application of reasonable expectations, deeming the host state's normal public policy adjustments and regulatory actions to be in breach of the obligation of fair and equitable treatment, thereby severely restricting the host state's scope for public regulation; conversely, other tribunals have strictly narrowed the criteria for recognising reasonable expectations, placing undue emphasis on the host state's sovereignty, which has resulted in investors' legitimate expectations failing to receive effective protection and has weakened the strength of international investment protection.

In most of the investment agreements China has signed to date, the provisions on fair and equitable treatment are rather vague and lack clear limitations on investors' legitimate expectations. For example, whilst the Regional Comprehensive Economic Partnership (RCEP), to which China is a signatory, refers to a "predictable, transparent and stable business environment" in its preamble, it does not contain specific provisions regarding investors' legitimate expectations in the investment chapter. This ambiguity means that, when interpreting FET clauses, arbitral tribunals may interpret the preamble expansively to impose an obligation to protect investors' legitimate expectations, thereby broadening the scope of China's obligations. Zheng Zhuqing (2024) (Zheng, Z. Q., 2024, pp. 66-73). As a major player in global two-way investment, China holds a dual role as both an investor-sending country and a host country. Consequently, examining the interpretation of investors' legitimate expectations regarding fair and equitable treatment in the investment treaties China has concluded with other nations is of significant importance. When addressing relevant arbitration cases, China requires clearer and more reasonable interpretative standards to safeguard its legitimate rights and interests, whilst also creating a stable, transparent and predictable investment environment for both domestic and foreign investors, thereby promoting the healthy development of international investment.

2. Foundational Theory of Fair and Equitable Treatment and Investor's Reasonable Expectations

2.1 The Legal Positioning of the Fair and Equitable Treatment Clause

Fair and equitable treatment is the most representative absolute standard of treatment in international investment agreements, differing from relative standards such as national treatment and most-favoured-nation treatment. Its core requirement is that the host state, when dealing with foreign investors and their investments, should act in good faith, refrain from arbitrary or discriminatory conduct, and provide foreign investors with a stable, transparent and predictable legal and policy environment, thereby safeguarding their legitimate rights and interests against unlawful infringement. Judging from the text of existing international investment agreements, fair and equitable treatment clauses can be broadly categorised into three types: firstly, purely abstract clauses, which merely stipulate in principle that “the host state shall accord fair and equitable treatment to foreign investors and their investments”, without imposing any additional limitations on their meaning or scope of application; secondly, clauses linked to international law, which tie the fair and equitable treatment clause to the minimum standard of treatment for foreigners under customary international law, explicitly stating that the application of the fair and equitable treatment clause must not fall below the minimum protection requirements for foreigners under customary international law; thirdly, the enumerative type, which explicitly lists the specific elements encompassed by the fair and equitable treatment clause within the treaty, such as due process guarantees, the prohibition of arbitrary acts, and the protection of investors' legitimate expectations, thereby rendering the application of the fair and equitable treatment clause more precise.

In terms of its legal positioning, the fair and equitable treatment clause has evolved from a “minimum standard” to an “independent and autonomous standard”. Early arbitration practice tended to equate fair and equitable treatment with the minimum standards of customary international law, finding a breach of contract only where the host state engaged in egregious conduct such as denial of justice or severe discrimination; in recent years, arbitral tribunals have increasingly adopted the independent standard theory, holding that fair and equitable treatment possesses its own normative content, with its scope of protection covering investors' legitimate expectations, policy stability and procedural fairness, among other aspects. This shift has created scope for the application of the principle of legitimate expectations. Studies by Zuo Haicong et al. (2022) (Zuo, H. C., & Yan, X., 2022, pp. 70-82, pp. 158-15).

2.2 The Scope and Theoretical Origins of an Investor's Reasonable Expectation

An investor's reasonable expectation refers to the legitimate expectations formed by a foreign investor prior to making an investment decision, based on explicit commitments made by the host state's authorities, publicly available laws and policies, a stable legal framework, or specific official acts, concerning the investment environment, the protection of rights, and the realisation of returns. Such expectations serve as the direct basis for the investor's decision and should be respected and protected by the host state. Its core characteristics are primarily reflected in three aspects: firstly, objectivity; the

investor's expectation must be based on identifiable and verifiable official acts of the host state (such as statutory provisions, policy documents, official commitments, etc.), rather than the investor's subjective assumptions or unilateral conjecture; secondly, reasonableness: such expectations must meet the standards of a generally rational investor, be compatible with the host state's legal order and public interest, and must not contravene public policy or the host state's core interests; thirdly, relevance: there must be a direct causal relationship between the investor's reasonable expectations and the investment decision, and a legal causal link between the failure of those expectations and the host state's conduct, thereby resulting in loss to the investor.

From a theoretical perspective, the principle of an investor's reasonable expectation is not an indigenous rule of international investment law, but rather derives from the principle of protection of legitimate expectations in domestic administrative law, representing an extension and application of that principle to the field of international investment. In common law jurisdictions, reasonable expectation is one of the fundamental principles of administrative law. Its core requirement is that administrative authorities must honour the commitments they have made, maintain consistency and stability in administrative acts, and refrain from arbitrarily altering or revoking administrative acts that have taken effect, thereby protecting the legitimate expectations of those subject to administrative acts; In civil law jurisdictions, the principle of protection of legitimate expectations serves a similar purpose, emphasising that public authorities must not abuse their powers or act capriciously, but must respect the reasonable reliance of citizens and legal entities on their administrative acts, thereby upholding the stability of the legal order. International investment tribunals have introduced the principle of protection of legitimate expectations from domestic administrative law into the field of international investment law, essentially to constrain the sovereign regulatory actions of host states and prevent them from exploiting their regulatory powers to harm the legitimate rights and interests of foreign investors, thereby aligning with the core values of international investment protection (Liu, S., 2022, pp. 155-176, p. 208).

2.3 The Logical Connection between Reasonable Expectations and the Fair and Equitable Treatment Clause

There is a close logical connection between investors' reasonable expectations and the fair and equitable treatment (FET) clause, presenting the relationship of "content and carrier". On one hand, the FET clause serves as the legal carrier and basis for the application of IRE (Investor Rights Enforcement). In cases where international investment agreements do not explicitly stipulate investors' reasonable expectations, tribunals derive the host state's implied obligation to protect investors' reasonable expectations through legal interpretation of the abstract connotations in the FET clause such as "fairness," "justice," "good faith," and "stability," thereby providing a basis for the application of reasonable expectations under international law. On the other hand, reasonable expectations serve as a tool for applying the FET clause, transforming abstract requirements of fairness and equity into concrete adjudicative standards, and determining whether the host state has violated the FET obligation

by assessing whether reasonable expectations have been infringed.

From the practice of international investment arbitration, violations of investors' reasonable expectations have become one of the typical scenarios for finding that a host state has breached its FET obligations. If the host state arbitrarily revokes investment incentive policies, changes relevant laws, or goes against its official commitments after an investor has made an investment, causing the investor's reasonable expectations to be disappointed and resulting in losses, this constitutes a violation of the FET clause. At the same time, it should be clarified that reasonable expectations are not the sole core element of the FET clause. Prohibitions on arbitrary conduct, guarantees of due process, and rejection of judicial injustice are all important connotations of the FET clause. The application of reasonable expectations should cooperate with and complement other elements, avoiding the situation where tribunals rely solely on reasonable expectations as the basis for judgment, which could lead to a one-sided standard of adjudication (Lin, Y. P., & Zhu, Y., 2020, pp. 72-89).

3. Practical Challenges in the Application of Investors' Reasonable Expectations

3.1 Inconsistent Standards of Determination and Lack of Consistency in Arbitral Awards

Currently, international investment arbitration lacks uniform standards regarding the determination of reasonable expectations, resulting in fragmented outcomes. This is primarily manifested as follows: on the one hand, there are significant divergences among arbitral tribunals regarding the scope of the basis for such determinations; some tribunals regard the host state's policy statements or guidance as the foundation for reasonable expectations, whilst others strictly require that the basis must be a specific, clear and legally binding official commitment; On the other hand, there is also controversy regarding the criteria for assessment. Some tribunals focus on the investor's subjective perception, holding that an expectation arising from the investor's own perception may be recognised as a reasonable expectation provided it possesses a certain degree of reasonableness; other tribunals, however, emphasise objectivity, using the perception of a "reasonable investor" as the benchmark, whilst also taking into account the host state's legal framework and public interest. This uncertainty regarding the criteria for such determinations not only increases investment risks for foreign investors but also undermines the credibility and authority of international investment arbitration (He, Y., & Gu, F., 2023, pp. 229-237).

3.2 Excessive Expansion of The Scope of Application, Encroaching upon the Host State's Regulatory Sovereignty

Some arbitral tribunals, adhering to an "investor-centric" approach, have excessively broadened the scope of legitimate expectations, characterising the host state's normal public regulatory actions as breaches of contract. For instance, in cases involving environmental protection, public health and financial stability, tribunals have disregarded the host state's regulatory authority, ruling that a breach has occurred solely on the grounds that the investor anticipated suffering harm, whilst ignoring national sovereignty and the public interest. This tendency has provoked strong dissatisfaction among developing countries, which view legitimate expectations as a tool to restrict their economic

sovereignty, thereby contravening the principle of balance in international investment law (Yan, X., 2022, pp. 121-133).

3.3 Weak Theoretical Foundation and Questions Regarding the Legitimacy of the Rule

The theoretical foundation of the principle of investors' legitimate expectations is relatively weak, and its legitimacy in international investment law has always faced considerable skepticism. From the perspective of international law sources, this principle originates from the principle of reliance protection in domestic administrative law, lacking both explicit support from international customary law and a unified basis in treaty law, which makes its applicability highly controversial. Although some scholars support the view that "a core component of fair and equitable treatment is legitimate expectations," many others believe that the necessary link between the two has not been fully demonstrated. For example, Basaran (2024) (Basaran, H. R., 2024, pp. 77-100) explicitly points out that the current international legal system has not yet developed to the stage of establishing investors' legitimate expectations as a "general principle of law," and its protection lacks general legal reasoning support. In his view, neither explicit provisions in international treaties nor commonly accepted legal practices across countries provide sufficient general basis for the principle of legitimate expectations, and therefore it should not be regarded as a legally binding principle with universal force.

3.4 Imbalance between Investor and Host State Interests, and Unreasonable Allocation of the Burden of Proof

Current application rules are overly biased towards investor protection, neglecting the host state's right to development and the public interest. Investors may claim that their legitimate expectations have been breached without being required to undertake excessive due diligence; conversely, when the host state implements regulation in the public interest, it bears a strict burden of proof to demonstrate the necessity, reasonableness and non-discriminatory nature of its actions. This imbalance leads to the host state adopting a conservative and markedly constrained approach when formulating public policy, thereby hindering the realisation of the public interest.

4. Approaches to Refining the Application of Investors' Reasonable Expectations

4.1 Clarifying the Constituent Elements and Standardising Adjudication Criteria

To resolve issues of inconsistent application, the normative elements constituting reasonable expectations should be clarified through refinements to treaty texts and a review of arbitral precedents: firstly, strictly limiting the basis of expectations to recognise only specific, explicit and authoritative official commitments or legal acts made by the host state, excluding general policy statements and unofficial expressions of intent; secondly, the investor's duty of good faith and due diligence should be reinforced, with reasonable due diligence serving as a necessary prerequisite for establishing the legitimacy of the expectation; thirdly, an objective standard for assessing reasonableness should be established, using the typical understanding of a rational investor as the benchmark, whilst taking into account the host state's legal framework and public policy; fourthly, the rules governing causation

should be clarified, excluding losses resulting from purely market risks or the investor's own operational negligence.

4.2 Defining the Scope of Application and Respecting the Host State's Regulatory Authority

Establishing an exception for the public interest, recognising that regulatory actions taken by the host state in good faith, in a non-discriminatory and proportionate manner for the purposes of national security, public health, the environment and economic stability do not constitute a breach of contract. At the same time, the "principle of proportionality" is introduced, requiring the host state, when altering policies, to select the approach causing the least harm to investors, fulfil procedural obligations such as notification, consultation and transitional arrangements, and balance regulatory needs with investment protection. Furthermore, it is made clear that investors may not expect the host state to maintain legal and policy frameworks that remain permanently unchanged, and must reasonably bear normal regulatory risks (Qin, X. J., 2021, pp. 189-200).

4.3 Standardising Interpretation Methods and Strengthening the Legal Foundation

Strict adherence to the rules of interpretation under international law is required to prevent arbitral tribunals from engaging in excessive law-making. In accordance with the methods of interpretation established by the Vienna Convention on the Law of Treaties—namely, text, context, purpose and object—reasonable expectations should be positioned as an intrinsic element of fair and equitable treatment, rather than as a new right independent of the treaty text. By standardising the interpretative approach, the principle of reasonable expectations can be provided with a more robust legal foundation, thereby enhancing the normativity and consistency of its application. Secondly, efforts should be made to systematically review and consolidate precedents in international investment arbitration, fostering a relatively stable consensus on interpretation. A mechanism for referencing arbitration precedents should be established to guide arbitral tribunals in drawing upon the reasoning of past similar cases when adjudicating matters, thereby reducing discrepancies in rulings and enhancing the consistency and standardisation of the application of the IRE. By standardising the path of legal interpretation, the principle of investor's legitimate expectations can be provided with a more robust foundation in international law, thereby enhancing the legitimacy of its application in the field of international investment (Wang, Y. Z., 2015, pp. 147-157).

4.4 Balancing Rights and Obligations, and Refining the Allocation of the Burden of Proof

To address the imbalance of interests between investors and host states, the relationship between the rights and obligations of both parties should be restructured, and the rules governing the allocation of the burden of proof should be refined to achieve a balanced protection of their respective interests. With regard to the allocation of rights and obligations, it should be made clear that the rights and obligations of investors and host states are reciprocal. Whilst investors enjoy the right to protection of legitimate expectations, they must fulfil obligations such as due diligence, compliant operations, and respect for the host state's laws, policies and public interest; whilst host states enjoy regulatory sovereignty, they must fulfil responsibilities such as treating investors in good faith, maintaining policy

stability, and promptly fulfilling notification and consultation obligations. Regarding the allocation of the burden of proof, the fundamental principle of “he who asserts must prove” should be established to achieve a balanced distribution of the burden of proof: investors should bear the initial burden of proof, demonstrating that their claimed legitimate expectations have a legal basis, that their investment decisions were made in good faith, and that the host state’s actions caused those expectations to be frustrated and resulted in losses; the host state, in turn, may raise defences regarding the public interest objectives of its actions, the necessity of regulation, procedural fairness and proportionality, and shall bear the corresponding burden of proof to demonstrate that its actions do not constitute a breach of the obligation of fair and equitable treatment. At the same time, the principle of risk assumption should be established, clarifying that investors must be aware of and bear general legal and policy risks at the time of investment; they may not subsequently claim that the host state has breached the duty of reasonable expectations on the grounds that such risks led to the failure of their expectations. A balanced allocation of rights and obligations, coupled with a mechanism for the allocation of the burden of proof, will help to ensure fairness and impartiality in international investment arbitration and prevent the proliferation of unreasonable claims.

4.5 China’s Response Strategy

As a major global importer and exporter of capital, China should uphold a stance of balanced protection, sovereignty first, and rule-based governance regarding the issue of legitimate expectations. At the level of treaty practice, China should, during the negotiation and conclusion of international investment agreements such as bilateral investment treaties and free trade agreements, clarify the definition, scope and boundaries of application of FET clauses; objectify and circumscribe investors’ legitimate expectations; explicitly list the criteria for determining IRE and the applicable exceptions; and reject any expansive interpretation of IRE by arbitral tribunals. At the same time, a joint interpretation mechanism between the contracting parties should be introduced to stipulate that, in the event of a dispute regarding the interpretation of FET clauses and IRE, the contracting parties shall jointly provide an interpretation, thereby preventing arbitral tribunals from deviating from the parties’ legislative intent and undermining China’s national interests. Furthermore, public interest exceptions and the principle of proportionality should be explicitly incorporated into the agreements to strengthen the host state’s regulatory sovereignty and provide legal safeguards for China to implement public policies and safeguard the public interest.

At the domestic legal level, relevant provisions regarding policy commitments, protection of legitimate expectations and compensation for expropriation in the Foreign Investment Law of the People’s Republic of China and its implementing regulations should be further implemented. The procedural mechanisms and compensation mechanisms for adjustments to foreign investment policies should be improved, with clear conditions, procedures and compensation standards established for policy adjustments by the host country, thereby reducing the occurrence of international investment disputes at source. At the same time, a robust response mechanism for international investment arbitration

should be established and improved. Research and analysis of international investment arbitration cases should be strengthened, and a risk early-warning system should be put in place to enhance the dispute resolution capabilities of government departments and enterprises, enabling a timely response to various international investment arbitration cases and safeguarding national sovereignty and the public interest.

With regard to the protection of overseas investments, greater guidance and support should be provided to Chinese enterprises investing abroad. Enterprises should be guided to strengthen their compliance awareness and due diligence capabilities. Before making overseas investment decisions, they should fully assess the legal, policy, political and regulatory risks in the host country, reasonably anticipate changes in the investment environment, and avoid creating unreasonable expectations. At the same time, enterprises should be encouraged to utilise tools such as overseas investment insurance and protection under bilateral investment treaties to safeguard their legitimate rights and interests, thereby achieving a balance between risk prevention and the protection of interests, and supporting the high-quality development of Chinese enterprises “going global”.

5. Conclusion

This paper conducts a systematic study on the application of the investor’s legitimate expectations within the Fair and Equitable Treatment (FET) clause. It examines the foundational theories, core concepts and intrinsic logical connections between the FET clause and the Investor-State Dispute Settlement (ISDS) mechanism, analysing the prominent challenges in the practical application of IRE, such as inconsistent standards of recognition, excessive expansion of scope, weak theoretical foundations and imbalances of interests. It proposes pathways for improvement in terms of constituent elements, scope of application, methods of interpretation, burden of proof and China’s response strategies, offering both theoretical value and practical guidance.

Compared with existing research, this paper not only acknowledges the central role of investors’ reasonable expectations in the application of FET clauses but also objectively analyses the challenges in their application. It moves beyond a singular research perspective to balance the dual needs of international and domestic law, as well as those of capital-importing and capital-exporting countries. By refining the improvement pathways into specific dimensions such as constituent elements, burden of proof and methods of interpretation, the paper enhances the practicality of the proposed solutions. At the same time, this paper has certain research limitations: it does not sufficiently explore the differences in the application of IRE across countries with different legal systems and in different types of international investment disputes; it pays insufficient attention to the issue of determining IRE in new investment fields such as the digital economy and green investment; and it does not adequately consider the differing interests of countries at different levels of development.

At present, reforms to international investment dispute resolution mechanisms are being vigorously advanced, and the international community's need for unified rules governing the application of IRE is becoming increasingly urgent. In the future, the international community should strengthen multilateral cooperation to promote the clarification of IRE application rules within multilateral investment agreements, thereby achieving the objectification and delimitation of IRE application; China should actively participate in the formulation and refinement of international investment rules, optimise the design of relevant treaties, strengthen the alignment between domestic rule of law and international investment rules, and refine its response strategies. Future research could focus on new investment areas such as the digital economy and green investment, strengthen comparative analysis of transnational arbitration cases, and explore in depth the interests of countries at different stages of development. This would further optimise the rules and pathways for applying IRE, promote the application of reasonable investor expectations to strike a balance between investor rights and the host state's regulatory authority, contribute to the stable development of the international investment legal system, and provide stronger legal safeguards for global investment cooperation.

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