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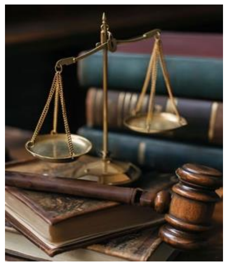

A Theoretical and Doctrinal Study of Investor Due Diligence in International Investment Arbitration

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ABSTRACT

Investor prudence obligations are crucial in international investment arbitration, yet their application faces challenges due to unclear and inconsistent standards set by arbitral tribunals. This inconsistency stems from the concept of investor prudence obligations being derived from the broader notion of prudential obligations, which primarily focus on States as the subjects of regulation. Consequently, applying these obligations to non-State actors, like investors, presents inherent difficulties. Moreover, the theoretical frameworks employed by arbitral tribunals often fail to address the specific needs of investor prudence obligations within this context. The obligations have evolved, influenced by the interactions between sovereign States and investors, leading to a shift in their functional positioning and boundaries. To enhance the normative expression of these obligations, it is essential to align them with the operational logic of existing jurisprudence. Key considerations should include the investor's identity, economic capacity, and the host country's social environment, which affect their control over risks. Additionally, tribunals should differentiate between various stages of legal relations, assessing both the investor's and host country's risk control capacities, to establish case-specific standards for prudential obligations.

Keywords: International Investment Arbitration; Investor Duty of Prudence; Investment Protection; Sovereign Interests; Predictability.

1. Introduction

In recent years, the question of how to balance host countries and foreign investors within the framework of international investment law has become central to the reform of international investment arbitration. With the rise of multinational enterprises, there is a growing consensus in the international community that investors must assume corresponding obligations when they enjoy the investment treatment given by the host country. The current general lack of normative provisions directly and explicitly regulating investors in investment treaties has resulted in arbitral tribunals often facing an awkward situation at the level of international law when deciding on the wrongful conduct of investors, instead having to apply the domestic law of the host country.[1]

To alleviate these difficulties, some arbitration tribunals have introduced the normative concept of investor prudence obligations in their decisions. At the application path level, most arbitral tribunals have incorporated investor prudential obligations into the regulated range of the entity's provisions by treaty interpretation. For example, the "compliance with the laws of the host country" clause requires that the investor's entire investment process be conducted in strict conformity with the rules and regulations of the host countries; otherwise, he or she will not receive the investment treatment he or she deserves. The protection of investors' reasonable expectations under the "fair and equitable treatment" clause is also a prerequisite for the fulfilment of the investor's prudential obligations. Such a paradigm of interpretation was also recognized by most arbitral tribunals in subsequent arbitral practice.

However, the consistency of the review model with the arbitral conclusion does not mean that the application of investor prudence obligations in international investment arbitration is clear enough. Quite the contrary, the reasons why the duty of prudence, as a legal norm that began in the field of public international law, could apply to non-State actors in the context of international investment arbitration, its legal construction and how the expression of the norm should be

[1] See Jean-Michel Marcoux, ***"Transnational Public Policy as an International Practice in Investment Arbitration"***, Journal of International Dispute Settlement, Volume 10, Issue 3, September 2019, pp 496 - 497.

determined were not exhaustively addressed in the award. Similarly, at the legal research level, there is a lack of attention and a single perspective on the application of prudential obligations in international investment arbitration.
On the one hand, the existing literature suggests that international law scholars have limited exploration of prudential obligations in the context of international investment law and are not sufficient to generate systematic thinking, either from the perspective of macro institutional construction or from the perspectives of micro rule interpretation. At present, on the other hand, most scholars choose to apply the public law paradigm and sovereign perspective to the normative study of prudential obligations. While such a model would restore to the greatest extent the essence of the duty of prudence at its inception, However, there is no doubt that with the increasing complexity of international relations and the wealth of legal subjects, the above research methods can no longer fully adapt to the development of international law or respond to the actual needs of international investment arbitration.
Thus, the conceptual ambiguity of the predicate level directly results in several inconsistencies and uncertainties in the application of investor prudence obligations at the real level. Fundamentally, the unique litigation structure of international investment arbitration and the complex structure of legal relations impose requirements for domain span and subjective conversion on the application of prudential obligations. Investor prudential obligations need to respond through functional differentiation, and existing analytical frameworks and arbitration practices fail to recognize the paradigm shift in the application of prudential duty.
Accordingly, this article will first comb through the birth and evolution of the concept of "prudential obligation", observe the evolution of its meaning in international law practice from a time perspective, and focus further on the specific application of "investor prudence obligation" in international investment arbitration and related disputes. This paper will use the vertical and horizontal differentiation of the function of "prudential obligation" in the context of international investment arbitration as logical starting points and elaborate on the changes in the function of investor prudence from the field of public law to the field of international investment law. On this basis, the traditional interpretation of its legal basis was revisited and amended and refined accordingly, proposing applicable standards that were consistent with the evolution of prudential obligations themselves and adapted to international investment arbitration.

2. Basic Meaning and Practical Development of Investor Prudence Obligation

2.1 Tracing the Implications of Investor Prudential Obligations

In fact, the investor prudential obligation was not a directly created legal concept, and its original normative reliance was on the broader term "prudential obligation", due diligence refers to the legal subject should do reasonable or legal obligation of care in legal relationship.[2] In the field of international law, the concept of prudential obligations dates back to the 17th century, when they were used to mediate conflicts between States, whereby any State must make due efforts and contributions to the settlement of disputes and must not further aggravate them.[3]

In the 19th century, war became an important part of international relations, the precautionary obligation at this time relates primarily to the rule of international law to which a neutral State is obliged to prevent its nationals from aiding or supplying arms and ammunition to a belligerent State.[4] Since then, such obligations have gradually been extended beyond the laws of war and linked to the sovereignty of States. In the Palmas Islands arbitration case of 1928, the tribunal stated that national sovereignty implied the obligation of the State to protect the rights of other States within its territory,[5] before the Permanent Court of International Justice in the Lotus case, Judge Moore said that a State must exercise due diligence to prevent crimes within its jurisdiction against another State or its citizens.[6] With the development of international law, the duty of care has been gradually extended to international law[7], international humanitarian law[8], cyberspace law[9], international law of the sea[10] and so on, it follows that the system of prudential obligations was designed to impose appropriate limitations on the exercise of State sovereignty. While recognizing the full enjoyment by States of their sovereignty, the abuse of sovereignty should be prevented.[11]

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[2] See Timo Koivurova and Krittika Singh, ***"Due Diligence"***, in Rüdiger Wolfrum (ed.), The Max Planck Encyclopedia of Public International Law (Oxford University Press, 2012), p 1.
[3] See Markus Burgstaller and Giorgio Risso, ***"Due Diligence in International Investment Law"***, (2021) 38 Journal of International Arbitration, p 697.
[4] See A. Ouedraogu, ***"La neutralité et l'emergence du concept de due diligence en droit international: l'affaire de l'Alabama revisité"***, (2011) 13 Journal of The History of International Law, p 307.
[5] See Island of Palmas (Netherlands v. United States of America), 2 RIAA 829, Award, 1928, p 839.
[6] See S. S. Lotus (France v. Turkey), Judgment, P. C. I. J., Ser. A, No. 10, 1927, para 269.
[7] See Medes Malaihollo, ***"Due Diligence in International Environmental Law and International Human Rights Law: A Comparative Legal Study of the Nationally Determined Contributions under the Paris Agreement and Positive Obligations under the European Convention on Human Rights"***, (2021) 68 Netherlands International Law Review 121, pp 121 - 155.
[8] See Marco Longobardo, ***"The Relevance of the Concept of Due Diligence for International Humanitarian Law"***, (2019) 37 Wisconsin International Law Journal 44, pp 44 - 87.
[9] See Antonio Coco and Talita de Souza Dias, ***"'Cyber Due Diligence': A Patchwork of Protective Obligations in International Law"***, (2021) 32 European Journal of International Law 771, pp 771 - 806.
[10] See Tony Cabus (ed.), ***"Due Diligence and the High Seas"***, (Routledge, 2021).
[11] See Olivier Corten, ***"'La complicité' dans le droit de la responsabilité internationale: un concept inutile?"***, (2011) 57 Annuaire Français de Droit International 57, p 67.

Similarly, around international investment, the duty of prudence was initially reflected in the requirements of States regarding the treatment of aliens. In early State practice, there was a consensus that once a State allowed aliens to enter its territory, it had made a commitment to provide them with no less protection than its own nationals[12]. This idea has gradually developed into customary international law obligations for States to protect aliens and their property from acts of damage committed within their territorial jurisdiction, including obligations of prevention as well as obligations to punish.[13] The former implies that States need to provide appropriate legislative, administrative and judicial mechanisms to protect the legitimate rights and interests of aliens. The latter requires States to impose appropriate penalties on the wrongdoers for the loss of the legitimate rights and interests of aliens and to take timely measures to prevent the further expansion of the loss.

In the early days of the creation of the concept of prudential obligations, the State was considered the only eligible subject to be subject to its regulations, its institutional framework and basic elements are based on the interests and capacity of States to act as fundamental references. For a long time, most international judicial practice framed the functional extensions of prudential obligations as limitations on the application of State sovereignty. With the development of economic globalization, the situation has gradually improved, therefor, an increasing number of non-State actors began to participate actively in the formulation of international rules and became an indispensable catalyst for the development of international law. As the international economic situation continues to expand the economy and the economic relations become more and more complex, countries begin to realize that the inflow of foreign capital is not entirely positive. In addition to economic growth, the social impact of foreign investors on host countries, including negative effects such as environmental pollution, labor treatment and conflict management, cannot be ignored.[14]

However, foreign investors often engaged in outward investment activities in the form of transnational corporations, which were not eligible subjects under traditional international law, thus presenting an obstacle to the application of existing norms of international law to directly regulate the misconduct of foreign investments. If the conduct of investors is entirely regulated by the domestic law of the host country, the influence of political factors on judicial proceedings cannot be ruled out.

To address these legal gaps, the view has been called for the creation of the concept of "investor prudence" to frame minimum standards for the conduct of foreign investors at the level of international law.[15] Investor prudence obligations are now clearly enshrined in several international soft law documents relating to the social responsibility of TNCs.[16]

2.2 Specific Application of Investor Prudential Obligations in International Investment Arbitration

2.2.1 Regulatory Development of Investor Prudential Obligations

In early international investment arbitration decisions, the arbitral tribunals showed a more restrained attitude towards the application of investor prudence obligations. On the one hand, the original Bilateral Investment Treaty (BIT) lacked explicit provisions on investor liability, and arbitral tribunals lacked a clear legal basis to regulate investor wrongdoing.[17] On the other hand, most arbitral tribunals interpreted in their early decisions the purpose and purpose of BIT as unilateral investment promotion and protection,[18] and therefore the treatment afforded to investors under the BIT entity clause is often directly linked to the host country's obligations. This leads to the obligation of prudence in most cases as a legal justification for unilateral arbitration by investors and as an objective criterion used by arbitral tribunals to measure the legality of the host State's conduct, so, the application of the precautionary obligation rule is markedly one-way and asymmetric.

As international investment relations have grown and international investment legal norms have improved, the tribunals have become aware of the negative effects of such asymmetrical application on the legitimacy of the international investment arbitration system. As a result, some arbitration tribunals began to change their approach to adjudication. In *Plama v. Bulgaria*, the arbitral tribunal for the first time explicitly stated that the duty of care applied not only to the host State but also to the investor.[19]

Since then, the "investor prudential obligation" has been formally established as a referee's rule. Since then, practice has continued this view, resulting in a certain number of rulings where investor prudence obligations are the focus of the controversy. According to existing arbitration practice, the specific elements of investor prudence obligations can be

[12] See E. de Vattel (ed.), ***"The Law of Nations, Or, Principles of the Law of Nature, Applied to the Conduct and Affairs of Nations and Sovereigns"***, (T. & J. W. Johnson & Co., 1844), p 313.

[13] See C. Eagleton (ed.), ***"The Responsibility of States in International Law"***, (New York University Press, 1928), p 80.

[14] See Camille Martini, ***"Balancing Investors' Rights with Environmental Protection in International Investment Arbitration: An Assessment of Recent Trends in Investment Treaty Drafting"***, (2017) 50 International Lawyer, pp 529 - 531.

[15] See M. Paparinskis (ed.), ***"The International Minimum Standard and Fair and Equitable Treatment"***, (Oxford University Press,2013), p 256.

[16] See UNCHR, Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, UN Doc. A/ HRC/ 8 / 5, 7 April 2008, p 17.

[17] See Martin Jarrett (ed.), ***"Contributory Fault and Investor Misconduct in Investment Arbitration"***, (Cambridge University Press, 2019), pp 1 - 2.

[18] See Thomas Schultz and Cédric Dupont, ***"Investment Arbitration: Promoting the Rule of Law or Over-empowering Investors? A Quantitative Empirical Study"***, (2015) 25 European Journal of International Law 1147, p 1152.

[19] See Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/ 03 / 24, Award, 27 August 2008, para. 222.

summarized as compliance with the legal norms of the host country and reasonable prediction of commercial risks and local policy changes in the host country.[20]
For the former, it requires foreign investors to ensure that investments comply with the relevant laws and regulations of the host country before making investments, and to guarantee the legitimacy of the investment during investment activities. In *Anderson v Costa Rica*, for example, the Tribunal held that prudent investment practice required any investor to conduct adequate investigations before committing funds to any project.[21]
An important element of this duty of care is for investors to ensure that their investments comply with the laws of the host country. In this case, the arbitral tribunal expanded the investor's prudential obligation to the extent that foreign investors are equally obliged to pay due attention to the legality of the conduct of local investment partners in the host country;[22] In addition to the requirement of legality of the investment conduct, the duty of care of the investor has also been defined by the Tribunal as an important factor in determining whether the investor can successfully invoke the entity treatment clause in the BIT. This includes an assessment of the commercial risks associated with the investment and a prediction of changes in the regulatory framework and investment policy of the host State, as the Arbitral Tribunal in *Emilio Agustin Maffezini v. Kingdom of Spain* As stated in the case, "international investment treaties should not be considered insurance against bad business judgment" and investors who fail to fulfil their duty of prudence, which manifests itself as a failure to investigate and assess possible business risks prior to investing, should not be afforded the corresponding protection under an investment treaty.[23]
Similarly, in *Waste Management v Mexico* In this case, the arbitral tribunal rejected an investor's claim for compensation against the expropriation by the host country because it failed to assess the feasibility of the investment in the context of the host country's economic environment;[24] The latter mainly concerns the protection of investor's legitimate expectations, i.e. the obligation of the host country to provide investors with a relatively stable investment environment and to protect the legitimate expected expectations of investors based on the host country's policy commitments. This does not mean, however, that all investors' expected benefits should be protected by investment treaties; investors also need to exercise a duty of prudence. *Parkerings v. Lithuania* ruled that the right of investors to derive the expected benefits from the stability and predictability of the host country's investment environment depends on their ability to meet their obligations of prudence, and that investors should anticipate changes in host country policies and adjust their investment strategies accordingly.[25]
<u>2.2.2 Status of Application of Investor Prudential Obligations: Mechanism Differences and Ambiguity of Standards</u>
It is not difficult to see from the presentation of the above-mentioned arbitration practice that the arbitral tribunal's understanding of the investor's prudential obligation has moved away from the previous evasion and restraint, instead linking the prudential duty to the treatment of the investor, and examining investor wrongdoing in a more positive manner. This appears to have solved the problem of imbalance and imbalance arising from the duty of prudence in refereeing. In fact, however, the application of investor prudential obligations in arbitration practice still contains several misjudgments that cannot be ignored, including ambiguities in the understanding of the mechanisms underlying prudential duty and a lack of analysis of relevant models of conduct evaluation.
First, there is an inappropriateness of the regulatory operating mechanism in the application of investor prudence obligations. The duty of prudence is essentially an obligation of conduct, not an obligation for results.[26] In other words, it only requires investors to effectively meet the corresponding requirements based on the prudential obligation, and the ability to achieve the desired outcome should not be a factor in evaluating whether the prudential requirement has been met.
However, the interpretation of the duty of care in some rulings has broken through the above distinction between the objects of regulation. For example, in the case of *Urbaser v. Argentina*, the arbitral tribunal considered whether the investor fulfilled the duty of care. The judgment based on this is not whether investors have investigated and consulted ahead of time about changes in Argentina's investment policies, but rather that investors must be aware that social

[20] See Markus Burgstaller and Giorgio Risso, ***"Due Diligence in International Investment Law"***, (2021) 38 Journal of International Arbitration 697, p 699.
[21] See Alasdair Ross Anderson and others v. Republic of Costa Rica, ICSID Case No. ARB (AF) / 07 / 3, Award, 19 May 2010, para. 55.
[22] See Churchill Mining PLC and Planet Mining Pty Ltd v. Republic of Indonesia, ICSID Case No. ARB/ 12 / 14 and 12 / 40, Award,6 December 2016, paras. 501 - 509.
[23] See Emilio Agustín Maffezini v. Kingdom of Spain, ICSID Case No. ARB/ 97 / 7, Award, 13 November 2000, para. 64.
[24] See Waste Management, Inc. v. United Mexican States (No. 2), ICSID Case No. ARB (AF) / 00 / 3, Award, 30 April 2004, paras. 57, 113.
[25] See Parkerings-Compagniet A. S. v. Republic of Lithuania, ICSID Case No. ARB/ 05 / 8, Award, 11 September 2007, para. 333.
[26] See Timo Koivurova and Krittika Singh, ***"Due Diligence"***, in Rüdiger Wolfrum (ed.), The Max Planck Encyclopedia of Public International Law (Oxford University Press, 2012), para. 1.

conditions in the host country are likely to change at any time.[27] Similarly, in *Stadtwerke Munchen and others v. Spain*,[28] *LSG Building Solutions and others v. Romania*,[29] the arbitral tribunal adopted a similar model of argument.

Second, the arbitral tribunal's review of investor compliance models has shown a tendency towards uniformity and formatting, with a more fixed set of analytical models and judgment criteria to measure compliance with prudent obligations in various scenarios. In other words, whether with respect to commercial risks, political risks or policy changes in the host country, the arbitral tribunal interpreted the element of the prudential obligation as requiring specific measures by the investor, regardless of the investor's specific circumstances. For example, investors' due diligence obligations have been identified by numerous arbitral tribunals as key factors in measuring whether host countries violate investors' reasonable expectations and thus fair and equitable treatment. The extent to which investors' prudential obligations are met, particularly in the context of regulatory changes in the host country, is directly related to the reasonableness of investor expectations.

However, in measuring the above elements, arbitral tribunals often choose to examine whether the investor has taken specific measures. In *Mamidoil v. Albania*, for example, the arbitral tribunal held that the investor had failed to exercise his duty of prudence by not hiring a professional lawyer who understood the laws of the host country, even though the investor had consulted the relevant authorities of the host countries.[30] Subsequent cases such as *Foresight v. Spain*[31] and *Opera Fund EcoInvest v. Spain*[32] further confirmed that the standard of the duty of care can only be met by seeking legal advice from a professional body.

In addition, arbitral tribunals have also shown a tendency to be overly idealistic in assessing the prudential obligations of investors' conduct, in other words that investors must use all "due" means to avoid business risks and the impact of changes in the regulatory framework of the host country. In *Blusun v. Italian Republic*, the Tribunal held that the duty of care required an investor to be aware of all investment-related laws and regulations and policy documents of the host State.[33]

However, from a practical point of view, it is difficult for foreign investors to obtain detailed first-hand information on domestic policy changes in the host country. It is therefore clearly inappropriate that the arbitral tribunal does not differentiate between the actual circumstances of the investor and that the applicable paradigm for evaluating his conduct based on a uniform rational investor standard.

Finally, the interpretation of the criteria for investor prudence obligations varies from arbitral tribunal to tribunal. Some arbitral tribunals defined the criteria for the implementation of the prudential obligation as measures that would be taken by a wise investor.[34] Some arbitral tribunals also use the term "reasonable" as the basic threshold for judging whether an investor has fulfilled its duty of care.[35] Other arbitral tribunals use expressions such as "diligent,"[36] "prudent"[37] and "meaningful".[38] It is thus evident that there is a great deal of inconsistency in arbitration practice in the criteria for the application of investor prudence obligations.

Moreover, even regarding the above-mentioned different standards, the arbitral tribunal did not specify a specific interpretation in its award, leaving the application of the investor prudential obligation primarily dependent on the arbitral court's discretion. While the arbitral tribunal expected to regulate the conduct of foreign investors through the application of prudential obligations, the uncertainty of the content and the ambiguity of the standards would greatly impede their effective application and would interfere with the normal investment behavior of investors.

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[27] See Urbaser S. A. & Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic, ICSID Case No. ARB/ 07 / 26, Award, 8 December 2016, paras. 622, 628.

[28] See Stadtwerke München GmbH and others v. Kingdom of Spain, ICSID Case No. ARB/ 15 / 1, Award, 2 December 2019, para. 308.

[29] See LSG Building Solutions GmbH and others v. Romania, ICSID Case No. ARB/ 18 / 19, Decision on Jurisdiction, Liability and Principles of Reparation, 11 July 2022, para. 1094.

[30] See Mamidoil Jetoil Greek Petroleum Products Societe S. A. v. Republic of Albania, ICSID Case No. ARB/ 11 / 24, Award, 30 March 2015, para. 671.

[31] See Foresight Luxembourg Solar 1 S. á. R1., et al. v. Kingdom of Spain, SCC Case No. 2015 / 150, Final Award and Partial Dissenting Opinion of Arbitrator Raül Vinuesa, 14 November 2018, para. 380.

[32] See OperaFund v. Spain, ICSID Case No. ARB/ 15 / 36, Award, 6 September 2019, para. 487.

[33] See Blusun S. A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic, ICSID Case No. ARB/ 14 / 3, Final Award, 27 December 2016, para. 392.

[34] See MTD Equity Sdn. Bhd. & MTD Chile S. A. v. Republic of Chile, ICSID Case No. ARB/ 01 / 7, Award, 25 May 2004, paras. 242 - 243.

[35] See Churchill Mining PLC & Planet Mining Pty. Ltd. v. Republic of Indonesia, ICSID Case No. ARB/ 12 / 14, Award, 6 December 2016, para. 501.

[36] See RREEF Infrastructure (G. P.) Limited and RREEF Pan-European Infrastructure Two Lux S. à r. l. v. Kingdom of Spain, ICSID Case No. ARB/ 13 / 30, Decision on Annulment, 10 June 2022, para. 122.

[37] See Stadtwerke München GmbH and others v. Kingdom of Spain, ICSID Case No. ARB/ 15 / 1, Award, 2 December 2019, para. 308.

[38] See BSG Resources Limited (in administration), BSG Resources (Guinea) Limited and BSG Resources (Guinea) SàRL v. Republic of Guinea (I), ICSID Case No. ARB/ 14 / 22, Award, 18 May 2022, para. 904.

3. Functional Differentiation of Investor Prudential Obligations in International Investment Arbitration Practice

Some scholars have attributed the difficulty in the application of the above-mentioned investor prudential obligations in international investment arbitration practice to the ambiguity and subjectivity of the scope and scope of the investor prudential right itself.[39] It is true that the arbitral tribunal should interpret the specific norm from a conceptual point of departure.

However, this understanding does not fundamentally reveal the flaws in the institutional application of investor prudential obligations in the unique arena of international investment arbitration. It is affirmed that the basic meaning of the duty of prudence itself will change accordingly as the applicable areas shift. Similarly, when prudential obligations are introduced by arbitral tribunals in international investment arbitration, their normative orientation and functional positioning will inevitably be affected by the structure of external venues.

This is the deeper cause of the problem of real-level application, the branch system of international law, which is widely used in international investment arbitration and other prudential obligations, has a fundamental difference between the value base and the rule framework. The decentralization of its unique litigation model and the coupling of legal domains place new demands on the functional positioning and operational paradigm of prudential obligations.[40]

Specifically, the duty of prudence creates functional differentiation in the process of interacting with the complex framework of international investment arbitration, the investor prudential obligation, as a differentiated normative product, has also been given a normative identity and functional positioning in the special area of international investment arbitration that is different from other areas, to which the existing interpretative tools and analytical frameworks of arbitral tribunals have failed to respond effectively. It is therefore necessary to re-examine the process of functional differentiation of prudential obligations in international investment arbitration and the value-oriented and legal drivers behind it.

3.1 A Tangible Manifestation of Functional Differentiation

3.1.1 Vertical Differentiation: The Functional Orientation of Prudential Obligations from "Limit" to "Balance"

As noted above, the duty of prudence was originally designed as a norm to limit the exercise of State sovereignty. To prevent the abuse of sovereignty, the State needs a certain degree of self-restraint and external restrictions in the exercise of sovereign power. As a result of the interpretation and development of international judicial practice, the duty of prudence not only requires sovereign States to fulfil negative obligations to ensure that the exercise of sovereignty does not have a negative impact on the international community, but also to take proactive measures to prevent damage that has not yet been caused.[41]

This control function was evident in the early decisions of international investment arbitration. Conventional wisdom holds that, while international investment arbitration gives investors the right to sue the host country directly, in fact, investors remain at a disadvantage in their legal relations with the host country.[42]

Because, after receiving investment, the host country could easily use its regulatory power to deprive the investor of the investment proceeds on the grounds of public interest. Accordingly, in the original investment arbitration practice, the function of the prudential obligation was to limit undue interference by the sovereign acts of the host country in foreign investment, while also requiring the host country to assume a positive obligation to protect the investment property.[43]

However, this understanding exaggerates the role of sovereignty in investment relations in a one-way direction from a static perspective. Indeed, with the diversification of international investment approaches and the growth of investment sizes, the risk of investment losses can arise not only from the improper exercise of the sovereignty of the host country but also from the impropriety of foreign investors.[44]

In addition, from the perspective of sustainable development, the goal of BIT should not be unilateral investment protection, but to achieve mutual improvement of the well-being of both sides through economic exchanges.[45]

In response to the new changes in international investment legal relations and the international community's new demands for investment arbitration, the accumulation of State practice has led to vertical functional differentiation of

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[39] See Yulia Levashova, ***"Fair and Equitable Treatment and Investor's Due Diligence Under International Investment Law"***, (2020) 67 Netherlands International Law Review 233, p. 244.

[40] See He Yan and Gu Fang, ***"Research on the Application of Investor Reasonable Expectation Rules: System Coupling and Normative Division"***, Southeast Academic Journal, No. 4, 2023, pp. 231-232.

[41] See Samantha Besson, ***"La Due Diligence En Droit International"***, (2020) 409 Recueil des Cours 1, p. 274.

[42] See Ivar Alvik (ed.), ***"Contracting with Sovereignty: State Contracts and International Arbitration"***, (Hart Publishing, 2011), p. 2.

[43] See Eric De Brabandere, ***"Host States! Due Diligence Obligations in International Investment Law",*** (2015) 42 Syracuse Journal of International Law and Commerce 320, pp. 333 - 337.

[44] See Anna Kozyakova, ***"Foreign Investor Misconduct in International Investment Law"***, (Springer, 2020), pp. 45 - 60.

[45] See Liu Sun, ***"The Humanization Trend of International Law and the Innovation of International Investment Law"***, Journal of Legal Studies, No. 4, 2011, pp. 196-197; Huang Shixi, ***"Conflicts and Challenges in the Application of Investment Rules and Human Rights Rules in International Investment Disputes"***, Contemporary Law, No. 4, 2018, pp. 119-120.

prudential obligations[46]. Its functional audience is no longer limited to the host country, but needs to be evaluated separately for the behavior of investors and the host country; Functional orientation is no longer limited to limiting the sovereignty of the host country, but rather accomplishes the reallocation of investment risk from a micro-point perspective by regulating the investment behavior of investors, thereby achieving a macro-point balance of the rights and obligations of the host nation and investors.[47]

Specifically, in the vertical regulatory legal relationship between host countries and investors, the increased public power of the host country has created additional risk-control responsibilities in international investment arbitration.[48] The introduction of investor prudential obligations has transformed previous risk allocation models that combine investment losses exclusively with the fulfilment of the host country's treaty obligations. Instead, part of the risk obligation was shifted down to the investor's side. The functional positioning of prudential obligations also shifted accordingly from oversight of the sovereign exercise of the host country to compliance requirements for investors.[49]

On the one hand, investors need to ensure that their investments comply fully with the legal requirements of the host country; On the other hand, investors also need to make advance identification and analysis of the laws and policies of the host country related to investment. If the investor fails to meet the above prudential obligations, he or she will be liable for the loss of his or her investment.

Accordingly, the host country could also defend the investor's obligation to be cautious, alleviating some of the asymmetries of rights and obligations between the parties and the natural imbalances of international investment arbitration. This philosophy can also be reflected in the decisions of some arbitral tribunals. For example, in *Mamidoil v. Albania*, the Tribunal clearly stated that, to provide investors with a stable and transparent investment environment, host countries need to carefully modify investment-related legal provisions and enforce them impartially, while investors must also be aware of the content and legislative background of the host country's laws and administrative regulations. In other words, the duty of prudence is a standard for both the State and the investor, and without an adequate and balanced assessment of the conduct of both parties, fairness and justice cannot be fully achieved.[50]

In conclusion, the practical developments and philosophical shifts in international investment legal relations have reshaped the international community's perception of the function of prudential obligations. To better adapt to these changes, State practice and arbitration interpretation have shifted prudential obligations away from traditional functional orientation, ultimately resulting in vertical functional differentiation, from one-way limitation to two-way balance.

3.1.2 Horizontal Differentiation: The Functional Boundaries of Prudential Obligations have Expanded from Supervisory Responsibilities to General Considerations

In addition to the vertical shift in functional concentration, the prudential obligation has also undergone horizontal differentiation under the influence of the complex field of international investment arbitration, i.e., the expansion of the functional boundaries of the investor prudent obligation. Through the historical development of the duty of care, we can see that the essence of the original duty of care is that legal entities need to anticipate the adverse effects of their behavior and take appropriate measures to prevent them.[51]

The investor prudent duty also inherits this concept to some extent. Investment, as an economic activity aimed at generating profits, is inevitably affected by commercial risks. Therefore, investors must handle their invested assets with greater caution than ordinary people and avoid relying too heavily on external assistance, a standard known as the rational investor.[52]

On the one hand, from the perspective of investment behavior itself, investors, as the primary responsible persons and beneficiaries of external investment activities, should naturally gather and understand investment related information and assess and predict the risks associated with the investment. On the other hand, this standard is also a necessary condition for the continuation of the legal relationship between investors and host states.[53]

In international investment arbitration, in addition to the vertical administrative relationship, there is also a horizontal cooperative relationship between investors and host states. Under an investment contract, investors and host states can

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[46] See Daria Davitti, ***"On the Meanings of International Investment Law and International Human Rights Law: The Alternative Narrative of Due Diligence"***, (2012) 12 Human Rights Law Review 421, pp. 423 - 429.

[47] See Marcin Kałduński, ***"The Element of Risk in International Investment Arbitration"***, (2011) 13 International Community Law Review 111, pp. 112 - 113.

[48] See M. Sornarajah, ***"The Settlement of Foreign Investment Disputes"***, (Kluwer Law International, 2000), pp. 29 - 30.

[49] See Jorge E. Viñuales, ***"Foreign Investment and the Environment in International Law"***, (Cambridge University Press, 2012), pp. 189 - 221.

[50] See Mamidoil Jetoil Greek Petroleum Products Société S. A. v. Republic of Albania, ICSID Case No. ARB/ 11 / 24, Award, 30 March 2015, para. 634.

[51] See Gramercy Funds Management LLC and Gramercy Peru Holdings LLC v. Republic of Peru, ICSID Case No. UNCT/ 18 / 2, Award, 6 December 2022, paras. 60 - 61.

[52] See Huang Liping, ***"Investor Liability in International Investment Arbitration: Contributory Fault and Rational Investor Standards"***, Global Legal Review, No. 3, 2022, pp 184-185; Valentina Vadi (ed.), Proportionality, Reasonableness and Standards of Review in International Investment Law and Arbitration (Edward Elgar, 2018), p 145.

[53] See Martina Magnarelli (ed.), ***"Privaty of Contract in International Investment Arbitration"***, Original Sin or Useful Tool (Kluwer, 2020), pp. 18 - 20.

engage in investment activities as equal entities. This means that both parties must actively take appropriate actions and strive to achieve the purpose of the contract. In this type of private law relationship, the rights, and obligations agreement model, based on the autonomy of will and the spirit of the contract, which stipulates the obligation to abide by agreements, will inevitably place both parties under the greatest obligation to fulfill their respective obligations.[54]
For investors, a necessary condition for this obligation is the proper management of investment assets and careful planning of investment strategies. Clearly, when prudent investor commitment provides functional guidance at the level of horizontal cooperation between the host country and foreign investors, it cultivates some of the basic elements of the business world, requiring investors to treat their investment properties with the awareness of rational business entities and to measure their investment behavior against standards higher than commercial rationality.[55]
The above understanding of the functional scope of investor prudential obligations in the horizontal relationship of international investment arbitration is certainly reasonable. However, its explanatory power remains insufficient to cover the full picture of investment activities. Foreign investment brings not only positive economic benefits to host countries but also significant negative externalities.[56]
Foreign investment inevitably brings a series of social problems to the host country, including environmental degradation and the treatment of workers. In practice, investment activities not only involve investors and host countries but also affect the interests of third parties other than the parties, namely the human and social rights of the local population in the host country.[57]
In this case, if the investor's prudential obligation still requires foreign investors to focus solely on the economic benefits of the investment without considering the interests of the host country, this is equivalent to completely transferring the investment risks and negative impacts to the host country through the investment contract.[58]
This clearly contradicts the fundamental principle of fairness. Therefore, given the bilateral nature of the investment impact, investors cannot make similar investment decisions based entirely on commercial rationality. The unilateral pursuit of maximizing private interests will inevitably lead to negative consequences for other entities. Based on the conflict between investment benefits and the host country's social interests in the practices mentioned above, the prudential obligations of investors in the horizontal private legal relationship between investors and host countries are further differentiated, thus breaching the value base and normative framework of commercial codes and expanding the functional boundaries of third parties other than the investment parties.[59]
In other words, in addition to urging investors to formulate prudent investment strategies and assume responsibility for gains and losses in their investment assets, the prudent obligation of investors also plays a role in mitigating the negative externalities of investment behavior on the host society. Investors should not seek investment returns at the expense of excessive harm to the social welfare of the host country's population. Instead, in pursuing economic objectives, they should consider the potential negative impacts that investment activities may have on the host country's society and take the necessary measures to avoid them. Some arbitration tribunals have also recognized this horizontal breach of functional boundaries. For example, in *Perenco v. Ecuador*, the arbitral tribunal ruled that investors establishing factories in the host country must consider the environmental impact on the host country, which is also an important factor in measuring the investor's obligation of prudent investment.[60]
In *Bear Creek v. Peru*, the tribunal ruled that the relevant ILO standards apply not only to countries, but that investors must also ensure the basic treatment of workers in the host country. In short, in addition to the functional differentiation resulting from the obligation of prudent investment in the process of achieving vertical administrative relations, the functional boundaries of the obligation of prudent investment have also been expanded in the process of interaction in horizontal cooperative relations. Under the trend of mutual shaping of investment practices and rules, the value-based expression of investors' prudent investment obligations has breached its established self-regulatory commercial normative features, and its functional boundaries have consequently expanded from a model of self-responsibility dominated by commercial rules to a value-pluralistic model that considers the social interests of the host country.[61]

3.2 Legal Motivations for Functional Differentiation

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[54] See Julian Arato, ***"The Logic of Contract in the World of Investment Treaties"***, (2016) 58 William & Mary Law Review 351, p 357.

[55] See Maria Laura Marceddu and Pietro Ortolani, ***"What Is Wrong with Investment Arbitration? Evidence from a Set of Behavioural Experiments***", (2020) 31 European Journal of International Law 405, p 407.

[56] See Julian Arato, ***"The Logic of Contract in the World of Investment Treaties"***, (2016) 58 William & Mary Law Review 351, p 357.

[57] See Maria Laura Marceddu and Pietro Ortolani, ***"What Is Wrong with Investment Arbitration? Evidence from a Set of Behavioural Experiments"***, (2020) 31 European Journal of International Law 405, p 407.

[58] See Katia Fach Gómez (ed.), ***"Private Actors in International Investment Law"***, (Springer, 2021), pp 5 - 25.

[59] See Jonathan Bonnitcha Robert McCorquodale, ***"The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights"***, (2017) 28 European Journal of International Law 899, pp 901 - 902.

[60] See Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador), ICSID CaseNo. ARB/ 08 / 6, Interim Decision on the Environmental Counterclaim, 11 August 2015, paras. 389 - 390.

[61] See Bear Creek Mining Corporation v. Republic of Peru, ICSID Case No. ARB/ 14 / 21, Award, 30 November 2017, para. 644.

From the above analysis, the investor's prudent duty does have a functional differentiation phenomenon at the actual level. However, since there is no strict "follow precedent" system in international investment arbitration, simply combing through previous arbitration practices cannot provide a more effective legal support for the arbitral tribunal to interpret and apply the investor's prudent duty in subsequent rulings, nor can it provide clear normative guidance for foreign investors. Therefore, it is necessary to further explore the legal motivations behind functional differentiation. Based on the vertical and horizontal bidirectional differentiation path of the investor's prudent duty, its legal motivation can be analyzed from both macro and micro perspectives.

3.2.1 Macro Perspective: Interaction and Integration of Sovereign Interests and Investment Interests

The smooth development of investment activities requires the cooperation and complementation of investment treaties and investment contracts. The investment treaty between the host country and the investor's home country, as a basic framework, defines the basic treatment related to investment that investors should enjoy. The specific implementation methods and implementation standards still need to be determined by the investor and the host country through the conclusion of an investment contract.[62] The legal relationship of the investment contract is the best perspective and necessary path for studying the legal motivation for the differentiation of investors' prudent obligations.

To a certain extent, the logical starting point of the legal expression of the investment contract is that the host country exchanges foreign investors with foreign investments by transferring part of its sovereign powers.[63] In this interactive process, investors obtain some basic interests that originally belonged to the scope of the host country's sovereignty, such as operating rights, resource use rights and other investment-related rights. This also requires the host country to provide corresponding policy support and legal protection. However, this does not mean that investors have completely occupied this part of sovereignty through investment contracts. On the contrary, investors have only obtained limited economic powers.

The reason is that sovereignty, as an abstract concept of rights collection, itself has multiple aspects and multi-dimensional attributes.[64] Some people believe that in international investment arbitration, the state has both the identity of a sovereign regulator and a party to investment arbitration.[65] The former means that the host country can attract investment by taking the economic autonomy and ownership of natural resources under sovereignty as conditions.

When this part of the power of sovereignty is embodied as a commodity equivalent to investment for exchange, it is equivalent to stripping the state of control over part of the commercial attributes of sovereignty and handing it over to foreign investors; while the latter emphasizes that the sovereignty of the host country is the legal symbol of the highest power in the country, which itself means the management and final decision-making power of domestic affairs.

Therefore, the partial transfer of sovereignty itself is an external manifestation of the authority of the host country. As the judgment of the Permanent Court of International Justice in the "Lotus Case" widely cited by later generations, “the sovereignty of a state cannot be assumed to be limited”,[66] the transfer of state sovereignty must be approved by the state to produce international legal effect.[67]

It can be seen from this that the investment contract concluded between the host country and the foreign investor only treats the commodifiable part of sovereignty as a treatment given to the investor, and the host country still retains the management power corresponding to this part of the economy. It is precisely because of the retention of management power that arbitration practice allows the host country to exercise its regulatory power under certain conditions on the grounds of public interest.[68] Therefore, in fact, under the international investment legal system, investors and host countries are essentially the holders of sovereignty related to investment behavior. As an international law principle intended to limit the abuse of sovereignty, the duty of care should naturally also apply to investors.

In addition, the interaction and integration between sovereignty and investment is also reflected in the symmetry of risk and return. Foreign investors have reached an economic community with the host country in terms of the economic benefits of investment through investment injection. Specifically, in the investment legal relationship, the host country and the investor are on the same interest chain. If the investment strategy adopted by the investor enables the investment property to increase in value, the economic development of the host country will also benefit from it. The improvement of the host country's economic environment can further provide investors with a more ideal investment environment, broaden the profit space of investment, and form a virtuous circle.[69] On the contrary, if the investor's investment suffers

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[62] See SGS Société Générale de Surveillance S. A. v. Republic of the Philippines, ICSID Case No. ARB/ 02 / 6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, para. 141.

[63] See Zachary Douglas et al. (eds.), ***“The Foundations of International Investment Law: Bringing Theory into Practice”***, (Oxford University Press, 2014), p. 331.

[64] See Daniel Lee (ed.), ***“The Right of Sovereignty: Jean Bodin on the Sovereign State and the Law of Nations”***, (Oxford University Press, 2021), pp. 3 - 6

[65] See Ivar Alvik (ed.), ***“Contracting with Sovereignty: State Contracts and International Arbitration”***, (Hart Publishing, 2011), p. 239.

[66] See S. S. Lotus (France v. Turkey), Judgment, P. C. I. J., Ser. A, No. 10, 1927, para. 269.

[67] See S. S. Wimbledon (Britain et al. v. Germany), Judgment, P. C. I. J, Series A, No. 1, 1923, pp. 24 - 25.

[68] See Catharine Titi (ed.), ***“The Right to Regulate in International Investment Law”***, (Bloomsbury Publishing, 2014), pp. 33 - 35.

[69] See Tamar Baiashvili and Luca Gattini, ***“Impact of FDI on Economic Growth: The Role of Country Income Levels and Institutional Strength”***, EIB Working Paper 2020 / 02, 2020, p. 19.

losses, it will inevitably have an adverse impact on the social conditions of the host country. This negative effect will further deteriorate the investment environment.[70]

It can be seen from this that in the dynamic evolution of international investment legal relations, the expectations of the host country and investors for investment are gradually overlapping. The two share investment returns and should naturally share investment risks. Driven by this objective connection, the investor's prudent obligation provides a necessary guidance for this actual demand.

From the above analysis, we can see that one of the original functions of the creation of prudential obligations is to allocate risks. For foreign investors, they accept preferential treatment from the host country, so they need to bear the corresponding obligation to protect the social interests of the host country. Based on this, the investor prudential obligation has completed the functional differentiation of different dimensions in the interactive integration of sovereignty and investment.

3.2.2 Micro Perspective: Strengthening Investor Protection of Investment

The theoretical root of the functional differentiation between investment and investor prudent obligation can also be observed from the micro level, that is, taking the relationship between investors and investment as the starting point for legal analysis. Both traditional theoretical views[71] and early arbitration practices[72] tend to regard investors as the weak party, and then over-protect the interests of investors. The reason is that when investors invest their investment property in the host country for related production and operation, they are bound to be subject to the constraints of the host country's domestic legal framework and the control of the host country's local competent authorities.[73]

In this case, the legal status of the investment property is in an uncertain state, and the host country can reduce or deny the investment treatment that should be given by relying on the Public Interest Clause or Non-exclusionary Measures Clause in the investment treaty, or on the grounds of domestic policy changes.[74]

Therefore, even if the investment treaty clearly stipulates the rights enjoyed by investors based on investment, due to the host country's dual role as a beneficiary and manager, the investor's ability to protect investment property is still at a relatively limited level. The above analysis is also the reason why the duty of prudence is only applicable to the host country's behavior in early investment arbitration practice.[75] However, there is no doubt that this understanding is obviously behind the times and one-sided. From the perspective of investment practice, the early foreign investment model was relatively simple and mostly indirect investment by foreign investors through purchasing shares of host country enterprises.[76]

As an intangible property, the value and legal positioning of equity itself are uncertain. In this regard, the host country will inevitably impose more restrictions. Whether investors acquire or transfer equity, they must strictly comply with the relevant laws and regulations of the host country. The current foreign investment model is more about investors combining indirect investment with direct investment, using combination strategies to optimize the form and configuration of investment assets.[77]

Specifically, the direct investment model with the establishment of new enterprises or factories as the main form makes investment assets tangible, and investors therefore have more legal protection and operating space. Investors can not only negotiate with the host government on behalf of their industry to obtain more favorable policy support, but also transfer and reorganize investment assets through multinational companies scattered around the world, further enhancing the liquidity and flexibility of investment.[78] This gives investors the opportunity to "treaty shopping" and prepare the most advantageous investment plan.[79] It can be seen that recent investment practices have broken the traditional perception of investors, and the modernization trend of international investment has enabled investors to increasingly protect their investment assets.

4. Reflection and Reconstruction of the Normative Expression of Investor's Prudent Duty

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[70] Ibid pp 20-21.

[71] See Hanno Wehland, ***"Forum Shopping: Investment Arbitration"***, in Hélène Ruiz Fabri (ed.), The Max Planck Encyclopedia of International Procedural Law (Oxford University Press, 2019), paras. 4 - 6.

[72] See Wang Peng: ***"Analysis of Power Structure in International Investment Agreements"***, Legal Publishing House, 2019, pp. 160-164.

[73] See Peter D. Cameron, ***"Stabilization Clauses: Do They Have a Future"***, (2020) 7 BCDR International Arbitration Review 109, pp. 111 - 115.

[74] See Carolina Moehlecke, ***"The Chilling Effect of International Investment Disputes: Limited Challenges to State Sovereignty"***, (2020) 64 International Studies Quarterly 1, pp. 1 - 12.

[75] See Eric De Brabandere, ***"Host States, Due Diligence Obligations in International Investment Law"***, (2015) 42 Syracuse Journal of International Law and Commerce 320, pp. 333 - 337.

[76] See United Nations Conference on Trade and Development, World Investment Report 1999, July 1999, pp. 1 - 4.

[77] See Andreas Cahn and David C. Donald (eds.), ***"Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany"***, the UK and the USA (Cambridge University Press, 2018), pp. 306 - 344.

[78] See United Nations Industrial Development Organization, Multinational Enterprises Foreign Direct Investment Location Decisions within The Global Factory, Research and Statistics Branch Working Paper 04 / 2009, 2009, pp. 78 - 85.

[79] See Hanno Wehland, ***"Forum Shopping: Investment Arbitration"***, in Hélène Ruiz Fabri (ed.), The Max Planck Encyclopedia of International Procedural Law (Oxford University Press, 2019), paras. 4 - 6.

After clarifying the functional differentiation of foreign investors' prudent duty and the legal motivation behind it, it is not difficult to find that the current arbitration practice ignores and deviates from the theoretical guidance path and presentation context that promotes its functional differentiation in the normative deconstruction of investor's prudent duty and the normative expression when applying it, but rather mechanically directly cites the conclusions made by other arbitration tribunals when evaluating the state's prudent duty, which is obviously not compatible with the legal relationship of international investment arbitration. To further solve the application problem, it is necessary to re-examine the legal core of investor's prudent duty in the context of international investment arbitration, and thus reshape the practical construction of the applicable standards.

4.1 Reshaping the Legal Core of Investor's Prudent Duty: From "Identity Theory" to "Control-Foreseeability Theory"

The core of jurisprudence is the basis on which norms can achieve their intended functions, and it is also the main principle that can be interpreted and applied in international investment arbitration in a reasonable way. From the above summary of the applicable situation, the theoretical paradigm abstracted from the current arbitration practice can be summarized as the "identity theory", that is, the objective identity of the investor determines the applicable threshold of the investor's prudential obligation.

In short, regardless of the actual situation of the investor, the requirements of a rational investor must be met, and a comprehensive assessment of investment risks should be taken. This kind of normative expression with identity as the core of jurisprudence has corresponding limitations and deficiencies both at the level of theoretical construction and in actual adjudication. First, this paradigm presupposes an unreasonable premise, that is, the assumption that rational investors are an absolute objective criterion that is not constrained by the actions of external fields and other legal subjects. This is evident in Olguín v. Nowhere is this more evident than in the Paraguay case. In assessing whether the investor had fulfilled its duty of care, the tribunal held that Olguín, as a commercially talented and experienced businessman, was still making high-risk investments and therefore did not deserve the protection of the investment treaty.

Even in this case, where part of the risk stemmed from the host country's oversight of the financial institution, the tribunal still relied on the standard of a rational investor under ideal conditions.[80] It is true that the duty of prudence is an obligation of conduct, which should evaluate the appropriateness of a specific act by certain objective criteria. However, this does not mean that the standard should be fixed.[81] On the contrary, any normative interpretation should strive to achieve the goal of its function.[82] The foregoing has proved that the function of the duty of prudence in international investment arbitration is no longer a one-way limit but pursues a balance between the rights and obligations of both parties. The complex nature of the legal relationship of investment determines that the normal operation of investment does not depend solely on the unilateral efforts of investors. The regulatory actions of the host country government, the social situation of the host country, etc., may be a source of risk for investment.

In other words, it is impossible for even the most experienced investor to make a pre-assessment of all the risks associated with an investment. Therefore, if investors are mechanically and dogmatically required to use fixed standards, it is obviously contrary to the normative purpose of investors' prudential obligations. Second, the theoretical shaping of the "identity theory" is essentially an abstract analogy of the application of the duty of care in other areas of public international law. When interpreting the judgment of the International Court of Justice, some scholars directly bind the source of the duty of care to sovereignty in the sense of identity symbols, that is, the duty of care is a by-product of sovereignty.[83]

Along this line, for investors, the standard of judgment for judging their duty of care is the rational requirement brought about by their status. On the one hand, this inappropriate understanding is due to the one-sided interpretation of previous international law precedents, and on the other hand, it also stems from the failure to extract the core basic concept of the duty of care from the specific field in the process of analogy application, and then correctly adapt to the international investment arbitration system.[84] The Corfu Channel case explicitly explored for the first time the relationship between the duty of care and the principle of sovereignty. The International Court of Justice stated in its judgment that "every State is under an obligation not to allow its territory to be used knowingly for acts contrary to the rights of other States".[85] This is also the main basis for the "identity theory". However, a closer examination of the Corfu Channel judgment shows that the Court did not intend to use sovereignty itself as a source of jurisprudence for the duty of care. The

80 See Eudoro Armando Olguín v. Republic of Paraguay, ICSID Case No. ARB/ 98 / 5, Award, 26 July 2001, para. 65.

81 See Neil McDonald, ***"The Role of Due Diligence in International Law"***, (2019) 68 International & Comparative Law Quarterly 1041, pp. 1044 - 1049.

82 See J. Romesh Weeramantry (ed.), ***"Treaty Interpretation in Investment Arbitration"***, (Oxford University Press, 2012), p. 56.

83 See Joanna Kulesza (ed.), ***"Due Diligence in International Law"***, (Brill, 2016), p. 56.

84 See Heike Krieger et al. (eds.), ***"Due Diligence in the International Legal Order"***, (Oxford University Press, 2020), pp. 75 - 76.

85 See Corfu Channel Case (United Kingdom v. Albania), Judgment, I. C. J. Reports 1949, p. 22.

International Court of Justice, in its summary of the gist of the judgment, pointed out that territorial control is the source of obligatory responsibility.[86] This is even clearer in the Congolese armed conflict.[87]
The normative source of the duty of care is not the specific identity and the general expectations it carries, but the control and predictability of the risk sources associated with a specific legal object. For the former, the ability to control the source of risk means that the relevant entity can determine the actual direction of the risk largely in other words, it can use the risk to influence other actors.[88] The right behind this control is the legal object of the limitation of the duty of care, not the source of the duty of care. From the perspective of international investment arbitration, the deeper theoretical basis and variable of concern behind the above-mentioned differentiation of prudential obligations are also investors' ability to control investment risks.
From a macro perspective, the interaction between sovereignty and investment enables investors and host countries to form a synergy of interests and work together in the investment process. With the systematic support of the sovereign's economic power, investors can grasp the investment trend more accurately and respond to risks in a timely manner. At the micro level, while investors' ability to protect investment assets is gradually strengthened, their ability to control risks that may cause investment damage is also naturally improved.
Therefore, taking the ability to control risk sources as the core of legal theory can not only integrate the basic principle of prudential duty in theory, but also effectively respond to the needs of investment practice. However, the control of risk sources is not the only reference factor that frames the theoretical coordinates of investors' prudential obligations. As mentioned in the Corfu Channel judgment, "the mere fact that a state exercises control over its territory and waters does not lead to the conclusion that it must have known or ought to have known of any unlawful act committed there".[89]
The ability to control the source of risk cannot be separated from the objective subject limitations. In the process of outbound investment, the premise for investors to take measures to prevent relevant risks is that investors can foresee that such risks will occur with a high probability under certain circumstances,[90] however, due to the limitations of investors' own capabilities and cognitive levels, as well as the vagaries of investment forms, ordinary investors are still unable to foresee extreme events such as natural disasters, wars, and illegal interference by the host country. Therefore, predictability should also be used as another part of the theoretical basis, and together with the risk control ability, the legal core of the investor's prudential obligation should be constructed. To sum up, the theoretical basis and logical framework of the "identity theory" are both inconsistent and incomplete, and the "control-foresight theory" should be taken as the legal core of the investor's prudential obligation.

4.2 Reconstruction of the Applicable Standard

From the inductive analysis of the above-mentioned arbitration practice, there are many drawbacks in the current applicable standard of the investor's prudential duty. After the reshaping of its jurisprudential core, the applicable standards should also be reconstructed. Since the theoretical structure of the investor's prudential obligation depends on the investor's control over future risks and their predictability, the author believes that the new applicable standard should also take control and foreseeability as the main reference and integrate and evaluate the objective factors related to it. First, the arbitral tribunal should take the ability to control the risk as the primary criterion, and foreseeability as the "exemption condition". The reason is that being able to control the source of risk necessarily requires the legal subject to have a certain degree of understanding of the risks related to the subject matter in advance, so the former itself includes a certain degree of risk prediction ability.[91]
Thus, predictability, which is the core of jurisprudence, is aimed at the relevant parts that go beyond the cognitive capacity of the main system. The factors that determine an investor's ability to control the source of risk include the investor's commercial strength, political authority, social relations, and rights in legal relations.[92] In previous arbitral awards, although the arbitral tribunal did not explicitly state that the above elements are related to risk control, some awards have included the above elements in the definition of measures corresponding to the investor's duty of care. For example, in *Lemire v. Ukraine*, the tribunal first found that the investor should conduct the relevant investigation before investing, but as an individual investor, the host State's failure to publicly assess the issuance of the broadcasting license and the related lack of transparency were clearly beyond the investor's ability to foresee, and the tribunal rejected the host State's defense that the investor had breached the duty of care.[93] In addition, in *MTD v. In the Chile case*, MTD, as a multinational corporation with subsidiaries in Chile, should have had considerable access to the host country's investment-related land planning policies, but chose to follow only the advice of lay consultants. This clearly does not

[86] See Corfu Channel Case (United Kingdom v. Albania), Judgment, I. C. J. Reports 1949, p. 1.
[87] See Case Concerning Armed Activities on the Territory of the Congo (DRC v. Uganda), Judgment, I. C. J. Reports 2005, para. 173.
[88] See Alice Ollino, ***"Due Diligence Obligations in International Law"***, (Cambridge University Press, 2022), pp. 133 - 135.
[89] See Corfu Channel Case (United Kingdom v. Albania), Judgment, I. C. J. Reports 1949, p. 18.
[90] See Alice Ollino, ***"Due Diligence Obligations in International Law",*** (Cambridge University Press, 2022), p. 156.
[91] See Mikayil Mammadov v. Azerbajan, Judgment, App no 4762 / 05, 2009, para. 111.
[92] See Heike Krieger et al. (eds.), ***"Due Diligence in the International Legal Order"***, (Oxford University Press, 2021), pp. 90 - 91.
[93] See Joseph Charles Lemire v. Ukraine, ICSID Case No. ARB/ 06 / 18, Decision on Jurisdiction and Liability of 14 January 2010, paras. 403 - 408, 416 - 422.

meet the standard of compliance with the duty of care;[94] For the analysis of predictability, the arbitral tribunal can make a judgment based on the investor's experience, the investment environment and social background of the host country, and the international economic situation.[95] e.g., in *Mamidoil v. In the Albani* decision, the tribunal held that the host country, Albania, had experienced a severe financial crisis that had brought it to the brink of complete economic collapse and that the duty of care required investors to foresee that investments in such an environment were extremely risky.[96] Second, the arbitral tribunal needs to distinguish between the legal relationship between the investor and the host State at different stages of the investment process. Before making an investment, the investment property is under the full control of the investor, in which case the investor's duty of care should be of a high standard, and the investor needs to have a complete understanding of the social context of the host country as much as possible; After the act of investment has been made, as mentioned above, there is a twofold legal relationship between the host State and the investor. At the horizontal level, the two are equal and cooperative, which involves the performance of investment and the granting of treatment.

5. Implications for Morocco

As Morocco continues to position itself as a key player in the international investment arena, the implications of investor due diligence and the evolving norms in international investment arbitration are crucial for its economic development. The country has made significant strides in attracting foreign investment, leveraging its strategic geographical location as a gateway to Africa and Europe. However, with the increasing scale of foreign investments, it is imperative for Morocco to navigate the complexities of investor obligations and the regulatory landscape effectively. This comprehensive analysis explores the implications of investor due diligence for Morocco, focusing on regulatory enhancements, balancing investment attraction with domestic development, strengthening due diligence practices, improving dispute resolution mechanisms, and fostering a collaborative investment environment.

5.1 Regulatory Framework Enhancement

Morocco's legal framework for foreign investment is foundational to its attractiveness as an investment destination. However, to align with international best practices, Morocco must enhance its regulatory framework to include clearer obligations for investors. Currently, while Morocco has established several Bilateral Investment Treaties (BITs), many lack explicit provisions detailing investor duties.

To mitigate risks associated with foreign investments, Morocco should consider adopting BITs that explicitly outline investor obligations. For example, the Morocco-Nigeria BIT mandates compliance with environmental assessments, setting a precedent for Morocco to follow. By including such provisions, Morocco can ensure that investors are held accountable for their actions and their impact on local communities and the environment. This clarity will not only protect Moroccan interests but also enhance the country's reputation as a responsible investment destination.

In addition to obligatory clauses, Morocco should incorporate encouragement clauses in its investment treaties. Drawing inspiration from the Canadian Model BIT, these clauses would promote responsible business conduct among investors. By encouraging investors to adopt sustainable practices, such as considering labor rights, environmental protection, and community engagement, Morocco can align foreign investments with its national development goals. This dual approach—combining encouragement with mandatory obligations—will foster a more sustainable investment environment.

5.2 Balancing Investor Attraction and Domestic Development

As Morocco strives to attract foreign investment, it faces the challenge of balancing the need for capital influx with the imperative of ensuring that such investments contribute positively to local development. This balance is critical for maintaining social stability and fostering economic growth.

To achieve this balance, Morocco should adopt a dual approach in its investment agreements. By including both encouragement and obligatory clauses, the country can create a framework that incentivizes foreign investors while ensuring they adhere to local regulations and contribute to sustainable development. For instance, while investors may be encouraged to engage in corporate social responsibility initiatives, they must also comply with specific regulatory requirements related to environmental protection and labor practices. This comprehensive framework will help Morocco attract quality investments that align with its development objectives.

Mandating that investors contribute to sustainable development is vital for Morocco’s long-term growth. This can be achieved by requiring foreign investors to demonstrate how their projects will benefit local communities, create jobs, and minimize environmental impacts. By prioritizing investments that align with national priorities, Morocco can ensure that foreign capital contributes to its broader socio-economic goals. This approach not only enhances the quality of investments but also builds trust between investors and local communities.

5.3 Strengthening Due Diligence Practices

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[94] See MTD Equity Sdn. Bhd. & MTD Chile S. A. v. Republic of Chile, ICSID Case No. ARB/ 01 / 7, Award, 25 May 2004, paras. 176 - 177.

[95] See Carolina Moehlecke1 and Rachel L. Wellhausen, ***“Political Risk and International Investment Law”***, (2022) 25 Annual Review of Political Science 485, pp. 489 - 491.

[96] See Mamidoil Jetoil Greek Petroleum Products Societe S. A. v. Republic of Albania, ICSID Case No. ARB/ 11 / 24, 30 March 2015, para. 671.

For Moroccan enterprises and investors, understanding and fulfilling due diligence obligations is essential, especially when investing abroad. A robust due diligence process can mitigate risks and enhance the chances of successful investments.
Moroccan investors venturing into foreign markets must thoroughly research the legal and regulatory landscapes of their target countries. This includes understanding investment laws, tax regulations, labor laws, and environmental standards. By conducting comprehensive due diligence, Moroccan investors can minimize the risk of non-compliance and potential disputes. Additionally, understanding local customs and business practices can enhance the likelihood of successful integration into the host market.
Collaborating with local professionals is another critical aspect of effective due diligence. Moroccan investors should seek partnerships with local firms, legal advisors, and industry experts to gain insights into the business environment and cultural nuances of the host country. This engagement not only facilitates compliance with local regulations but also helps mitigate risks associated with unfamiliar markets. By leveraging local expertise, Moroccan investors can make informed decisions and adapt their strategies to align with local expectations.

5.4 Improving Dispute Resolution Mechanisms

As the scale of foreign investments in Morocco increases, so does the likelihood of disputes arising between investors and the government or local communities. Therefore, enhancing dispute resolution mechanisms is crucial for protecting the rights of investors and ensuring a stable investment climate.
Morocco should focus on strengthening its legal framework surrounding investment arbitration. By providing clear and efficient mechanisms for resolving disputes, the country can instill confidence in foreign investors. This includes establishing specialized arbitration institutions and ensuring that arbitration processes are transparent, fair, and accessible. Additionally, Morocco should consider adopting international arbitration standards to align its practices with global norms.
Educating Moroccan investors about available arbitration options is essential for safeguarding their rights. Investors should be informed about the mechanisms for investment arbitration, including the steps to take in case of disputes. This awareness will empower investors to take proactive measures to protect their interests and seek recourse when necessary. Furthermore, promoting awareness of successful arbitration cases can enhance confidence in the effectiveness of the dispute resolution system.

5.5 Fostering a Collaborative Investment Environment

Creating a collaborative investment environment is vital for ensuring that foreign investments align with national development goals and benefit local communities. This collaborative approach can foster trust and facilitate smoother interactions between investors and stakeholders.
Encouraging dialogue between the government, investors, and local populations is essential for addressing concerns and expectations. Morocco should establish platforms for stakeholder engagement, where investors can communicate their projects and seek input from local communities. This engagement can help identify potential issues early on and foster a sense of ownership among local populations, leading to more successful investment outcomes.
Promoting public-private partnerships (PPPs) can enhance the effectiveness of investment projects in Morocco. By collaborating with the government, private investors can leverage public resources and expertise to implement projects that align with national priorities. PPPs can be particularly beneficial in sectors such as infrastructure, healthcare, and education, where investment can have a significant impact on local communities. By fostering collaboration between the public and private sectors, Morocco can create a more conducive environment for sustainable investments.

6. Conclusion

In conclusion, the evolving landscape of international investment arbitration necessitates a nuanced understanding of investor prudence obligations. As multinational enterprises continue to expand their global footprint, the need for a balanced framework that holds investors accountable while respecting the rights of host countries has become increasingly urgent. This article highlights the critical gaps in the current normative provisions governing investor conduct and underscores the importance of integrating prudential obligations into the legal fabric of international investment law. The examination of the historical development and practical application of investor prudence obligations reveals that while some arbitral tribunals have begun to embrace this concept, significant inconsistencies and ambiguities remain. The traditional public law paradigm, while valuable, is insufficient to address the complexities of contemporary international relations and the diverse array of legal subjects involved in investment arbitration. As such, a shift towards a more functional and differentiated approach is imperative. By revisiting and refining the legal basis for prudential obligations, this article advocates establishing clear, applicable standards that align with the evolving nature of these obligations. Such standards should not only reflect the expectations of host countries but also foster a culture of responsible investment that benefits all stakeholders involved. Ultimately, the successful integration of investor prudence obligations into international investment arbitration will require collaboration among scholars, practitioners, and policymakers. By embracing a comprehensive and adaptive framework, the international community can better navigate the challenges posed by globalization and ensure that both investors and host countries can thrive in a fair and equitable investment environment.

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