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Asymmetric Risk Allocation in Foreign Direct Investment: Integrating Transnational Corporate Due Diligence

Alokasi Risiko Asimetris Penanaman Modal Asing: Integrasi Kewajiban Uji Tuntas Korporasi Transnasional

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Abstract

This study examines the structural imbalance within the international investment regime, where Bilateral Investment Treaties facilitate asymmetric risk allocation by functioning as unpriced public insurance for multinational enterprises. The escalating volume of Investor-State Dispute Settlement claims and speculative valuation methods significantly restrict the host state's regulatory autonomy, inducing a detrimental regulatory chill. Utilizing doctrinal legal research with conceptual and statute approaches, this research analyzes the triangular interaction between extraterritorial home state regulations, host state pragmatism exemplified by Indonesia's Omnibus Law and transnational corporate obligations. The findings reveal that current protections prioritize investor interests over sustainable public policy. Consequently, this study proposes integrating mandatory transnational due diligence as a jurisdictional filter for Fair and Equitable Treatment protection. Such recalibration, grounded in the principle of systemic integration, effectively limits expansive legitimate expectations and restores sovereign authority to regulate in the public interest, ensuring a more equitable distribution of investment risks within the global architecture.

Abstrak

Penelitian ini mengkaji ketidakseimbangan struktural dalam rezim investasi internasional, di mana Perjanjian Investasi Bilateral memfasilitasi alokasi risiko asimetris dengan berfungsi sebagai asuransi publik tanpa harga bagi perusahaan multinasional. Eskalasi volume klaim Penyelesaian Sengketa Investor-Negara dan metode valuasi spekulatif secara signifikan membatasi otonomi regulasi negara penerima, sehingga memicu efek *regulatory chill* yang merugikan. Menggunakan penelitian hukum doktrinal dengan pendekatan konseptual dan perundang-undangan, penelitian ini menganalisis interaksi triangular antara regulasi ekstrateritorial negara asal, pragmatisme negara penerima seperti yang dicontohkan oleh Undang-Undang Cipta Kerja Indonesia dan kewajiban korporasi transnasional. Temuan menunjukkan bahwa perlindungan saat ini memprioritaskan kepentingan investor di atas kebijakan publik yang berkelanjutan. Oleh karena itu, penelitian ini mengusulkan integrasi uji tuntas transnasional wajib sebagai filter yurisdiksional bagi perlindungan Perlakuan Adil dan Setara. Rekalibrasi tersebut, yang berlandaskan pada prinsip integrasi sistemik, secara efektif membatasi ekspektasi sah yang ekspansif dan memulihkan kewenangan berdaulat untuk mengatur demi kepentingan publik, guna memastikan distribusi risiko investasi dalam arsitektur global.

A. INTRODUCTION

1. Background

The architecture of contemporary international economic law positions Foreign Direct Investment (FDI) as a fundamental instrument for catalyzing global economic development. Theoretically, cross-border financial intermediation and capital flows are believed to contribute significantly to economic growth by enhancing capital allocation, reducing transaction costs, and mitigating information asymmetry between capital-exporting and capital-importing states.[1]

In this idealized landscape, FDI ought to foster mutually proportional benefits. However, in practice and operation, the international investment law regime—orchestrated through a complex network of over three thousand Bilateral Investment Treaties (BITs) and International Investment Agreements (IIAs)—has created a profoundly asymmetrical risk allocation landscape.[2]

These agreements, initially conceptualized in their formative decades as anchors of the rule of law to mitigate political risk for investors operating in volatile or unpredictable jurisdictions, now function de facto as *unpriced public insurance* policies exclusively benefiting foreign corporate entities.[3]

This functional shift has triggered an essential *clash of norms* and alarming precedents, wherein investor protection mechanisms frequently collide diametrically with the sovereignty and regulatory autonomy of host states. This conflict is amplified when host states implement urgent public policies concerning public health, green energy transitions, climate mitigation, or environmental sustainability.[4] This phenomenon is empirically represented in the Indonesian regulatory landscape, particularly through the enactment of the Job Creation Law (*Omnibus Law*). Through this regulation, Indonesia exemplifies the archetype of a developing state aggressively relaxing domestic protection

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[1] Muhammad Ubaidillah Al Mustofa, Imron Mawardi, and Mohammad Haidar Risyad, "Exploring the FDI-Growth-Finance Nexus: Does the Level of Economies Matter?," *Cogent Economics & Finance* 13, no. 1 (December 31, 2025), https://doi.org/10.1080/23322039.2025.2551160.
[2] Josef Ostřanský and Lukas Schaugg, "Investment Treaties as a Risk Allocation Tool," *International Institute for Sustainable Development*, 2025, https://www.iisd.org/system/files/2025-07/investment-treaties-risk-allocation-tool.pdf.
[3] Carolina Moehlecke and Rachel L. Wellhausen, "Political Risk and International Investment Law," *Annual Review of Political Science* 25, no. 1 (May 12, 2022): 485–507, https://doi.org/10.1146/annurev-polisci-051120-014429.
[4] Marcia Gladys Rumambi and Gunardi Lie, "Antara Kedaulatan Negara Dan Kepastian Investor: Analisis Kritis Arbitrase Internasional Dalam Sengketa Investasi Asing," *Journal of Legal, Political, and Humanistic Inquiry* 1, no. 4 (April 2026): 306–17, https://doi.org/10.65310/x3cakw54.

standards to attract FDI inflows—a pragmatic approach that paradoxically widens its exposure to future Investor-State Dispute Settlement (ISDS) claims.[5]

This normative tension is further exacerbated by the exponential surge in ISDS disputes. Recent analytical data confirms that the cumulative number of ISDS cases exceeded 1,400 by the end of 2024, with 98% predicated upon first-generation investment treaties devoid of guidelines, parameters, or interpretative limits regarding proportional compensation for host states.[6]

Compensation claims filed by multinational corporations currently reach an average valuation of USD 1.1 billion per case, with average arbitral awards exceeding USD 250 million. These liabilities impose fiscal burdens that significantly restrict the host state's regulatory space—a phenomenon documented in scholarly literature as the *regulatory chill* effect.[7]

These empirical dynamics objectively confirm an acute legal lacuna and architectural deficiency within the global investment risk distribution system. Risk factors involving commercial project failure, climate transition volatility, and social friction are frequently externalized by Multinational Enterprises (MNEs) onto the host state’s taxpayers, while financial gains remain strictly internalized within the private sphere. This structural distortion fuels scholarly debate regarding the boundaries of international jurisdiction: to what extent does the host state possess the *inherent right to regulate* its domestic affairs without being perpetually threatened by allegations of *indirect expropriation* or breaches of *Fair and Equitable Treatment* (FET) standards by international arbitral tribunals.[8]

To comprehensively dissect these complexities and bolster the dogmatic depth of this research, a thorough mapping of the *state of the art* in international investment law discourse is essential. Contemporary primary research highlights various facets of this

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[5] Tri Anggoro Putro, “Establishment of Omnibus Law in Solving Investment Issues in Indonesia,” *Indonesian Comparative Law Review* 3, no. 2 (November 12, 2021): 105–23, https://doi.org/10.18196/iclr.v3i2.12738.
[6] Amalia Salsabila Torina, “Investor State Dispute Settlement (ISDS) Dalam Kegiatan Investasi Asing,” *Jurnal Ilmu Hukum, Humaniora Dan Politik* 5, no. 3 (January 2025): 1704–12, https://doi.org/10.38035/jihhp.v5i3.3657.
[7] Linklaters, “UNCTAD Reports on Trends in Compensation and Damages in Investor-State Dispute Settlement Proceedings,” Linklaters, 2024, https://www.linklaters.com/insights/blogs/arbitrationlinks/2024/october/unctad-compensation-report.
[8] Maulana Irfan Sufa, Prita Amalia, and Helitha Novianty Muchtar, “Perkembangan Implementasi Due Diligence Bagi Investor Dalam Penyelesaian Sengketa Mengenai Legitimate Expectation,” *Kertha Semaya : Journal Ilmu Hukum* 13, no. 9 (August 2025): 1887–1901, https://doi.org/10.24843/KS.2025.v13.i09.p03.

asymmetry through diverse methodological lenses. From the perspective of treaty architecture, recent scholarship decisively posits that BITs currently operate exclusively as instruments of public insurance, shifting political risk from investors back onto the host state. A crucial paradigm shift is observed in modern treaty negotiation practices, which increasingly endeavor to incorporate explicit regulatory exceptions to safeguard host-state autonomy from the overly expansive interpretative practices of arbitral tribunals.[9] Furthermore, empirical studies underscore that the failure of MNEs to internalize sustainability risks engenders asset valuation distortions that cannot be mitigated in the absence of robust public regulatory intervention.[10]

Furthermore, debates have extended to the evolution of the transnational obligations of MNEs. Muchlinski sharply criticizes the exclusive ISDS regime as a form of "privatised legal entrepreneurship".[11] As an antithesis, extraterritorial legal instruments from home states, such as the UN Guiding Principles on Business and Human Rights (UNGPs) and the EU Corporate Sustainability Due Diligence Directive (CSDDD), seek to impose human rights and environmental due diligence obligations upon MNEs across territorial boundaries.[12]

Through a thematic synthesis of this academic discourse, a fundamental *research gap* is identified. Previous studies have tended to dissect this asymmetry in a fragmented manner: some scholars focus solely on treaty text reform, while others concentrate on corporate responsibility discourse in home states, without organically linking them to investment arbitration jurisprudence. The primary *blind spot* in current academic discourse is the absence of a theoretical construction that holistically integrates the triangular interaction between: (1) home-state extraterritorial actions (e.g., CSDDD), (2) host-state control pragmatism (relaxing domestic standards for FDI), and (3) the transnational obligations of MNEs. This dogmatic integration necessitates the instrumentation of the *clean hands doctrine* or the principle of *systemic integration* under

9 Marcia Gladys Rumambi and Gunardi Lie, "Antara Kedaulatan Negara Dan Kepastian Investor: Analisis Kritis Arbitrase Internasional Dalam Sengketa Investasi Asing."
10 Jonathan E. Leightner, Kacey Axon, and Simon Medcalfe, "The Correlation Between Income Inequality and per Capita GDP in Georgia's Counties," *Journal of Risk and Financial Management* 19, no. 3 (March 2026): 234, https://doi.org/10.3390/jrfm19030234.
11 Runar Hilleren Lie, "The Influence of Law Firms in Investment Arbitration," in *The Legitimacy of Investment Arbitration* (Cambridge University Press, 2022), 100–132, https://doi.org/10.1017/9781108946636.005.
12 Stephanie Triefus, "The UNGPs and ISDS: Should Businesses Assess the Human Rights Impacts of Investor–State Arbitration?," *Business and Human Rights Journal*, November 24, 2023, 1–23, https://doi.org/10.1017/bhj.2023.45.

Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT), acting as a bridge that enables extraterritorial due diligence obligations to function as a prerequisite for the applicability of investment protection.[13]

Diverging from previous research that largely focuses on the contractual equilibrium between the host state and the investor in isolation, this study offers a significant *novelty* by deconstructing investment risk allocation through a triangular interaction lens. This article interrogates the *due diligence* obligations mandated by home states not merely as corporate compliance reporting instruments, but as constitutive jurisdictional elements that strictly limit the applicability of the *Legitimate Expectations* doctrine within FET protections in investment arbitral tribunals. If an investor is proven to have failed to meet these transnational due diligence standards, their legal expectations are *ipso facto* flawed and unworthy of treaty protection. This is predicated on the postulate that *legitimate expectations* do not operate in a vacuum but are subject to the principles of *good faith* and *investor due diligence*.[14] Furthermore, as the Indonesian legal reality (the Job Creation Law) has been situated as an empirical representation from the outset, the analysis in this study functions as an operational verification of the host state's control paradox, which indirectly restructures this asymmetrical risk trap.

The primary thesis statement forcefully defended in this article is that the phenomenon of asymmetrical risk allocation cannot be resolved merely through the termination of legacy investment treaties or the inclusion of general exception clauses; rather, it requires a dogmatic integration of MNEs' transnational obligations into the core of international arbitral jurisprudence. The externalization of environmental and human rights risks by MNEs no longer holds jurisprudential justification, as the fulfillment of due diligence obligations has evolved into a standard of *transnational public policy*. The comprehensive solution proposed herein is a recalibration of institutional law, wherein the protection of investment arbitration—particularly the FET standard—is jurisdictionally conditioned upon the material proof of the investor's *good faith* compliance with global due diligence obligations. Absent the fulfillment of this prerequisite, compensation claims against the host state's sustainability regulations must

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[13] Stephan W Schill and Vladislav Djanic, "Wherefore Art Thou? Towards a Public Interest-Based Justification of International Investment Law," *ICSID Review - Foreign Investment Law Journal* 33, no. 1 (February 1, 2018): 29–55, https://doi.org/10.1093/icsidreview/six025.
[14] Shaun Matos, "Investor Due Diligence and Legitimate Expectations," *The Journal of World Investment & Trade* 23, no. 2 (April 26, 2022): 313–28, https://doi.org/10.1163/22119000-12340231.

be rejected *de jure*.

2. Research Questions

Proceeding from this conceptual gap, this article intends to address two primary research questions:

a. How does the triangular interaction between home-state regulation, host-state policy pragmatism, and the void in corporate transnational obligations facilitate the asymmetry of risk allocation within the contemporary international investment regime?
b. How can transnational *due diligence* obligations be jurisdictionally integrated into the ISDS arbitral architecture to limit the expansion of investor *legitimate expectations* and restore the host state's regulatory autonomy?

3. Research Methodology

This research employs a doctrinal legal research method, analyzed through a prescriptive lens using conceptual, statutory, and case-based approaches. The primary legal sources consist of international investment instruments (Bilateral Investment Treaties/BITs and International Investment Agreements/IIAs), extraterritorial frameworks (the UN Guiding Principles on Business and Human Rights/UNGPs and the EU Corporate Sustainability Due Diligence Directive/CSDDD), domestic regulations (Law No. 11 of 2020 on Job Creation), and international arbitral jurisprudence, with a specific focus on awards rendered by the International Centre for Settlement of Investment Disputes (ICSID). Secondary legal materials are extracted from reputable, Scopus-indexed global legal journals. This doctrinal analysis is further supported by empirical secondary data concerning Investor-State Dispute Settlement (ISDS) trends, sourced from the United Nations Conference on Trade and Development (UNCTAD) reports.[15] Legal materials were collected through a systematic literature review. Analysis was applied utilizing deductive syllogism as well as systematic and teleological interpretations guided by Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT), to examine the interaction between investment protection standards and transnational regulations in formulating a new investment risk equilibrium argument.[16]

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[15] United Nations Trade and Development, "Facts and Figures on Investor–State Dispute Settlement Cases," 2024, https://unctad.org/system/files/official-document/diaepcbinf2024d5_en.pdf.
[16] Laurence Boisson de Chazournes and Elise Ruggeri Abonnat, "Contract and Treaty Interpretation in International Arbitration," in *Cambridge Compendium of International Commercial and Investment Arbitration* (Cambridge University Press, 2023), 1723–50, https://doi.org/10.1017/9781108304467.057.

B. DISCUSSION

1. Anatomy and Dogmatic Roots of Asymmetrical Risk Allocation in the ISDS Regime

Modern international investment law is fundamentally engineered upon the postulates of classical free-market economics, which emphasize the urgency of efficient capital flow circulation free from cross-jurisdictional administrative barriers. This initial conception assumed that the free movement of capital would yield prosperity distributed symmetrically between capital-exporting entities and developing host states. However, the dominant legal instruments governing these postulates—Bilateral Investment Treaties (BITs) and International Investment Agreements (IIAs)—have gradually transformed into legal structures that inherently facilitate asymmetrical risk allocation. To comprehend this distortion, BIT instruments must no longer be dissected merely as diplomatic charters of understanding, but rather conceptualized through the lens of political economy as mechanisms of (unpriced public insurance).[17]

This insurance mechanism operates through a structural anomaly. In standard commercial financing regimes, the provision of political risk insurance by multilateral institutions requires rigorous actuarial calculations and premium payments that reflect the objective risk profile of the host state's governance. Conversely, through the architecture of BITs, Multinational Enterprises (MNEs) obtain guarantees of protection against legislative policy shifts, political fluctuations, and communitarian demands, with the collateral drawn directly from the host state's treasury.[18] When an investment is disrupted by a legitimate public policy shift, the burden of loss is externalized from the corporate balance sheet and transferred onto the sovereign fiscal ledger.

he empirical manifestation of this risk asymmetry accumulates significantly within the practice of *Investor-State Dispute Settlement (ISDS)* adjudication. The doctrine of state sovereignty—historically centered on the resolution of "Permanent Sovereignty over Natural Resources" (PSNR)—is currently facing jurisdictional restrictions resulting from the *normative collision* with the expansive doctrine of the (Investor's Legitimate

[17] Jonathan Bonnitcha, Lauge N Skovgaard Poulsen, and Michael Waibel, "The Investment Treaty Regime in Context," in *The Political Economy of the Investment Treaty Regime* (Oxford University Press, 2017), 1–32, https://doi.org/10.1093/law/9780198719540.003.0001.
[18] Jonathan Bonnitcha, Lauge N Skovgaard Poulsen, and Michael Waibel, "Politics of Investment Treaties in Developed Countries," in *The Political Economy of the Investment Treaty Regime* (Oxford University Press, 2017), 181–206, https://doi.org/10.1093/law/9780198719540.003.0007.

Expectations).[19] These restrictions are further exacerbated by the reluctance of arbitral tribunals to apply the principle of *systemic integration* as mandated by Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT). Rather than interpreting standard protection clauses such as *Fair and Equitable Treatment (FET)* and the prohibition of expropriation in harmony with other international legal obligations (e.g., the Paris Agreement or human rights covenants), tribunals tend to interpret them within a commercial vacuum.[20] Consequently, when a host state modifies its regulations to respond to the global climate crisis, investors possess direct access to drag the state into international arbitration.

Quantitatively, current data validates the operation of this asymmetry. As of early 2026, the cumulative total of officially registered ISDS disputes has surpassed 1,401 cases.[21] Of grave fiscal concern is the escalation in damage quantification. The average value of claims currently stands at USD 1.1 billion per case, with arbitral awards granted by tribunals increasing to an average of USD 250 million.[22] This astronomical surge is rooted in the tribunals' interpretative simplification of the "full reparation" doctrine, derived from the landmark judgment of the Permanent Court of International Justice (PCIJ) in the *Chorzów Factory* case (1928). Tribunals frequently err by conflating the compensation standards for lawful expropriation (pursued for public purpose) with those for unlawful expropriation. Consequently, legitimate state regulatory actions aimed at public protection are penalized under the same rigorous reparation standards reserved for grave international wrongful acts.[23]

To operationalize the *Chorzów* doctrine within contemporary commercial disputes, tribunals regressively adopt the *Discounted Cash Flow* (DCF) valuation method. The application of this method represents the culmination of asymmetrical risk allocation. DCF is inherently speculative, as it assumes future regulatory stability as a "constant." In

[19] Ying Zhu, "A Quasi-normative Conflict: Resolving the Tension between Investment Treaties and Climate Action," *Review of European, Comparative & International Environmental Law* 33, no. 2 (July 2, 2024): 183–93, https://doi.org/10.1111/reel.12565.
[20] Jorge E Viñuales, "International Environmental Law after Half a Century," *European Journal Of International Law* 36, no. 4 (November 1, 2025): 995–1009, https://doi.org/10.1093/ejil/chaf065.
[21] United Nations Conference on Trade and Development, "Investment Dispute Settlement Navigator," United Nations Conference on Trade and Development, 2026, https://investmentpolicy.unctad.org/investment-dispute-settlement.
[22] Linklaters, "UNCTAD Reports on Trends in Compensation and Damages in Investor-State Dispute Settlement Proceedings."
[23] Christina L. Beharry and Elisa Méndez Bräutigam, "Damages and Valuation in International Investment Arbitration," in *Handbook of International Investment Law and Policy* (Singapore: Springer Singapore, 2021), 1423–54, https://doi.org/10.1007/978-981-13-3615-7_58.

reality, within an era of climate crisis, environmental regulatory adjustment is an absolute "variable" that will inevitably undergo continuous change.[24] As a consequence of failing to incorporate regulatory risk into the discount factor, host states are not merely required to reimburse physical capital (*sunk costs*); they are jurisdictionally mandated to compensate for the investor's hypothetical future profit expectations spanning decades.[25]

Table 1. Sectoral Asymmetrical Risk Configuration in ISDS Disputes (UNCTAD Data Aggregation 2024–2025)

Dominant Industrial Sector	Percentage of Total Cases	Primary Legal Instruments Invoked	Characteristics of Claims and Argumentative Basis for Asymmetrical Risk	Tribunal Resolution and Implications for Host States
Fossil Energy & Oil/Gas	~21%	Energy Charter Treaty (ECT) & First-Generation BITs	Disputes triggered by pro-climate regulations (*fossil fuel phase-out*), denial of ecological permits, or concession revocation.	High investor success rates. Directly induces severe *regulatory chill* concerning green energy transition agendas.
Mining & Extractive	~15%	Specific BITs & Legacy NAFTA (Chapter 11)	Claims stemming from stricter environmental standards, royalty increases (*resource nationalism*), and land moratoriums.	Claim values inflated drastically via speculative *Discounted Cash Flow* (DCF) valuation methods to justify long-term mine-life compensation.
Construction & Infrastructure	~16%	BITs with *Umbrella Clauses*	Triggered by disputes over the allocation of financial risk in PPP projects and the termination of administrative contracts..	Exploitation of *umbrella clauses*, elevating pure commercial contract disputes into breaches of international public law treaties.

The comparative analysis in Table 1 confirms a regulatory disconnection: the industrial sectors most aggressive in mobilizing ISDS are precisely those producing the greatest negative externalities to environmental sustainability. MNEs accumulate capital by minimizing the internalization of ecological restoration costs. Yet, when host states assert their regulatory autonomy to compel the internalization of such costs—for instance, through clean energy transitions—MNEs activate the ISDS safety net. The logical consequence of this policy anomaly is the erosion of fiscal sovereignty, wherein the

[24] Oliver Hailes, "Unjust Enrichment in Investor–State Arbitration: A Principled Limit on Compensation for Future Income from Fossil Fuels," *Review of European, Comparative & International Environmental Law* 32, no. 2 (July 10, 2023): 358–70, https://doi.org/10.1111/reel.12483.
[25] Julian Arato, "The Institutions of Exceptions: Justification in Trade and Investment Treaties," *Michigan Journal of International Law*, April 2026, 41, https://doi.org/10.36642/mjil.47.1.institutions.

investment regime facilitates the (socialization of losses and privatization of profits).[26] Taxpayers are forced to bear a double burden: they suffer the physical consequences of environmental degradation while simultaneously being compelled to finance multi-billion-dollar arbitration awards to secure the speculative profit margins of foreign investors.

2. Home-State Extraterritoriality and the Transformation of MNE Transnational Obligations

In the orthodox discourse of 20th-century investment law, the home state was positioned exclusively as a passive actor following the signing of a Bilateral Investment Treaty (BIT). This traditional construction reduced the home state's role to the provision of diplomatic protection at the intergovernmental level. Meanwhile, Multinational Enterprises (MNEs) were assumed by classical literature to be rational commercial actors whose legal obligations were confined solely to domestic administrative compliance within the host state (*host state law*). Historically, this paradigm facilitated MNEs in creating complex corporate structuring to optimize commercial gains, capture tax incentives, and limit liability to undercapitalized local subsidiaries.[27]

Nevertheless, contemporary scholarship and the evolution of cross-jurisdictional legal practices indicate a radical shift away from this passive paradigm. Strategic capital-exporting jurisdictions have begun revitalizing their active sovereign prerogatives by enacting regulatory regimes that impose extraterritorial supervisory obligations upon parent corporations. A fundamental legislative intervention in this discourse is the European Union's adoption of the *Corporate Sustainability Due Diligence Directive* (CSDDD). The enactment of this imperative regulation signifies an essential normative paradigm shift, wherein previously non-binding *soft law* instruments—such as the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Guidelines—are definitively transformed into positive legal instruments that bind corporations within the home state.[28]

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[26] Kyla Tienhaara, "Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement," *Transnational Environmental Law* 7, no. 2 (July 22, 2018): 229–50, https://doi.org/10.1017/S2047102517000309.

[27] Kezhen Su and Wei Shen, "Environmental Protection Provisions in International Investment Agreements: Global Trends and Chinese Practices," *Sustainability* 15, no. 11 (May 24, 2023): 8525, https://doi.org/10.3390/su15118525.

[28] Talal Abdulla Al-Emadi et al., "The EU Corporate Sustainability Due Diligence Directive: Implications and the Qatari Case Study," *The Journal of World Energy Law & Business* 18, no. 4 (November 5, 2025), https://doi.org/10.1093/jwelb/jwaf022.

The EU CSDDD directive mandates that large-scale corporate entities not only identify risks passively but also proactively prevent, mitigate, and cease material adverse impacts on environmental sustainability and human rights throughout their *global value chains*. This dynamic fundamentally introduces a new jurisprudential dimension: "Transnational Obligations." Under this regime, civil and reputational legal risks are inherently attached to business operations as they expand across national borders. Consequently, MNEs can no longer rely absolutely on the corporate veil or *treaty shopping* to maximize protection under *Investor-State Dispute Settlement* (ISDS) instruments while simultaneously externalizing legal liabilities and evading social accountability in the developing host states where their extractive activities occur.[29]

From the perspective of the sociology of international law, the implementation of mandatory *Human Rights and Environmental Due Diligence* (mHREDD) instruments by home states initiates the embryo of *Transnational Public Policy*. Contemporary investment arbitration is gradually adopting the jurisdictional awareness that manifest violations of Transnational Public Policy—such as bribery, structured corruption, or forced labor—constitute fundamental defects that directly impact the tribunal's jurisdiction or render claims inadmissible (*inadmissibility of claims*). Furthermore, issues regarding failures in human rights and environmental due diligence obligations are, in practice, operationalized during the merits phase. Violations of such due diligence obligations construct *contributory fault*, which undermines *Fair and Equitable Treatment* (FET) claims and delegitimizes the investor's assertion of *bona fide* conduct, ultimately resulting in the reduction of compensation awards.[30] This doctrine is not merely a representation of domestic normative sectoral ego, but rather a crystallization of the universal consensus of the international community.

The elevation of MNEs' obligations into the discourse of international arbitration carries crucial doctrinal and practical implications. Theoretically, this discourse deconstructs the orthodox thesis that postulates the investment regime as an isolated space, bifurcating commercial recovery rights from human rights obligations. Instrumentally, the home-state mHREDD regulations provide a material defense

[29] Long Tran, "Responsibility for Human Rights Due Diligence in International Investment Law: Experiences from ASEAN and Implications for Vietnam," *International Journal of Law and Management*, January 1, 2026, 1–24, https://doi.org/10.1108/IJLMA-09-2025-0423.
[30] Tomoko Ishikawa, "Corporate Environmental Responsibility and the Investor's Principal Claims," in *Corporate Environmental Responsibility in Investor-State Dispute Settlement* (Cambridge University Press, 2022), 158–99, https://doi.org/10.1017/9781009076425.008.

mechanism for host states in ISDS fora. When an MNE consortium domiciled in an EU jurisdiction aggressively sues a developing state for environmental sustainability regulatory shifts, the host state possesses a doctrinal footing to respond systematically. They may argue before the arbitral tribunal that the commercial loss is not a result of a breach of *legitimate expectations* caused by host-state policy, but rather a manifest result of the investor's structural failure to adhere to mandatory due diligence standards from its home jurisdiction (e.g., by invoking the EU CSDDD or the French *Loi de Vigilance*). Failure to comply with mandatory laws in the home state operates as *legal facts* that vitiate the investor's *bona fide* status. Through this inter-regime dialogue, the burden of risk is juridically recalibrated back to the MNE as the primary beneficiary of commercial gains, without violating the fundamental principles of investment protection.[31]

3. Host-State Control: The Tug-of-War of Regulatory Autonomy and the Creation of Domestic Risk (The Indonesian Context)

The discourse regarding the effectiveness and demarcation boundaries of *Host State Control* is rooted in the dogmatic struggle between the Theory of Absolute Sovereignty and the Theory of Limited Sovereignty. The narrative of limited sovereignty constitutes the foundation of contemporary international investment law architecture, wherein states are deemed to voluntarily reduce a portion of their domestic legal authority to comply with international obligations. However, precedent dictates that this compliance does not imply the abandonment of a state's essential obligation to continuously regulate public interests—the *right to regulate*. Although the historical application of Bilateral Investment Treaties (BITs) has tended to marginalize the *policy space* of developing states, current geopolitical dynamics signal a resurgence in the host state's resolve to balance investment protection interests with global urgencies, particularly concerning the mitigation of the global climate crisis.[32]

However, a critical analysis of the host state's control implementation reveals a contradictory empirical fact: the asymmetry of risk allocation in the arbitral sphere does not stem exclusively from external treaty impositions. This trap is simultaneously constructed through the architecture of sectoral positive law at the level of national

[31] Andrea Bonomi, "Business and Human Rights: Issues of Private International Law," in *Business and Human Rights* (Brill | Nijhoff, 2025), 291–313, https://doi.org/10.1163/9789004715158_012.
[32] Jorge E. Viñuales, "Foreign Investment and the Environment in International Law: Current Trends," in *Research Handbook on Environment and Investment Law* (Edward Elgar Publishing, 2019), Page, 120. https://doi.org/10.4337/9781784714635.00007.

legislative governance. Law No. 11 of 2020 on Job Creation (*Omnibus Law*), along with its implementing regulations, serves as a representative empirical case study. As an instrument of *legal engineering* designed to facilitate the *ease of doing business*, the Omnibus Law is formulated with a focus on structural deregulation via the *Online Single Submission (OSS)* infrastructure. This move was followed by fundamental overhauls, such as the adoption of the *Positive Investment List* and the reduction of minimum paid-up capital requirements. This ambitious deregulation drastically shifts the paradigm of environmental oversight methodology, moving away from stringent *ex-ante* filtration instruments (e.g., the weakening of Environmental Impact Assessment/AMDAL requirements for medium-risk categories) toward *ex-post* sanction-based oversight instruments, which are often sluggish in responding once environmental degradation has manifested.[33]

The causal consequence of this permissive domestic architecture is the creation of a *regulatory trap*. By degrading the significance of environmental feasibility filters in the initial licensing phase, the state effectively provides regulatory incentives that facilitate the entry of Foreign Direct Investment (FDI) with high ecological risk profiles. Such choices in public law governance indirectly accumulate an ecological risk debt, plunging the state's strategic sovereignty into a posture of chronic vulnerability when confronted with the exposure of international investment law regimes.[34]

The legal mechanics of this risk trap operate through the transition from *ex-ante* to *ex-post* regimes. In arbitral jurisprudence, the easing of regulatory concession requirements in the initial investment facilitation phase is often interpreted by tribunals as *specific representations* or *de facto stabilization clauses* by the host state. Consequently, when the government—subsequently, for instance, due to pressures of real ecological crisis impacts or to fulfill climate mandates under the Paris Agreement—is forced to undertake corrective intervention (such as unilateral license revocation in the *ex-post* phase), such sovereign action is vulnerable to being construed as *Indirect Expropriation* or an *arbitrary measure*. The doctrine of *regulatory estoppel* binds the host state; such corrective intervention is deemed a breach of *Legitimate Expectations* under the *Fair and*

[33] Sudharto P. Hadi, Rizkiana S. Hamdani, and Ali Roziqin, "A Sustainability Review on the Indonesian Job Creation Law," *Heliyon* 9, no. 2 (February 2023): e13431, https://doi.org/10.1016/j.heliyon.2023.e13431.
[34] Richard C. Adam, "Between Attraction and Evasion: Legal Factors Shaping FDI in Indonesia and Neighboring Countries," *Indonesia Law Review* 15, no. 1 (2025): 87–100, https://doi.org/10.15742/ilrev.v15n1.6.

Equitable Treatment (FET) standard, as the state is perceived to have reneged on the guarantee of facilitative regulatory stability that induced the capital influx in the first place.[35]

At this crossroads of critical discourse, a fatal fusion occurs between the erosion of national sovereignty and the robustness of the global jurisdictional architecture. The systemic failure of the executive and legislative branches to design proportional economic legislation effectively provides the factual basis for *Investor-State Dispute Settlement (ISDS)* tribunals to justify financial compensation awards that impose heavy burdens on the state. Consequently, merely revising new-generation BIT drafts to include *right to regulate* clauses restrictively at the international level proves to be superficial and ineffective as a protective shield.[36] This empirical phenomenon in Indonesia proves that international investment treaty reform remains a legal illusion if not accompanied by domestic legislative coherence. Short-term fiscal pragmatism through domestic deregulation instead reconstructs state sovereignty into a facilitator for exposure to asymmetrical ISDS litigation risks.[37]

4. Doctrinal Recalibration: Transnational Due Diligence as an Interpretative Parameter for the FET Standard

This article proposes a recalibration of the *Fair and Equitable Treatment* (FET) standard by integrating transnational *due diligence* obligations as an interpretative filter. This thesis synthesizes three key elements: home-state regulatory mandates, MNE operational standards, and host-state sovereignty. Doctrinally, the FET standard is frequently exploited through the sub-doctrine of *Legitimate Expectations* to obstruct domestic regulatory shifts. The injection of transnational compliance obligations (such as the EU CSDDD) serves as an objective parameter to determine whether an investor is

[35] Jessica Leonard, Prita Amalia, and An Chandrawulan, "Indonesian Perspective on The Investor–State Dispute Settlement Mechanism for Foreign Investment Dispute Settlement in The Field of Intellectual Property Rights," *Indonesia Law Review* 10, no. 1 (April 30, 2020): 17–28, https://doi.org/10.15742/ilrev.v10n1.615.
[36] Caslav Pejovic and Juliartha Pardede, "Revising Bilateral Investment Treaties as a New Tendency in Foreign Investment Law: India and Indonesia in the Focus," *Indonesian Journal of International Law* 17, no. 2 (January 31, 2020): 253–72, https://doi.org/10.17304/ijil.vol17.2.786.
[37] Putu George Matthew Simbolon and Tiurma Allagan, "The International Centre for the Settlement of Investment Dispute (ICSID) Annulment Reform: A Lesson Learned From the World Trade Organization Struggle," *Indonesian Journal of International Law* 21, no. 3 (May 2, 2024): 467–502, https://doi.org/10.17304/ijil.vol21.3.1.

entitled to international protection based on their pre-investment conduct.[38]

Based on legal syllogism, commercial expectations cannot be categorized as "legitimate" absent the investor’s comprehensive execution of *due diligence*. Contemporary arbitral jurisprudence—originating from *Saluka v. Czech Republic* and reinforced in European renewable energy disputes—asserts that a *prudent investor* is required to conduct in-depth investigations into the regulatory landscape and sociopolitical risks of the host state. Fulfillment of this *good faith* obligation is not merely an administrative formality, but a jurisdictional filter mechanism to dismiss claims for damages arising from commercial risks that should have been foreseeable. Absent *due diligence*, investor claims essentially transform into *unpriced public insurance*, imposing a disproportionate burden on the host state’s fiscal resources.[39]

Therefore, this article postulates the operationalization of "Absolute Transnational Corporate Due Diligence Obligations" as a *jurisdictional filter constraint* in ISDS litigation. Should this fail to be proven at the jurisdictional stage, this obligation must be applied at the merits stage as an absolute defense mechanism for the sovereign state. Neglect of environmental and human rights aspects in investment planning invalidates the legitimacy of an investor's expectations regarding future regulatory stability. Instruments such as the EU CSDDD provide *objective standardized benchmark metrics* for arbitrators to define the minimum threshold of compliance for an investor acting in *good faith*.

Table 2. Comparative Paradigms of Investment Risk Allocation

Parameter Dimension	Orthodox Paradigm (Asymmetrical)	New Paradigm (Proportional Equilibrium)
Source of Rights Legitimacy	Confined to the exclusive text of BITs.	Synchronization of BITs with transnational mHREDD norms.
Interpretation of FET & Expectations	Based on unilateral promises of regulatory stability.	Contingent upon evidence of *due diligence* execution by a *prudent investor*.
Role of the Home State	Unconditional diplomatic protection.	Extraterritorial enforcement of *hard law* across global supply chains.
Host State Autonomy	Subordinated to investor-centric interpretations.	Strengthening of the *Right to Regulate* based on international obligations.
Method of Damages	Speculative long-term	Application of *contributory fault* based on

[38] Verity McCullagh, “The EU Corporate Sustainability Due Diligence Directive: Real Change or More of the Same?,” *European Business Law Review* 35, no. Issue 5 (August 1, 2024): 603–26, https://doi.org/10.54648/EULR2024034.
[39] Mavluda Sattorova and Jean Ho, “The Rise of Due Diligence in International Investment Law,” *Journal of International Economic Law* 29, no. 1 (March 1, 2026): 39–63, https://doi.org/10.1093/jiel/jgag007.

	projections (DCF).	the investor's negligence in *due diligence*.

The technical operationalization of this integration is facilitated by Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT). The principle of *Systemic Integration* mandates that arbitrators consider "any relevant rules of international law" when interpreting treaties. In this context, home-state extraterritorial regulations concerning human rights and the environment should not be viewed as isolated foreign laws, but rather as integral components of the international legal consensus that governs MNE conduct. By embracing Article 31(3)(c) of the VCLT, arbitral tribunals are transformed from hermetically sealed civil fora into integral parts of a harmonious international legal order.[40]

In conclusion, the integration of transnational *due diligence* obligations into investment adjudication ensures that *Fair and Equitable Treatment* (FET) protection is granted solely to investors acting in *good faith*. This approach effectively terminates the regime of *unpriced public insurance* that has historically exploited the fiscal resources of developing states. By establishing mHREDD compliance as a prerequisite for protection, international investment law returns to its original function: protecting responsible investments while restoring the host state’s regulatory sovereignty for the sake of the universal public interest.

C. CONCLUSION

The contemporary international investment law regime, through its intricate web of Bilateral Investment Treaties (BITs), has fostered a landscape of profoundly asymmetrical risk allocation, wherein investor protection mechanisms frequently clash diametrically with the sovereignty and regulatory autonomy of host states. This tension is exacerbated by the surge in ISDS disputes and the utilization of speculative valuation methods that trigger a regulatory chill effect, thereby systematically externalizing the risks of commercial failure onto the taxpayers of host states. To rectify this structural distortion, a dogmatic integration of transnational due diligence obligations is imperative, serving as a constitutive jurisdictional element that constrains the applicability of the legitimate expectations doctrine within Fair and Equitable Treatment (FET) protection in

[40] Varun Chhachhar et al., “Human Rights Concern in International Investment Law: A Study of Indian International Investment Agreements,” *Indonesian Journal of International Law* 22, no. 3 (April 28, 2025): 467–506, https://doi.org/10.17304/ijil.vol22.3.1827.

arbitral tribunals. This systemic recalibration, predicated upon the principle of systemic integration under Article 31(3)(c) of the VCLT, ultimately aims to restore the original function of investment law: to foster responsible investment while safeguarding the universal public interest.

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