Impact of Investment Wrongdoing on Arbitration Proceedings

How Far Should an Investment Wrongdoing Get?

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Submission deadline: 12/01/2012

Word count: 16.975 (max. 18.000)

27.11.2012

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List of Abbreviations

ADR	Alternative Dispute Resolution
BIT	Bilateral Investment Treaty
ECT	Energy Charter Treaty
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
NY Convention	Convention on the Recognition and Enforcement of Foreign Arbitral Awards
OECD	Organization for Economic Co-operation and Development
p.	page
para.	paragraph
paras.	paragraphs
pp.	pages
UK	The United Kingdom of Great Britain and Northern Ireland
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNIDROIT	International Institute for the Unification of Private Law
US	The United States of America
v	versus

1 Introduction

International investment arbitration serves as a tool for resolving legal disputes between foreign investors and host states.[1] The arbitral tribunal decides whether the host state fulfilled its international and national law obligations.[2] It also establishes the right of a claimant, mostly the investor, to resort to arbitration and benefit from the protection under the treaty or contract.[3]

Practice demonstrates that illegal acts committed by investors may hinder the performance of their procedural and substantive rights during arbitration. For the purposes of this thesis, the term "*investment wrongdoing*" refers to the illegal acts of an investor. Investment wrongdoing might lead to the rejection of jurisdiction or inadmissibility of the claim.[4] The examples of investment wrongdoings include fraud,[5]

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[1]UNCTAD, *Investor-state disputes : prevention and alternatives to arbitration* (New York: United Nations, 2010), p.xxii, Christopher F Dugan et al., *Investor-state arbitration* (New York: Oxford University Press, 2011), p.117, Rahim Moloo and Alex Khachaturian, "The Compliance with the Law Requirement in International Investment Law," *Fordham International Law Journal* 34 (September 27, 2012): p.1474.

[2] Dugan et al., *Investor-state arbitration*, p.147.

[3]Andrew Newcombe, "Investor Misconduct: Jurisdiction, Admissibility or Merits?," in *Evolution in Investment Treaty Law and Arbitration*, ed. Chester Brown et al. (Cambridge: Cambridge University Press, n.d.), p.189.

[4] Pr. Newcombe in "Investor Misconduct" uses the term "*misconduct*" to describe the same set of acts.

[5] See *Inceysa Vallisoletana, SL V. Republic of El Salvador* (ICSID ARB/03/26 2006); *Gustav F W Hamester GmbH & Co KG V. Republic of Ghana* (ICSID ARB/07/24 2010); *Plama Consortium Limited V. Republic of Bulgaria* (ICSID ARB/03/24 2008); *Spyridon Roussalis V. Romania AS* (ICSID ARB/06/1 2007); *Amco Asia Et Al. V. Indonesia* (ICSID ARB/81/1 1983).

bribery[6] and corruption,[7] non-observance of domestic laws of the host state,[8] as well as human rights violations.[9]

Investment wrongdoing might occur upon initiation[10] or operation[11] of investment. Some investors might even engage in wrongdoings in order to obtain standing before the arbitral tribunals.[12] Although having different levels of severity, these acts trigger unsuccessful arbitral proceedings for the investor.

The tribunals have failed to develop a uniform approach with respect to investment wrongdoing.[13] The wrongdoings have been addressed together with the jurisdictional

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[6] *Westinghouse International Projects Company Et Al. V. National Power Corporation* (1991); J. Gillis Wetter, "Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110" 10, no. 3, Arbitration International (1994): pp.278–279.

[7] See *World Duty Free Company Limited v Republic of Kenya* (ICSID ARB/00/077 2006).

[8] See Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law"; Ursula Kriebaum, "Investment Arbitration - Illegal Investments," ed. Christian Klausegger and Giovanni De Berti, *Austrian Yearbook on International Arbitration* (2010):pp.307–335.

[9] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1487.

[10] See *Inceysa Vallisoletana, SL V. Republic of El Salvador*; *World Duty Free Company Limited v Republic of Kenya*; *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines* (ICSID ARB/03/25 2007).

[11] See *Técnicas Medioambientales Tecmed, S.A. V. United Mexican States* (ICSID ARB (AF)/00/2 2003); *International Thunderbird Gaming Corporation V. Mexico* (ICSID ARB/99/2 2006).

[12] See *Cementownia "Nowa Huta" S.A. v Republic of Turkey* (ICSID ARB(AF)/06/2 2009).

[13] See Christina Knahr, "Investments "in Accordance with Host State Law," *Transnational Dispute Management* 5 (2007); Andrew Newcombe, "Investor Misconduct and Investment Treaty Arbitration: Mapping the Terrain," *Kluwer Arbitration Blog*, January 25, 2010; Michael Hwang and Kevin Lim, "Corruption in Arbitration - Law and Reality," *Asian International Arbitration Journal* 8, no. 1:pp.1–119; Rahim Moloo, "A Comment on the Clear Hands Doctrine in International Law," *Transnational Dispute Management* 8, no.1(February2011); Jason N Summerfield, "The Corruption Defense in Investment Disputes: A Discussion of the Imbalance Between International Discourse and Arbitral Decisions," *Transnational Dispute Management* 6, no. 1 (March 2009); Jason Webb Yackee, "Investment Treaties & Investor Corruption: An Emerging Defense for Host States" 52 (2012):pp.723–745.

issues[14] or affected admissibility of the investor's claim.[15] When the claim is admissible, the evidence on wrongdoings is taken into account on the merits phase,[16] as well as when allocating costs[17] and damages.[18] Scholarly opinions confirm that the cases with investment wrongdoings lead to procedural confusion, where the line between jurisdiction, admissibility and merits is hard to draw.[19]

1.1 Research Question

This thesis aims to determine an appropriate stage for addressing investment wrongdoing during arbitration proceedings. It presents analysis of the decisions of international arbitral tribunals and consequently answers the following questions:

i. How may investment wrongdoing affect the consent of the host state and subsequently, the jurisdiction of the arbitral tribunal?
ii. Does investment wrongdoing disqualify an investment for the purposes of jurisdiction of the arbitral tribunal?
iii. Which general principles apply to investment wrongdoing and what are the consequences of their application?

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[14] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 207; *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, paras. 396–404.

[15] See *World Duty Free Company Limited v Republic of Kenya*; *Yukos Universal Limited (Isle of Man) V. the Russian Federation* (PCA 2009); *Veteran Petroleum Limited (Cyprus) V. the Russian Federation* (PCA 2009).

[16] *Joseph Charles Lemire V. Ukraine* (ICSID ARB/06/18 2011); cited in Newcombe, "Investor Misconduct," p.191.

[17] *Cementownia "Nowa Huta" S.A. v Republic of Turkey*, para. 177; cited in Newcombe, "Investor Misconduct," p.192.

[18] *MTD Equity Sdn. Bhd. and MTD Chile S.A. V. the Republic of Chile*, 242–243 (ICSID 2004); cited in Newcombe, "Investor Misconduct," p.192.

[19] See Knahr, "Investments "in Accordance with Host State Law"; Summerfield, "The Corruption Defense in Investment Disputes"; Yackee, "Investment Treaties & Investor Corruption: An Emerging Defense for Host States"; Newcombe, "Investor Misconduct and Investment Treaty Arbitration: Mapping the Terrain"; Hwang and Lim, "Corruption in Arbitration - Law and Reality."

The thesis shall demonstrate that investment wrongdoing is not a jurisdictional matter *per se*, unless the requirement of legality is explicit pre-requisite for the jurisdiction. The thesis concludes that consideration of investment wrongdoing is more appropriate at the admissibility or merits stage.

1.2 Practical Relevance of the Research Question

The decision on when to address investment wrongdoing is not a mere procedural formality.[20] Determination of the appropriate stage is significant for investors, host states and development of investment arbitration in general. In order to demonstrate the importance of the research question, the distinction shall be drawn between the stages of jurisdiction and admissibility. It is also relevant to identify the consequences of the arbitration proceedings, once the issue of investment wrongdoing is considered at the merits stage.

The jurisdiction of the international arbitral tribunal is the basis for hearing the case.[21] The lack of jurisdiction entails that the tribunal has no competence to deal with the dispute.[22] The jurisdiction of international investment tribunal is based on several elements, such as jurisdiction *ratione voluntatis* and *ratione materiae*.[23] The tribunal

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[20] Dugan et al., *Investor-state arbitration*, p.147.

[21] Andrea Marco Steingruber, *Consent in international arbitration* (Oxford: Oxford University Press, 2012), p.1; Rudolf Dolzer and Christoph Schreuer, *Principles of international investment law* (Oxford; New York: Oxford University Press, 2008), p.214.

[22] Alan Redfern and Martin Hunter, "Law and practice of international commercial arbitration", 2004, para. 5.30; Dietmar W Prager and Rebecca Jenkin, *Abaclat and Others V. The Argentine Republic* Kluwer Law International, Contribution by the ITA Board of Reporters, para. 247 (ICSID ARB/07/5 2011).

[23] Steingruber, *Consent in international arbitration*, paras. 13.01; 13:06; Newcombe, "Investor Misconduct," pp.192–193; M Sornarajah, *The international law on foreign investment* (Cambridge; New York: Cambridge University Press, 2010), p.307.

has jurisdiction *ratione voluntatis*, once it establishes that the parties have consented to resolve the dispute by means of arbitration.[24]

The basis for the jurisdiction of the tribunal might be found in (a) direct agreement between the parties;[25] (b) national legislation of the host state;[26] (c) bilateral or multilateral treaty between the host and home states.[27] Sometimes the investor might bring the claim on the basis of several sources.[28] The tribunal must establish the existence of consent "*with great care*", since it is basis for its jurisdiction.[29] If the tribunal decides on the issue that falls outside of the scope of consent, the award may be rendered void due to the excess of jurisdiction.[30]

Another element of the jurisdiction of the arbitral tribunal is *ratione materiae*. The jurisdiction *ratione materiae* is established if the dispute in question arises out of an

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[24] Dugan et al., *Investor-state arbitration*, p.219; Steingruber, *Consent in international arbitration*, paras. 5.44; 5.55; "The Scope of Investor's Protection under the ICSID/BIT Mechanism: Recent Trends," in *Contemporary issues in international arbitration and mediation : the Fordham papers 2010*, ed. Arthur W. Rovine (Boston : Martinus Nijhoff Publishers, 2011), p.33.

[25] *Mobil v New Zealand* (ICSID 1989); *Vacuum Salt Products v Ghana* (ICSID 1994); cited in Steingruber, *Consent in international arbitration*, para. 11.28.

[26] *Southern Pacific Properties (Middle East) Ltd v Arab Republic of Egypt* (ICSID ARB/84/3 1988); *Tradex Hellas S.A.(Greece) V. Republic of Albania*, (ICSID ARB/94/2 1996), cited in Steingruber, *Consent in international arbitration*, para. 11.28.

[27] Dolzer and Schreuer, *Principles of international investment law*, pp.238–239; Steingruber, *Consent in international arbitration*, para. 11.28; Christoph H Schreuer et al., *The ICSID Convention a Commentary* (Cambridge: Cambridge University Press, 2009), para. 245.

[28] Sornarajah, *The international law on foreign investment*, p.308.

[29] Michele Potesta, "The Interpretation of Consent to ICSID Arbitration Contained in Domestic Investment Laws," *Arbitration International* 27, no. 2 (January 2011): p.2; Summerfield, "The Corruption Defense in Investment Disputes," p.14; Dugan et al., *Investor-state arbitration*, p.224.

[30] Sornarajah, *The international law on foreign investment*, p.287; See Hilmar Raeschke-Kessler, "Corruption in Foreign Investment - Contracts and Dispute Settlement Between Investors, States and Agents" 9, no. 1, The Journal of World Investment & Trade (2008).

investment.[31] Thus, in order to have jurisdiction the tribunal shall firstly verify that the transaction qualifies as an investment.[32]

The issues considered at the admissibility stage are different. Decision on admissibility requires examination of appropriateness of judicial treatment.[33] The tribunal reviews the maturity of a claim, passage of agreed time bars or fulfilment of arbitral preconditions.[34]

The decision on lack of jurisdiction or inadmissibility has distinct legal consequences and leaves investors with different future options.[35] When the tribunal denies jurisdiction, the claimant loses the opportunity to re-submit the case to the same tribunal. Yet this does not exclude the review of jurisdiction by another body.[36] Unlike jurisdiction, inadmissibility is not subject to review.[37] However, if the claim is inadmissible at a certain point, the investor might resubmit the claim once it cures the flaw.[38] Accordingly, contrary to the denial of jurisdiction, the lack of admissibility does not exclude the possibility of submitting a modified or improved claim to the same tribunal.

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[31] Stern, "Contemporary issues in international arbitration and mediation," p.33; Catherine Yannaca-Small, *International investment law : understanding concepts and tracking innovations ; companion volume to International Investment Perspectives* (Paris: OECD, 2008), p.9.

[32] Joseph M Boddicker, "Whose Dictionary Controls?: Recent Challenges to the Term 'Investment' in ICSID Arbirtration" 25, no. 5, American University International Law Review (2010): p.1052; Gerold Zeiler, "Jurisdiction, Competence, and Admissibility of Claims in ICSID Arbitration Proceedings," in *International Investment Law for the 21st Century*, ed. Christina Binder et al. (Oxford University Press, 2009), p.10.

[33] Prager and Jenkin, *Abaclat and Others V. The Argentine Republic*, para. 247.

[34] William W. Park, *Arbitration of International Business Disputes : Studies in Law and Practice* (Oxford; New York: Oxford University Press, 2006), p.77.

[35] Prager and Jenkin, *Abaclat and Others V. The Argentine Republic*, para. 247.

[36] Ibid.

[37] Jan Paulsson, *Global reflections on international law, commerce and dispute resolution : liber amicorum in honour of Robert Briner ; editors, Gerald Aksen ... [et al.]. Jurisdiction and Admissibility* (Paris: ICC Pub., 2005), p.603.

[38] Prager and Jenkin, *Abaclat and Others V. The Argentine Republic*, para. 247.

Whether the investment wrongdoing is addressed at the jurisdictional or merits phase, is relevant for the states. The host states often refer to investment wrongdoings in order to avoid arbitration proceedings or justify their violations towards investors.[39] If the tribunal concludes that it has no jurisdiction on investment wrongdoing, the merits of the case will not be addressed. Thus, the tribunal would not decide on whether the host states fulfilled obligations owned to investors. Consequently, the host states would avoid the arbitration proceedings altogether.[40] On the other hand, seeing investment wrongdoing as jurisdictional matter, while resorting to the violations of the host states on merits, would give advantageous position to the host states.[41] When an investor violates the law, it results in the deprivation of the arbitral remedy, whereas violation by the state would only be the issue for the merits.[42]

The states have also successfully relied on investment wrongdoing in order to mitigate their own violations during merits stage.[43] If investment wrongdoing is considered as an issue for substantial consideration, the tribunal would weight actions of the investors against actions of the host states. Consequently, the decision of the tribunal would take into account the actions of the both parties. The violations by the state might not be followed by strict consequences, if the investor itself was involved in the acts contrary to the applicable law.[44]

The consideration of investment wrongdoings also influences the balance between the parties during arbitration. Currently, the BITs are mostly focused on the obligations of

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[39] Knahr, "Investments "in Accordance with Host State Law"; Yackee, "Investment Treaties & Investor Corruption: An Emerging Defense for Host States."

[40] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 207; *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, paras. 396–404.

[41] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 37, Dissenting Opinion of Arbitrator Cremades.

[42] Ibid.

[43] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil V. the Republic of Estonia*; *Joseph Charles Lemire V. Ukraine*; cited in Newcombe, "Investor Misconduct," p.191.

[44] Newcombe, "Investor Misconduct," p.191.

states, while giving only rights to investors.[45] Therefore, during arbitration proceedings the assessment is mostly limited to the evaluation of the acts of the host state. Addressing investment wrongdoings at the stage of admissibility or merits might assist in reaching the equilibrium between the parties. Together with the acts of host state, the tribunal would have to scrutinize wrongdoings of investors.[46]

Lastly, drawing the clear distinction between jurisdiction, admissibility and merits carries general relevance for investment arbitration. The consideration of substantive issues at the initial phase would inevitably extend the scope of jurisdictional issues. Consequently, the investor will have broader basis for challenging the awards before other forums.[47] Some authors consider that misperception of jurisdiction and admissibility makes the awards of international tribunals "*vulnerable*".[48] Unnecessary extension of jurisdictional issues and the grounds for challenging awards undermines the effectiveness of investment arbitration. The trend might be that arbitral institutions aim at equipping the parties with the right of appealing the award.[49] However, the scope of the appeal is limited[50] and does not aim to trespass the objective – effective resolution of the disputes. The confusion related to investment wrongdoing creates a certain level of procedural uncertainty and undermines predictability. This is not favourable for any method of dispute resolution, especially arbitration.[51]

Thus, the decision of the arbitral tribunal on the wrongdoing of investment bears important consequences. Together with the prospects of the parties after the dispute, it affects the balance between the rights and obligations of investors and host states during

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[45] Yackee, "Investment Treaties & Investor Corruption: An Emerging Defense for Host States," p.741.

[46] Ibid.

[47] Paulsson, *Global reflections on international law, commerce and dispute resolution*, p.601.

[48] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1490.

[49] *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 1965, sec. 5.

[50] Ibid.

[51] William Park, "Neutrality, Predictability and Economic Co-operation" 12, Journal of International Arbitration (1995): pp.99–112; Mariel Dimsey, *The resolution of international investment disputes : challenges and solutions* (Utrecht, the Netherlands; 2008), p.119.

arbitration. At the same time, unjustified extension of the scope of jurisdiction jeopardises the finality of the arbitral awards, whereas uncertainties related to the consequences of wrongdoings reduce the level of predictability of arbitration.

Due to these reasons, it is important to identify the circumstances when investment wrongdoing is strictly jurisdictional issue. In cases, where there is no explicit link to jurisdiction, the tribunals shall consider investment wrongdoing at the stage of admissibility. Provided that investment wrongdoing does not render the claim as inadmissible, the tribunals shall take the violations into account during merits stage.

1.3 Methodology

This research is not based on inter-disciplinal methodology and is strictly limited with the analysis of the legal issue. By evaluating the legal question from a critical perspective, the thesis tries to reach a solution for the legal problem that is evidenced by the arbitral case law.

The primary source for the study was the arbitral case law, namely, the decisions of investment, as well as commercial arbitral tribunals dealing with investor-state disputes or disputes between private parties. The research also relies on the procedural rules of international tribunals, international treaties and conventions. As a secondary source, the research has resorted to the opinions of legal scholars who have interpreted the case-law and relevant legal principles. The thesis also addresses the reports provided by the specialized international organizations.

The research took the writings of legal scholars as a point of departure. This was relevant for acquiring the background information about the topic, as well as for identifying the legal loopholes and controversies. Consequently, the research resorted to the primary sources, aiming to study and evaluate reasoning of the international arbitral tribunals.

1.4 Structure

The thesis is presented in three main parts. The first part addresses the impact of investment wrongdoing on the consent of the host state. The issue is whether investment wrongdoing is capable of invalidating the consent of the host state and subsequently, rendering the tribunal without jurisdiction.

As a second point, the thesis analyses the legality requirements in the treaties and their application to investment wrongdoing. This part distinguishes between the cases where investment wrongdoing had bearing for the jurisdiction of the tribunal, affected admissibility of a claim or was considered together with the merits.

The third part deals with the cases where investment wrongdoing is established due to non-compliance with international principles. The writing refers to the cases where international principles were applied for substantiation of the legality of an investment, in order to subsequently rule on jurisdiction, admissibility or merits. This part further addresses the cases, where international principles serve as mitigating factors. Namely, their application might waive the effect of wrongdoings on jurisdiction of the tribunal or admissibility of the claim. If the claim of the investor satisfies the criteria for admissibility, the mitigating factors might further preclude the host state from defeating the investor on the merits.

The last chapter summarizes the findings and presents concluding remarks on the research question.

2 Consent to Arbitration

The jurisdiction of international arbitral tribunals rests on the agreement between the parties.[52] The consensual nature of arbitration is also maintained in the investor-state disputes, which offers different tools for expressing the intent to arbitrate.[53] The state can conclude arbitration agreement with the investor, incorporate consent in domestic law and/or conclude a BIT or multilateral treaty providing for arbitration.[54] With respect to the impact of investment wrongdoing on consent, the first scenario is of particular relevance.

When challenging the jurisdiction of the arbitral tribunal, the host state might invoke the argument on investment wrongdoing. Firstly, the respondent might submit that the main contract is null and void since it involved wrongdoing. It might further assert that the wrongdoing also invalidated the consent to arbitration. Secondly, the respondent host state could argue that consent to arbitration, expressed in the bilateral or multilateral treaty was limited to legal investments. Consequently, due to invalidity or lack of the consent, the tribunal would not have jurisdiction.

The Chapter evaluates the pertinence of these arguments with respect to the jurisdiction of the arbitral tribunal.

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[52] Dolzer and Schreuer, *Principles of international investment law*, p.238.

[53] Gary B Born, *International Arbitration : Cases and Materials* (Kluwer Law International, 2011), p.457.

[54] Christoph Schreuer, "Consent to Arbitration," in *International Centre for Settlement of Investment Disputes* (presented at the UNCTAD, United Nations, 2003), p.6.

2.1 The Principle of Separability

Nowadays the decisions of ICSID tribunals and the treaty-based investment arbitration comprise an important part of investment law. This, however, does not diminish the relevance of contract based arbitration. In fact, the withdrawal of Latin American countries from ICSID and the intention of some states to terminate investment treaties, promises raise of the role of contract arbitration.[55]

Consent to arbitration through direct agreement might be expressed prior or after the origination of a dispute.[56] Consent clauses are often broad and inclusive.[57] The arbitration clause might be included in a contract that was obtained through fraud[58] or bribery.[59] In this case, one might question the legality of the arbitration clause. Commercial, as well as investment tribunals would resort to the principle of separability.[60] The separability doctrine has been applied by a vast number of international tribunals.[61] Under the doctrine, the arbitration agreement is an independent instrument and maintains validity, irrespective of the invalidity of contract.[62]

The main question is whether investment wrongdoing can invalidate the arbitration clause, which is incorporated in the main contract or even concluded separately. Generally, if the arbitration agreement and the contract share the same flaw, they can

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[55] Sornarajah, *The international law on foreign investment*, p.301.

[56] *Reynolds Jamaica Mines Limited and Reynolds Metals Company V. Jamaica*, 4 ICSID Reports, pp.61;67 (ICSID 1974); *Compañía Del Desarrollo De Santa Elena, S.A. v The Republic of Costa Rica*, p.26 (ICSID 2000); Steingruber, *Consent in international arbitration*, para. 5.79.

[57] Steingruber, *Consent in international arbitration*, para. 5.79.

[58] See *Inceysa Vallisoletana, SL V. Republic of El Salvador*.

[59] See *World Duty Free Company Limited v Republic of Kenya.*

[60] Steingruber, *Consent in international arbitration*, para. 5.90; Summerfield, "The Corruption Defense in Investment Disputes," p.14; Dugan et al., *Investor-state arbitration*, p.226.

[61] See *Lena Goldfields V. Soviet Government*, 36 Cornell Law Quarterly (1930); *Libyan American Oil Company (LIAMCO) (USA) V. Libyan Arab Republic*, Revue de l'Arbitrage, 1980, pp. 132-191; *Elf Aquitaine Iran (France) V. National Iranian Oil Company* (Ad Hoc Arbitration 1982).

[62] Steingruber, *Consent in international arbitration*, paras. 5.88; 5.92.

both be rendered null and void.[63] Hypothetically, the host state could argue that its consent to arbitrate was tainted by the investment wrongdoing.

The commercial arbitral tribunals have dealt with the impact of wrongdoing on the arbitration agreement in a number of cases. The practice of ICSID tribunals offers controversial, but interesting reasoning. Starting off with the land-mark decisions in commercial cases, we will further resort to the practice of investment tribunals. These cases provide guidance for assessing impact of wrongdoing on contractual arbitration clause and subsequently, jurisdiction.

The first issue is whether conclusion of an agreement that presupposes wrongdoing could lead to invalidity. Indeed, it is argued that the validity of the arbitration agreement under the separability doctrine also depends on the intentions of the parties.[64]

The decision of Judge Lagergren in *ICC Case No.1110* is often cited by international tribunals and highly qualified scholars when addressing the issue of investment wrongdoing.[65] When ruling on jurisdiction Judge Lagergren invoked Article V (2) of the NY Convention,[66] which provides that recognition and enforcement of the award might be refused if: (a) the subject matter of the dispute cannot be settled by arbitration or (b) the recognition or enforcement of the award would be contrary to the public policy.[67] Subsequently, Judge Lagergren pointed out that although the presented documents were *prima faciae* legal, the agreement between the parties contemplated the bribing of officials for obtaining business.[68] In the concluding part, the decision pointed

[63] Ibid.; Summerfield, "The Corruption Defense in Investment Disputes," p.14.

[64] Steingruber, *Consent in international arbitration*, para. 5.92.

[65] Wetter, "Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110," p.277.

[66] *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 1958.

[67] *Mr X, Buenos Aires v Company A*, para. 3 (ICC #1110 1963).

[68] Ibid., para. 17.

out that: "*one party is not thereby enabled to reap the fruits of his own dishonest conduct by enriching himself at the expense of the other*."[69]

Judge Lagergren denied jurisdiction, notwithstanding the fact that the arbitration agreement was drafted and concluded separately from the main contract. Moreover, the arbitration agreement was drafted after the dispute arose between the parties.[70] Thus, Judge Lagergren considered that even the contemplation of bribing involved in the main contract, was sufficient to render the tribunal without competence.

Although the case dealt with a private individual and the company, the conclusion reached by Judge Lagergren has relevance in the context of contemporary investment arbitration. One could assume that once the investor engages in the wrongdoing such as bribery or corruption, this act affects the arbitration agreement. In order to be complete, the arbitration agreement requires the link with substantial terms of a certain transaction.[71] Once the main transaction is tainted by illegality, the arbitration agreement could be viewed in light of the main contract. To put it differently, if the party would not assume to obtain the contract through illegal means, it would not have concluded the arbitration agreement. The weak point of this speculation is that it undermines the whole purpose and *rationale* behind the separability doctrine. This doctrine preserves the reliability of the arbitration. Otherwise, the parties would easily avoid their obligations to arbitrate.[72] The preservation of the validity of consent given by the state serves the purpose of maintaining the arbitral remedy for the investor.[73] Thus, in my view, the contemplation of illegality alone does not suffice for invalidating the arbitration clause in the context of investment arbitration.

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[69] Ibid., para. 21; Alexandra Diehl, "The Content of the FET Standard," in *The Core Standard of International Investment Protection* (Kluwer Law International, 2012), p.413.

[70] Wetter, "Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110," p.280.

[71] Steingruber, *Consent in international arbitration,* para. 5.63.

[72] Janet. A Rosen, "Arbitration Under Private International Law: The Doctrines of Separability and Compétence De La Compétence," *Fordhan Journal of International Law* 17, no. 3 (2003): p.601.

[73] Wetter, "Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110," p.279.

Another issue of relevance is the bearing of the severity of the wrongdoing on the application of the separability doctrine. The point for consideration is whether the level of severity affects the independence and validity of the consent to arbitrate, and subsequently, the jurisdiction of the arbitral tribunal.

Similar to *ICC Case No.1110,* the tribunal in *Westinghouse International Case* was faced with the issue of bribery and its effect on jurisdiction of the arbitral tribunal.[74] The tribunal addressed the issue of application of the separability doctrine when the main contracts were obtained by bribery.[75] The tribunal noted that separability is not absolute, since the defect of the main contract might as well relate to the arbitration clause.[76] Whether the bribery relates to the arbitration clause has to be decided on a case-by-case basis. However, in *Westinghouse International Case* the defendants failed to prove that the contracts were tainted by bribery.[77] Thus, the tribunal did not get to rule on the legality of the arbitration clause.[78]

Commenting on the *Westinghouse International Case,* Professor Wetter observed that the rationale behind the separability doctrine is preservation of the arbitral remedy.[79] The protection of this remedy is important when the main contract has been subject to termination. Preservation of remedy remains vital in cases where the party did not perform the contract because of the fraudulent actions by the adverse party. In view of Professor Wetter, the application of the separability doctrine in corruption cases might be different from ordinary cases. The author argued that the tribunal should have presented more credible reasoning on the application of the separability doctrine to cases of corruption: "*The idea to extend the doctrine to embrace corruption cases in the*

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[74] *Westinghouse International Projects Company Et Al. V. National Power Corporation,* cited in Wetter, "Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110," p.278.

[75] Wetter, "Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110," p.278.

[76] Ibid., pp.278–279.

[77] Ibid.

[78] Ibid., p.279.

[79] Ibid.

sense suggested by the Tribunal […] is not a proposition which is self-evident enough not to warrant serious analysis and discussion."[80]

This statement suggests that the application of the separability doctrine might not be identical to the illegal acts with different levels of severity. Since certain corrupt practices could be assigned to the category of severe wrongdoings,[81] the threshold for substantiating the validity of the arbitration agreements in these cases might be higher.

Although the severity of violation might be considered when applying the separability doctrine, this does not provide grounds for generalization. Indeed the practice demonstrates that even in cases involving corruption, the arbitration agreements have remained valid. The decision of the UK House of Lords in *Fiona Trust Case* confirms the statement. The case required the investigation of the operation of the separability doctrine with respect to corruption. The House of Lords stated that arbitration agreement can be void only when the grounds are directly related to the arbitration agreement itself. Since the corruption only related to the main contract, the tribunal found the arbitration agreement to be valid.[82] Mostly the separability doctrine has been applied similarly.[83] For example, in *World Duty Free Case*[84] the claim was based solely on alleged breaches of the contract.[85] The claimant argued that bribe was an independent collateral transaction and should have been considered as separate from the contract.[86] The tribunal established that the bribe was neither separate nor severable from the Agreement.[87] It refused to consider the secrecy of a bribe as an argument for

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[80] Ibid.

[81] Mohamed Abdel Raouf, "How should International Arbitrators Tackle Corruption Issues," in *Liber amicorum,* (Las Rozas (Madrid): La Ley, 2010), paras. 4; 6.

[82] *Fiona Trust & Holding Corporation and Others V. Yuri Privalov and Others*, paras. 23–25; 44 (Queen's Bench Division 2007).

[83] Hwang and Lim, "Corruption in Arbitration - Law and Reality," p.43.

[84] *World Duty Free Company Limited v Republic of Kenya*.

[85] Ibid., para. 79.

[86] Ibid., para. 174.

[87] Ibid.

its separateness from the contract.[88] Although the tribunal refused to establish the independence of a contract from the bribe, it did so with respect to arbitration agreement.[89] The tribunal noted that there was no evidence proving that bribe has procured Article 9 on agreement to arbitrate.[90]

The facts of the case above are remarkable. During the arbitration proceedings the claimant admitted that "*in order to be able to do business*," it made a "*personal donation*" to the President of the host state. [91] Thus, the claimant admitted that it was involved in corrupt activities. Although the factual background of the case confirmed the existence of severe wrongdoing,[92] the tribunal maintained the autonomy and validity of the arbitration agreement.[93] The tribunal noted that it could not be disputed that the bribery has occurred and that it served the purpose of getting an investment.[94] Notwithstanding this, the tribunal established the jurisdiction and further refused to consider the claim.[95] Hence, the tribunal did not question the existence of jurisdiction *ratione voluntatis*, notwithstanding the severity of investment wrongdoing.

When dismissing the claim, the tribunal noted that: "*The claimant is not legally entitled to maintain any of its pleaded claims in these proceedings as a matter of ordre public international and public policy under the contract's applicable laws.*"[96] This conclusion can lead to different interpretations.[97] The denial of claim might be based on the illegality of the contract. In this case, one might argue that the tribunal dismissed the claim since it had no legal basis.[98] This could qualify as a decision on the merits of the

[88] Ibid.

[89] Ibid., para. 184.

[90] Ibid.

[91] Ibid., para. 66.

[92] Ibid., paras. 142–148.

[93] Ibid., para. 184.

[94] Ibid., para. 136.

[95] Ibid., para. 188.

[96] Ibid.

[97] Newcombe, "Investor Misconduct," p.197.

[98] Ibid.

case.[99] On the other hand, the decision might have been based solely on public policy, as it is stated in the citation above. The denial could be the consequence of the admitted bribe that contradicted international public policy.[100]

The analysis above confirms that the contractual consent of the host state might raise the issue of the separability of the arbitration clause, intention of the parties and severity of investment wrongdoing. The case law demonstrates that the tribunals are more inclined to support the autonomy of the arbitral remedy in the contract or compromise.

To summarize, if an arbitration clause is incorporated in a contract, the investment wrongdoing does not *per se* cause the rejection of jurisdiction.[101] When investment wrongdoing is solely related to the contract, the tribunal will apply the separability doctrine and maintain jurisdiction.[102] Thus, the agreement to arbitrate will remain valid.[103] But if investment wrongdoing affects the arbitration agreement together with the main contract, the tribunal may decline jurisdiction.[104]

2.2 Multiple Contracts

In most cases, the investment operations involve high degree of complexity. The transaction might consist of several contracts,[105] Memorandums of Understanding, etc.

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[99] Ibid.

[100] Ibid.

[101] *UNCITRAL Model Law on International Commercial Arbitration 1985 : with amendments as adopted in 2006.* (Vienna [Austria]: United Nations, 2008), Article 16 (1); ICC, International Centre for ADR, *Arbitration and ADR rules.* (Paris, France: ICC, 2011), Article 6 (4); *Abaclat and Others V. The Argentine Republic*, para. 653.

[102] Summerfield, "The Corruption Defense in Investment Disputes," p.14.

[103] Ruslan Mirzayev, "International Investment Protection Regime and Criminal Investigations," *Journal of International Arbitration* 29, no. 1 (2012): p.84.

[104] R. Doak Bishop, James Crawford, and W. Michael Reisman, *Foreign Investment Disputes : Cases, Materials, and Commentary* (The Hague, 2005), p.1227; See *Westinghouse International Projects Company Et Al. V. National Power Corporation*.

[105] Raeschke-Kessler, "Corruption in Foreign Investment," p.5.

The consent to arbitration might not be explicitly provided in all contracts related to investment.[106] However, the case law confirms that the tribunals are inclined to give broad interpretation to the consent in these cases.[107]

The deal between the foreign investor and a host state might comprise of several contracts, where only one contract is obtained by wrongdoing. Even if the arbitration clause is provided in a separate document, its validity could potentially raise controversies. The case law on investment wrongdoing has not dealt with this factual background specifically. However, a conclusion might be drawn from the decisions of the arbitral tribunals on complex transactions.

In *Duke Energy Case*, the parties have concluded different contracts, however, only one of them referred to ICSID arbitration.[108] The tribunal upheld the principle of "*unity of investment*" and stated that: "*The reality of the overall investment, which is clear from the record, overcomes respondent's objection that it could never have consented to arbitration of a dispute related to the broader investment.*[109] This reasoning was later on challenged by the respondent, Peru, through the Annulment Procedure of ICSID. [110] The Annulment Committee rejected the arguments of Peru and concluded that: "*ICSID tribunals have applied the principle of the "unity of the investment" in situations where consent to ICSID arbitration is found in individual investment agreements or contracts.*"[111]

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[106] Dolzer and Schreuer, *Principles of international investment law*, p.239.

[107] *Duke Energy International Peru Investments No.1 LTD v Republic of Peru*, paras. 119–134 (ICSID ARB/03/28 2006); *Československa Obchodní Banka, A.s. V. Slovak Republic*, paras. 72, 74–75 (ICSID ARB/97/4 1999); *Klöckner Industrie-Anlagen GmbH and Others V. United Republic of Cameroon and Société Camerounaise Des Engrais*, paras. 65–69 (ICSID ARB/81/2 1983); *Société Ouest Africaine Des Bétons Industriels V. Senegal*, paras. 47–58 (ICSID ARB/82/1 1988).

[108] *Duke Energy v Peru*, para. 121.

[109] Ibid., para. 131.

[110] *Duke Energy International Peru Investments No.1 LTD v Republic of Peru* (ICSID ARB/03/28 2011).

[111] Ibid., para. 145.

The reasoning in *Duke Energy Case* demonstrated the following: when establishing jurisdiction, the tribunals have applied the arbitration clause to claims arising out of different contracts, which were concluded within one investment.[112] This reasoning could also apply to cases where the investment wrongdoing only tainted one contract within a complex investment transaction. Generally, the arbitral tribunals tend to view investment as a sole operation, which might consist of different legal transactions.[113] When deciding on the protection of investment, the tribunals consider all related transactions.[114] Thus, provided that the contracts were directed to a specific investment, the principle of unity of an investment might be applied. This might lead to the following conclusions. Firstly, the application of the unity principle would provide jurisdiction with respect to any contractual claim within the frame of investment, even if the arbitration clause is only included in one contract. Secondly, under the principle of unity of investment the whole investment might be rendered as illegal, once one of the contracts is tainted by wrongdoing. The tribunal could establish that the wrongdoing re one contract tainted the entire transaction, including the one with arbitration agreement. This could further challenge the claimant to argue that the defect of the main contract was not shared by the independent arbitration agreement.

As noted above, the separability doctrine serves as a presumption for the validity of the arbitration agreement, even if the substantive part of the contract is not valid.[115] In cases where the respondent raises the issue of investment wrongdoing, the particular relevance shall be given to the link between the illegal act and expression of the consent to arbitrate. The practice highlights that the tribunals are willing to uphold the independence of the arbitration agreement, unless the agreement shares the flaws of the main contract.[116]

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[112] Christoph Schreuer and Ursula Kriebaum, *A Liber Amicorum: Thomas Wälde : law beyond conventional thought*, (London: 2009), p.272.

[113] Kriebaum, "Investment Arbitration - Illegal Investments," p.332.

[114] Ibid.

[115] Born, *International arbitration*, p.308.

[116] Summerfield, "The Corruption Defense in Investment Disputes," p.14.

2.3 Consent in the BIT

The consent to arbitrate is mostly expressed in international treaties, whether bilateral or multilateral.[117] Thus, the expression of consent in investment arbitration is not solely limited to contractual relationship *per* se.[118]Although the consent of the parties is not embodied in one document, investment treaty arbitration is still based on mutual consent.[119] The consent of the host state expressed in the treaty shall be met by the intention of the investor to arbitrate. The latter might express the consent simply by submitting the dispute to arbitration.[120]

The states are authorized to limit their consent to arbitration and exclude certain types of disputes.[121] In order to challenge the jurisdiction of international arbitral tribunal, the host state might argue that consent was tainted by the investment wrongdoing.[122]

In the framework of the treaty-based arbitration, the law applicable to the consent is international law.[123] The tribunal in *Abaclat Case* noted that the question of consent was subject to principles of international law.[124] The principles of international law apply to substantial as well as formal validity of agreement to arbitrate.[125] Since international law does not provide any specific guidance in this regards,[126] the tribunal decided to verify the existence of written consent under Article 25(1) of the ICSID

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[117] Steingruber, *Consent in international arbitration*, paras. 5.51–5.52; Schreuer, "Consent to Arbitration," p.1.

[118] Steingruber, *Consent in international arbitration*, paras. 5.51–5.52.

[119] Ibid., para. 5.52.

[120] Ibid.

[121] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1476.

[122] Dolzer and Schreuer, *Principles of international investment law*, p.239.

[123] Dugan et al., *Investor-state arbitration*, p.208.

[124] *Abaclat and Others V. The Argentine Republic*, para. 430.

[125] Ibid..

[126] Ibid., paras. 432–434.

Convention.[127] It also examined whether the parties intended to submit the dispute to arbitration.[128]

Within ICSID jurisprudence, the scope of consent has been addressed by the *Inceysa Case*. The dispute between the parties was related to the jurisdiction *ratione voluntatis*.[129] The respondent challenged the jurisdiction of the tribunal based on the BIT and the contract.[130] Primarily, the tribunal assessed jurisdiction on the basis of the ICSID Convention and the BIT. Secondly, it resorted to domestic legislation of El Salvador, including the contract between the parties.[131] Under the facts of the case, the investor was accused of committing fraud.[132] However, it did not regard these issues as jurisdictional objections.[133] The claimant relied on the autonomy of the arbitration clause, arguing that flaws of the transaction did not relate to the agreement to arbitrate.[134]

This case presented interesting contentions with respect to the issue of consent.[135] The tribunal deemed that its fundamental task was to identify the issues which were included in the consent given by the respondent.[136] Moreover, the tribunal noted that examination of the consent expressed by the parties was a mandatory stage for any tribunal.[137]

This statement is helpful for identifying relevant points. Indeed the states are authorized to frame the scope of their consent, whereas the tribunals shall inquire into it. The question arises as for the effect of these boundaries on the jurisdiction of arbitral

[127] Ibid.

[128] Ibid., para. 435.

[129] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 144.

[130] Ibid., paras. 45–50.

[131] Ibid.

[132] Ibid., para. 53.

[133] Ibid., para. 163.

[134] Ibid.

[135] Ibid., para. 162.

[136] Ibid., para. 170.

[137] Ibid., paras. 171;174.

tribunal. The establishment of *ratione voluntatis* involves more difficulty, once the tribunal has to confront investment wrongdoing.

In *Plama Case,*[138] the tribunal affirmed the autonomy of arbitration clause in the ECT. It stated that dispute resolution clause was independent from the ECT and the transaction itself.[139] Thus, the tribunal has highlighted the application of separability doctrine to arbitration clauses in investment treaties. However, the establishment of the valid intention to arbitrate was not sufficient. There is still an element that distinguishes investment arbitration from ordinary commercial arbitration. The separability doctrine ensures the existence of *ratione voluntatis* in this case, yet the tribunal cannot consider the case without jurisdiction *ratione materiae*. The tribunal noted that agreement to arbitrate anticipates the existence of investment.[140] Consequently, the consent cannot be established if there is no investment under the ECT.[141] Although the claimant was accused of misrepresentations,[142] the tribunal stated that illegality did not pertain to its jurisdiction and would be relevant for assessing whether the claimant could benefit from the substantive standards of the ECT.[143]

The reasoning of the tribunal in *Plama Case* affirms that jurisdiction *ratione voluntatis* can be established in the presence of investment wrongdoing. The consent as such cannot be tainted by the wrongdoing. However, in order to ensure procedural fairness, the tribunal did not disregard the fraudulent actions of investor and took this into account on the merits stage.[144]

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[138] *Plama Consortium Limited V. Republic of Bulgaria*.

[139] Ibid., para. 130.

[140] Gabriel Bottini, "Legality of Investments under ICSID Jurisprudence," ed. Michael Waibel (The backlash against investment arbitration : perceptions and reality, Wolters Kluwer Law & Business; Aspen Publishers, 2010), p.311.

[141] Ibid.

[142] *Plama Consortium Limited V. Republic of Bulgaria*, para. 198.

[143] Ibid., para. 112.

[144] Ibid.

When the consent is provided in the BIT, the tribunal might maintain jurisdiction based on the separability of arbitration clause. However, the arguments with respect to the intention of the host state to cover only legal transactions, might serve as solid arguments for the rejection of jurisdiction. This question shall be considered further below when dealing with the jurisdiction *ratione materiae*.

2.4 Policy Observations

This section addresses general policy consequences of the rejection of jurisdiction in cases involving investment wrongdoing.

In practice, the wrongdoing of an investor is often only one side of the illegal affair. Another side of the illegal act develops once the state official accepts the bribe and offers some favourable conditions to the investor. The question is whether the investor should be the only party bearing the consequences of illegality during arbitration. Provided that it is so, what could be the bearing of the rejection of jurisdiction or inadmissibility in general? One of the negative consequences of considering investment wrongdoing during jurisdictional phase, where it is not strictly jurisdictional matter, is that only one party bears the consequences for violations. If the tribunal accepts that it has no jurisdiction due to wrongdoing, the host state would avoid arbitration proceedings. Thus a state, which also participated in illegal act, would in fact benefit,[145] whereas the investor would be deprived of its legal remedy.

In *World Duty Free Case*, the claimants stated that it was unfair from the respondent to advance the claim regarding the corruption. The tribunal did not disagree with this. In fact, the tribunal even highlighted that the evidence showed that the bribe was requested by the Kenyan President and was "*not wholly initiated by the claimant*."[146] The tribunal considered that if they would decide to grant the relief to claimant, this would

[145] Stephan Wilske, "Sanctions for Unethical and Illegal Behaviour in International Arbitration: A Double-Edged Sword?," *Contemporary Asia Arbitration Journal* 3, no. 2 (2010): p.214.

[146] *World Duty Free Company Limited v Republic of Kenya*, para. 180.

encourage the illegal conduct.[147] The tribunal did not draw any conclusions from the unwillingness of Kenya to prosecute its former president for corrupt activities.[148] It is debatable whether the decision of the tribunal discouraged rather than encouraged the states for maintaining corrupt systems. The situation where the actions of the state are ignored does not contribute to the fight against corruption, nor does it promote the protection of foreign investment or compliance with the principle of good faith.[149] The tribunal did not apply "*the balancing test*", where the illegal actions by the states and investors would be weighted.[150]

The practice shows that in most cases the states object to the jurisdiction of investment tribunals. Even when drafting bilateral treaties, the states anticipate the possible grounds that might be relied in the future for challenging the jurisdiction.[151] As for today, the case-law reveals that the state will avoid the arbitration proceedings and its subsequent outcome, once it proves the existence of investment wrongdoing.[152] As a result, the state will be free of the obligation to remedy the non-performance of the contract or investment treaty, including the obligation to compensate.[153] The state responsibility of the host state does not arise either.[154] This tendency highlights the importance of reasoning of the tribunals, with respect to such investment wrongdoing as corruption or bribe.[155] The state shall be encouraged to abstain from these acts. The wrongdoings committed by state officials shall not be free of legal consequences.[156]

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[147] Ibid., para. 178.

[148] Ibid., para. 180.

[149] Wilske, "Sanctions for Unethical and Illegal Behaviour in International Arbitration: A Double-Edged Sword?," p.220.

[150] Richard Kreindler, "Corruption in International Investment Arbitration: Jurisdiction and the Unclean Hands Doctrine," in *Between East and West : essays in honour of Ulf Franke* (Huntington, N.Y.: Juris, 2010), pp.320–321.

[151] Sornarajah, *The international law on foreign investment*, p.306.

[152] Summerfield, "The Corruption Defense in Investment Disputes," p.13.

[153] Ibid.

[154] Ibid.

[155] Raeschke-Kessler, "Corruption in Foreign Investment," p.13.

[156] Ibid., p.28.

Judge Lagergren noted that "*parties who ally themselves in an enterprise [tainted by corruption] must realize that they have forfeited any right to ask for the assistance of the machinery of justice […] in settling their disputes.*"[157] Some authors argue that this reasoning gave the incentive, as well as legal possibility for the host states to escape from arbitration and resolve a dispute in a more convenient forum.[158] For example, after losing the arbitration case, the Republic of Argentine reached settlement with Siemens AG, German multinational company. The latter refused to accept the compensation of 200 million US dollars. In response, Argentine withdrew the case with respect to the wrongdoings of the company.[159] Thus, in this case, the host state used the evidence on wrongdoing, in order to negotiate a favourable settlement with an investor. As a result, the state escaped the responsibility of paying compensation. This demonstrates that states are inclined to use the argument of investment wrongdoing in order to avoid arbitration proceedings or consequences thereof.

Since most investors choose arbitration in order to avoid the corruption in judicial system of the host state, the maintaining of arbitral remedy carries particular importance.[160] The considerations outlined above, demonstrate the necessity of maintaining the arbitral remedy where the legal and factual background so allows.

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[157] Summerfield, "The Corruption Defense in Investment Disputes," p.13.

[158] Ibid.

[159] Luke Eric Peterson, *Siemens Waives Rights Under Arbitral Award Against Argentina, Follows Company's Belated Corruption Confessions*, Investment Arbitration Reporter, September 2, 2009, sec. 6.

[160] Summerfield, "The Corruption Defense in Investment Disputes," p.3.

3 Requirements of Legality

The states as sovereign entities have discretion to undertake as many obligations as they desire.[161] They have inherited freedom to determine the level of protection granted to investors.[162] Based on their sovereignty they can opt out from undertaking certain obligations. Thus, if states do not regard illegal transactions as investments or refuse to protect them under the BIT, they cannot be bound to do so. This Chapter considers the requirements of legality of investments incorporated in the treaties. The writing focuses on the following aspects: (i) the scope of legality requirements; (ii) implied and explicit requirements of legality; (iii) the threshold of the required compliance; (iv) the consequences of application.

In general, substantive valid arbitration agreement is formed with an agreement to arbitrate and indication of legal relationship, which the parties wish to submit to arbitration.[163] The definition of investment represents the basis for establishing the jurisdiction *ratione materiae* of investment tribunals.[164] For example, the BITs present the list of transactions that will fall within the jurisdiction *ratione materiae*. The ICSID Convention only authorizes the tribunals to consider the cases arising "*out of investment.*"[165] The tribunals under the ICSID came up with the so-called double-barrel

[161] Steingruber, *Consent in international arbitration*, para. 14.05.

[162] Dolzer and Schreuer, *Principles of international investment law*, p.7; *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 184.

[163] Steingruber, *Consent in international arbitration*, para. 5.63.

[164] Sornarajah, *The international law on foreign investment*, p.308.

[165] *Azinian V. United Mexican States*, paras. 29; 124 (ICSID ARB(AF)07/2 1999).

test. The test is met once the transaction qualifies as the investment under both, the applicable treaty and the ICSID Convention.[166]

Some states enact national laws and regulations in order to attract foreign investment.[167] Consequently, the national legislation serves as a legal basis for the jurisdiction of the arbitral tribunal.[168] In a number of cases, the tribunals have addressed the issue of jurisdiction provided in national legislation.[169] National legislation might not always provide an actual offer to arbitrate. In some cases it might simply express the intention of states to negotiate an arbitration agreement when the dispute arises.[170] The offer stipulated in national legislation might also contain certain limitations with respect to time and other formalities.[171] Previously the consent to arbitrate was not often provided in the national laws,[172] but lately the number of cases initiated on the basis of national legislation has increased.[173] Notwithstanding this development, the case law has not specifically addressed the issue of investment wrongdoing where jurisdiction was based

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[166] *Salini Costruttori S.P.A. and Italstrade S.P.A. V. Kingdom of Morocco*, paras. 43–58 (ICSID ARB/00/4 2001); *Malaysian Historical Salvators SDN, BHD V. The Government of Malaysia*, para. 55 (ICSID ARB/05/10 2007).

[167] Potesta, "The Interpretation of Consent to ICSID Arbitration Contained in Domestic Investment Laws," p.1.

[168] Steingruber, *Consent in international arbitration*, p.199.

[169] See *Mobil Corporation and Others V. Bolivarian Republic of Venezuela* (ICSID ARB/07/27 2010); *CEMEX Caracas Investments B.V. and CEMEX Caracas II Investments B.V. V. Bolivarian Republic of Venezuela* (ICSID ARB/08/15 2010); *Brandes Investment Partners, LP. V. Bolivarian Republic of Venezuela* (ICSID ARB/08/3 2009); *Tradex Hellas S.A.(Greece) V. Republic of Albania*; *Zhinvali Development Ltd. V. Republic of Georgia* (ICSID ARB/00/1 2000); *Inceysa Vallisoletana, SL V. Republic of El Salvador*.

[170] Steingruber, *Consent in international arbitration*, p.200; "Estonian Law on Foreign Investments," in *Investment Laws of the World and Investment Treaties*, 1994, Article 22; "Law of Azerbaijan Republic on Protection of Foreign Investments," in *Investment Laws of the World and Investment Treaties*, 2004, Article 42; "Law of the Republic of Indonesia Concerning Investment," in *Investment Laws of the World and Investment Treaties*, 2008, Article 32(4).

[171] UNCTAD, *Investor-state disputes*, p.15.

[172] Steingruber, *Consent in international arbitration*, p.199.

[173] Potesta, "The Interpretation of Consent to ICSID Arbitration Contained in Domestic Investment Laws," p.2.

on the national law. Therefore, the writing is focused on evaluating the legality requirements under the treaties and their application by the arbitral tribunals.

3.1 Scope of Legality Clauses

The transaction involving investment wrongdoing might or might not be covered in the definition of investment. The protection of investments under the treaties has certain limitations.[174] The requirement of legality of investments is present in some BITs, as well as multilateral treaties.[175] Most treaties use the so called "*in accordance with the host state's law*" provisions, in order to limit the application of the treaty.[176] For example, the BIT between the Federal Republic of Germany and the Republic of Philippines reads in the respective article:

> "*The term investment shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State […]*"[177]

The practice of investment tribunals has revealed that "*in accordance with the law of the host state*" statement in the bilateral treaty is often regarded as a requirement of legality of investments.[178] The provisions call for the compatibility with the internal legislation of the host state.[179] However, they might require the compliance with the

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[174] *Ioannis Kardassopoulos v Georgia*, para. 182 (ICSID ARB/05/18 2007).

[175] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1476.

[176] Ibid.

[177] *Agreement Between the Federal Republic of Germany and the Republic of Philippines for the Promotion and Reciprocal Protection of Investments*, 1998, Article 1 (1).

[178] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1475; *Tokios Tokelės V. Ukraine*, para. 97 (ICSID ARB/02/18 2004).

[179] August Reinisch, and Christina Knahr, "International investment law in context" (Eleven International Pub. 2008), p.29.

principles of international law as well, since in some states international obligations are the part of national legislation.[180]

It should be highlighted that not so long ago the tribunals were not confident about the scope and meaning of these clauses. The decision in *Salini Case* sheds some light on this issue. The tribunal determined that the provision refers to the compliance of investor with the laws of the host state, not to the definition of investment under the national laws. [181] This restriction aims to limit the application and protection of the BIT to investments that comply with internal law of the host state.[182] The compliance shall be ensured from the stage of entry to the subsequent operation.[183] However, the stage where compliance is required shall be identified on the case-by-case basis.

Provided that the requirement of legality is included in the definition of investment, this limitation shall be considered as jurisdictional issue.[184] When the requirement of compliance with law is included in other parts, such as, the provision on the applicable law, this shall only be regarded as an issue for the merits.[185] Hence, non-compliance with this requirement will leave investment without substantial benefits, protection from national treatment, expropriation and etc.[186]

The compatibility with the host state's law upon the start of an investment is relevant for the jurisdiction.[187] For example, in the *Gustav Case* the tribunal noted that if the contract would have been obtained on the basis of fraud, the investment would have been illegal and would not be protected under the BIT. Whether or not the wrongdoing

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[180] See *Abaclat and Others V. The Argentine Republic*; *Inceysa Vallisoletana, SL V. Republic of El Salvador*.

[181] *Salini Costruttori S.P.A. and Italstrade S.P.A. V. Kingdom of Morocco*, para. 46.

[182] *Desert Line Projects LLC V. Republic of Yemen*, paras. 104–105 (ICSID ARB/05/17 2008).

[183] Sornarajah, *The international law on foreign investment*, p.317.

[184] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 186.

[185] Ibid., para. 187.

[186] *Abaclat and Others V. The Argentine Republic*, para. 383.

[187] *Gustav F W Hamester GmbH & Co KG V. Republic of Ghana*, para. 127.

occurred at the stage of performance has to be taken into account on the merits phase.[188] In this case, the respondent failed to prove that fraud took place. [189] The tribunal in the *Gustav* case interpreted the BIT and distinguished between the legality at the stage of initiation and performance of the investment. The Article on the scope of application of the BIT only required legality at the initiation of the investment. The tribunal stated that due to the wording provided in the treaty, the legality of initiation would have relevance for the jurisdiction, irrespective of the legality of performance.[190] However, before assessing the jurisdictional requirements under the treaty, the tribunal made some general observations. It stated that generally investment would not be protected when it violates national or international legal principles or national law of the host state. [191] For example, when investor is accused of corruption it shall expect to lose all rights provided in the bilateral investment treaties. This would apply to corrupt acts committed at any stage of investment making.[192]

3.2 Implied and Explicit Requirements

International investment tribunals tend to deny protection to the investor violating the laws of the host state; however, the practice is not uniform.[193] Even where "*in accordance with the host state's law*" provisions are explicitly provided in the BIT, the identification of their scope and content is complicated. Firstly, the part of national legislation that must be applied is hard to identify.[194] Secondly, the consequence of non-compliance is not foreseeable.[195]

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[188] Ibid., para. 129.

[189] Ibid., para. 134.

[190] Ibid., para. 127.

[191] Ibid., para. 123.

[192] Wilske, "Sanctions for Unethical and Illegal Behaviour in International Arbitration: A Double-Edged Sword?," p.214.

[193] Ibid., p.219.

[194] Yackee, "Investment Treaties & Investor Corruption: An Emerging Defense for Host States," p.740.

[195] Ibid., p.741.

The case law also demonstrates that this requirement might be implied, even when the phrase as such does not appear in the BIT.[196] Thus, the legality requirement might be explicitly provided in the treaty or be implied obligation under the general principles. The source for this obligation will find its reflection on the legal outcome.[197]

The implied legality requirement was applied to the investment made under multilateral treaty. In *Plama Case*, the tribunal had to assess legality under the ECT. The ECT did not contain the obligation of compliance with any law. However, the tribunal noted that the ECT could not protect investments that contradicted domestic or international law.[198] The tribunal referred to the introductory note of the ECT, which provides that the purpose of the treaty is to "*strengthen the rule of law.*"[199] The tribunal inquired into the legality of investment on the stage of admissibility and denied the protection.[200]

In *Toto Case* the jurisdiction was rejected on the basis of the implied legality requirement.[201] The tribunal relied on the judgment in *Phoenix Case*, where the notion of investment under Article 25(1) of the ICSID Convention was found to imply the compliance with the laws of the host state.[202] The reading of the *Phoenix Case* offered above has been criticized.[203] However, the reasoning of *Phoenix Case* and interpretation offered by *Toto Case* was further overturned in *Saba Fakes Case*. The tribunal noted that the requirement of legality is not incorporated in Article 25 of the ICSID convention.[204]

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[196] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, paras. 196; 200.

[197] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1475.

[198] *Plama Consortium Limited V. Republic of Bulgaria*, para. 138.

[199] Ibid., para. 139.

[200] Ibid.

[201] *Toto Construzioni Generali S.P.A. v Republic of Lebanon* (ICSID ARB/07/12 2009).

[202] Ibid., para. 85.

[203] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1492.

[204] *Mr. Saba Fakes V. Republic of Turkey*, paras. 112; 115 (ICSID ARB/07/20 2010).

3.3 Threshold of Illegality

One of the questions raised by the "*in accordance with the host state's law*" provisions is whether any kind of non-compliance suffices for the rejection of jurisdiction or inadmissibility of the claim.

The decision in the *Tokio Tokeles Case* can be used as guidance for determining the threshold of the wrongdoing that might affect the jurisdiction or admissibility.[205] The tribunal stated that exclusion of an investor on the basis of minor violations contradicts with the object and purpose of the BIT.[206] The same was concluded by the tribunal in the *Saba Fakes Case*.[207] The claimant argued that only violation of a "*fundamental legal principle*" would render investment as illegal.[208] The respondent submitted that non-compliance with any law would leave the investment without the substantive protection of the BIT.[209] The tribunal did not agree with the latter.[210] The tribunal highlighted that (i) the BIT solely refers to the legality at the stage of admission of investment, and (ii) dismissing investment claims on the basis of "*the violation of laws unrelated to the very nature of investment regulation*" undermines the object and purpose of the BIT. [211]

The tribunal in the *Saba Fakes Case* raised a valid argument stating that upon violation of domestic laws, the host state could take measures on the basis of national legislation. Except when stated in the applicable BIT, the state shall not rely on domestic legislation to escape its international undertakings.[212]

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[205] *Tokios Tokelės V. Ukraine*, para. 83.

[206] Ibid., para. 86.

[207] *Mr. Saba Fakes V. Republic of Turkey*, paras. 112; 115.

[208] Ibid., para. 118.

[209] Ibid., para. 119.

[210] Ibid.

[211] Ibid.

[212] Ibid.

The analysis of the *Gustav* tribunal is also relevant with respect to the nature and level of illegality. The tribunal noted that in that case there was no indication that the fraud affected the securing of an investment.[213] The tribunal refused to regard the acts of the investor as fraudulent. The respondent failed to establish that the wrongdoing was decisive for the initiation of investment.[214] The tribunal stated that the acts of the claimant "*might not be in line with […] 'l''éthique des affaires*'". However, this would only affect the merits of the case, not the issue of existence of investment and jurisdiction.[215]

This thesis shares the view expressed in *Tokios Tokelės Case* with respect to the threshold of illegality.[216] On the other hand, the shortcomings of the so called "*minor errors*" test[217] cannot be disregarded. Since there are no standards or principles differentiating between minor and severe violations for the purposes of legality requirements, the test leaves a room for subjective assessment by the tribunal.[218] The subjective interpretation of the level of illegality does not serve the predictability or uniformity of arbitral decisions.

3.4 Consequences of Legality Requirements

The consequences of applying legality requirements are not uniform. The case law presented below highlights that the legality requirements might lead to different legal outcome.

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[213] Ibid., para. 135.

[214] Ibid., para. 137.

[215] Ibid., para. 138.

[216] *Tokios Tokelės V. Ukraine*, para. 83.

[217] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1495.

[218] Ibid.

The respondent in *Inceysa Case* argued that the BIT in question only applied to legitimate investments.[219] The tribunal regarded the issue of legality as jurisdictional.[220] It came to a conclusion that the BIT did not protect illegal investments.[221] When deciding so, the tribunal invoked the travaux préparatoires of the BIT and argued that the parties intended to exclude illegal investments.[222] It is noteworthy that the tribunal in *Inceysa Case* did not regard the resolutions of the host state with respect to legality as decisive.[223] The tribunal stated that this would implicitly grant the states the right to unilaterally withdraw the consent by determining the legality of the investment under their laws.[224] The tribunal further clarified that the determination of legality was performed solely for asserting the competence of the panel.[225]

The ICSID tribunals have developed case law with respect to the fraudulent actions in the field of taxation. In *Spyridon Roussalis Case,*[226] the respondent argued that the BITs did not protect fraudulent investments. It further argued that protection of such investments would violate the rule of law. The BIT in question contained "*in accordance with the host state's law*" requirement.[227] The respondent also argued that the claimant had burden of proof that an investment was made in accordance with the applicable law of the host state.[228] Since the respondent further withdrew this argument, the tribunal did not inquire into the matter of existence of investment.[229] An ICSID tribunal has dealt with the issue of tax fraud in the *AMCO Case.*[230] The judgment of the tribunal is remarkable since it provides guidance for the types of illegality that might be relevant for jurisdictional purposes. The tribunal noted that obligation of legality was

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[219] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 45.

[220] Ibid., para. 153.

[221] Ibid., para. 206.

[222] Ibid.

[223] Ibid., para. 210.

[224] Ibid., para. 211.

[225] Ibid., para. 213.

[226] *Spyridon Roussalis V. Romania AS.*

[227] Ibid., para. 53.

[228] Ibid., para. 54.

[229] Ibid., para. 62.

[230] *Amco Asia Et Al. V. Indonesia*, para. 126.

provided in the host state's law; however, this obligation was not contracted with an investor and did not arise out of the investment. [231] Thus, the tribunal found that the issue of tax fraud was not within its competence *ratione materiae*.[232]

"*In accordance with the host state's law*" provision was also considered by the tribunal in the *Fraport Case*. The tribunal assessed whether the investment was made within the scope of the BIT *ratione materiae*.[233] The tribunal noted that the definition of investment in the BIT represented *lex specialis vis-à-vis* Article 25 of the ICSID Convention.[234] It further concluded that the investment was not made in accordance with the law of the host state and consequently the tribunal had no jurisdiction.[235] The tribunal stated that "*compliance with the host state's laws is explicit and hardly unreasonable requirement in the BIT*."[236]

An interesting analysis was offered in the *Phoenix Case*, where the tribunal held that the consequence of illegality could have been the denial of the claim on the merits stage. However, it further highlighted that since the violation of the law by the investor was obvious, the tribunal would deny jurisdiction for the sake of judicial economy.[237] The investment wrongdoing also resulted in the denial of jurisdiction in *Alasdair Ross Case*,[238] where the tribunal did not consider the claims due to non-compliance with the law of the respondent state, Costa Rica.[239] The tribunal noted that the diligent investor shall make itself sure that the transaction complied with the law of the host state.[240]

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[231] Ibid.

[232] Ibid., para. 136.

[233] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 307; *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, 112; 219; 247; (ICSID Annulment Committee 2010). The Annulment Committee reaffirmed the tribunal's interpretation of legality requirement.

[234] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 305.

[235] Ibid., para. 401.

[236] Ibid., para. 404.

[237] *Phoenix Action, LTD. V. the Czech Republic*, para. 104.

[238] *Anderson Et Al. V. Republic of Costa Rica*, para. 104 (ICSID ARB(AF)/07/3 2010).

[239] Ibid., para. 55.

[240] Ibid., para. 58.

The case law presented above highlights that majority of the tribunals do not consider illegal investments within the scope of the BITs for jurisdictional purposes. The denial of jurisdiction is rather harsh punishment even for severe crimes, such as corruption.[241] In arbitrations where the jurisdiction is not based on the BIT or where the legality requirement is not explicitly stipulated, the limitations come into play through the general principles. These grounds shall be addressed in more detail below.

[241] Stephan Wilske and Todd J. Fox, *International arbitration and international commercial law : synergy, convergence, and evolution : liber amicorum Eric Bergsten*, ed. Stefan Kröll and Loukas A. Mistelis (Alphen aan den Rijn, the Netherlands; Frederick, MD: Kluwer Law International ; Sold and distributed in North, Central, and South America by Aspen Publishers, 2011), pp.489 – 505.

4 Role of General Principles

The international principles are relevant for determining whether the investment wrongdoing results in the rejection of jurisdiction or inadmissibility of claim. In certain cases, international principles might even serve as exceptions to the wrongdoing and mitigate the effects of illegality for the purposes of jurisdiction, admissibility or merits.

This Chapter aims to establish the consequences of arbitration proceedings, once the investment fails to comply with any of the following: international public policy, clear hands doctrine and good faith principle. The main question is whether application of these principles leads to the rejection of jurisdiction, inadmissibility or substantial consequences on the merits phase. This Chapter shall further address the good faith mistake and estoppel, which might mitigate the consequences of an investment wrongdoing. These principles might serve as basis for maintaining jurisdiction or establishing admissibility in the cases where the wrongdoing would lead to the contrary.

The interpretation of investment treaties cannot be isolated from the general principles of international law.[242] Foreign investment is not only required to meet the requirements of the law of the host state.[243] Compliance with international principles equally affects the protection under the BIT and multinational treaties.[244] Some multilateral treaties, such as the ECT[245] and the ICSID Convention,[246] as well as BITs,[247] directly refer to the

[242] Stern, "Contemporary issues in international arbitration and mediation," p.42.

[243] Ibid., p.43.

[244] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1474.

[245] ECT, 1998, Article 26 (6).

[246] ICSID Convention, Art. 42(1).

general principles of international law. The relevance of international principles was confirmed in *Ioannis Kardassopoulos Case*.[248] The tribunal decided on compliance of investment with the law of the host state "*in accordance with applicable rules and principles of international law*." [249]

4.1 International Public Policy

The concept of international public policy is characterized by ambiguity.[250] It can be confined to violation of fundamental conceptions of legal order; a set of principles that carries essential importance for a certain society.[251] The divergence in terminology adds to the confusion. The word "*international*" does not connote that these principles are common to many countries. In fact, the content of international public policy might vary from one state to another.[252] The principles shared by the legal systems of different countries are referred to as transnational public policy.[253] This concept is narrower but more uniform than international public policy.[254] The tribunal in *World Duty Free Case* defined international public policy as "*international consensus as to universal standards and accepted norms of conduct that must be applied in all fora."*[255] The decision further used the terms international public policy and transnational public

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[247] Emmanuel Gaillard and Yas Banifatemi, "The Meaning of 'and' in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process," *ICSID Review - Foreign Investment Law Journal*: p.377.

[248] *Ioannis Kardassopoulos v Georgia*, para. 144.

[249] Ibid.

[250] Carolyn B. Lamm and Hansel T. Pham, "Fraud and Corruption in International Arbitration," in *Liber amicorum : Bernardo Cremades*, ed. Miguel Angel Fernández-Ballesteros and David Arias (La Ley, 2010), p.708; Martin Hunter and Gui Conde E Silva, "Transnational Public Policy and Its Application in Investment Arbitrations," *The Journal of World Investment* 4, no. 3 (2003): p.367.

[251] Hunter and Conde E Silva, "Transnational Public Policy and Its Application in Investment Arbitrations," p.367.

[252] Ibid.

[253] Ibid.; Lamm and Pham, "Fraud and Corruption in International Arbitration," p.707.

[254] Hunter and Conde E Silva, "Transnational Public Policy and Its Application in Investment Arbitrations," p.368.

[255] *World Duty Free Company Limited v Republic of Kenya*, paras. 138–139.

policy interchangeably.[256] When referring to national or international principles, this thesis shall use the term international public policy.

The international arbitral tribunals have often referred to public policy in the context of investment wrongdoing. Generally, illegal investments may be considered as contrary to international public policy and be excluded from the jurisdiction of the arbitral tribunals.[257] However, it does not mean that any criminal conduct by a foreign investor deprives the tribunal of its jurisdiction.[258] The scope as well as the consequences of application of international public policy shall be addressed below.

4.1.1 Applicability

The rationale behind the application of international public policy might be different in commercial and investment arbitration. In commercial cases, the tribunals tend to verify the compliance with the public policy in order to avoid unenforceability of the awards.[259] In investment treaty arbitration, the tribunal consults public policy as the law applicable under the auspices of public international law.[260]

The public policy issues generally arise when dealing with fraud and bribery.[261] The investors aim to reduce the application of national law, since the bilateral or multilateral treaty creates more favourable conditions for an investment. The host state cannot escape its obligations under international public policy by invoking its internal legislation. These principles would apply irrespective of whether they are integrated in

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[256] Ibid., para. 157.

[257] Bottini, "The backlash against investment arbitration," pp.298–299; Timothy A. Martin, *International Arbitration and Corruption: And Evolving Standard*, Transnational Dispute Management, 2004, p.4.

[258] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.73.

[259] *NY Convention*, Article V (2) (b)..

[260] Lamm and Pham, "Fraud and Corruption in International Arbitration," p.708.

[261] Hunter and Conde E Silva, "Transnational Public Policy and Its Application in Investment Arbitrations," p.707.

the internal legislation of the host state.[262] Although generally favourable for investors, these principles work against investors involved in wrongdoings.

The applicable law carries vital importance for the outcome of the dispute.[263] The arbitral tribunals have relied on different sources to bring in the principle of international public policy. Generally, the sources of public policy are fundamental principles of natural law, universal justice, jus cogens, the general principles of morality accepted by civilized nations, international custom, arbitral precedent and the spirit of international treaties.[264]

For example, the tribunal in the *Inceysa Case* stated that "*in accordance with the host state's law*" clause in itself was a demonstration of the applicability of the public policy. It subsequently concluded that protection of fraudulent investment would violate this principle.[265] The tribunal in the *World Duty Free Case* noted that the rules of public policy shall be prudently identified in international conventions, comparative law and arbitral awards.[266] The tribunal relied on domestic laws, international conventions, as well as case-law of courts and tribunals and concluded that bribery was contrary to international public policy of most states.[267]

Some scholars argue that where dispute resolution and substantive provisions are provided in international treaties, international tribunals are obliged to apply international public policy. The tribunals can hardly ignore the fundamental interests

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[262] Ibid., p.372.

[263] Yas Banifatemi, "The Law Applicable in Investment Treaty Arbitration," in *Arbitration under international investment agreements : a guide to the key issues*, ed. Katia Yannaca-Small (Oxford; New York: Oxford University Press, 2010), p.192.

[264] Hunter and Conde E Silva, "Transnational Public Policy and Its Application in Investment Arbitrations," p.369.

[265] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, paras. 246–248.

[266] *World Duty Free Company Limited v Republic of Kenya*, para. 141.

[267] Ibid., para. 157.

protected by international law.[268] The international public policy is also relevant when the dispute is solely based on the contract. For example, the tribunal in *World Duty Free Case* applied international public policy together with public policy considerations of Kenya and the UK.[269]

4.1.2 Consequences of the Application

The outcome of application of international public policy differs in accordance with the cases. Judge Lagergren stated that it could not arbitrate a dispute since it arose out of contract that was against international public policy.[270] In that case, the Judge regarded corruption as an "*international evil*" which contradicted good morals and international public policy shared by international community.[271] Judge highlighted that the decision on the rejection of jurisdiction was based on general principles and not on national rules on arbitrability.[272]

In *Inceysa Case*, the tribunal ruled on the legality of investment and denied jurisdiction. The tribunal found that fraudulent investments were not protected under the BIT. The tribunal applied international public policy as a principle of private international law.[273] Some authors consider that this could generate uncertainties.[274] The author finds the application of public policy, as principle of public international law, more pertinent.[275] In *Burkina Faso Case*, the tribunal had to deal with fraudulent misrepresentation.[276] The respondent argued that the agreement concluded between the host state and an investor

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[268] Hunter and Conde E Silva, "Transnational Public Policy and Its Application in Investment Arbitrations," p.369.

[269] *World Duty Free Company Limited v Republic of Kenya*, paras. 138;158.

[270] *Mr X, Buenos Aires v Company A*, paras. 8; 9.

[271] Ibid., para. 20.

[272] Ibid., para. 21.

[273] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, paras. 245–246.

[274] Bottini, "The backlash against investment arbitration," p.303.

[275] Ibid.

[276] *Société d'Investigation De Recherche Et d'Exploitation Minière v Burkina Faso*, para. 5.29 (ICSID ARB/97/1 2000).

violated public policy. The Tribunal held that in order to determine the legal consequences of this misrepresentation, it had to apply the principles beyond the internal public policy of the host state. The tribunal found that the agreement was null and void on the basis of violation of public policy and denied jurisdiction.[277]

In contrast with the previous cases, the *World Duty Free Case* did not invoke international public policy before considering the issue of admissibility. The contract was voidable because it was procured by corruption, and was eventually set aside by the victim of corruption, Kenya.[278] When reaching the conclusion on admissibility, the tribunal refused to consider the argument of claimant with respect to the corruption being common business practice in the host state.[279] The tribunal stated that the widespread corrupt practices did not alter legal consequences of this wrongdoing.[280] It further refused to uphold the claims based on both: contracts of corruption or the ones obtained by corrupt practices. [281] The irrelevance of the frequency of corruption was also highlighted in *ICC Case #3916*, where the tribunal stated that notwithstanding the presence of corruption in business practice, it is impossible to ignore the negative impact of such acts.[282]

The application of international public policy might render the tribunal without jurisdiction.[283] The tribunal would assess the validity of the contract on the basis of international public policy in order to find its jurisdiction. However, the resort to public policy considerations leads to the substantive assessment, which is not pertinent on the jurisdictional stage.[284] The application of international public policy may be more pertinent once the tribunal addresses the merits of the case.

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[277] Ibid., paras. 5.01–5.44.

[278] *World Duty Free Company Limited v Republic of Kenya*.

[279] Ibid., para. 156.

[280] Ibid.

[281] Ibid., para. 157.

[282] *ICC Award No. 3916*, p.511 (ICC 1982).

[283] Bottini, "The backlash against investment arbitration," pp.298–299.

[284] Abdulhay Sayed, *Corruption in international trade and commercial arbitration* (Kluwer Law International, 2004), p.67.

4.2 Clear Hands Doctrine

The status of the clear hands doctrine as of a principle of international law has been disputed, however, the essence of this doctrine has been provided in the BITs and decisions of international tribunals.[285] The requirement of legality for investments is considered as a reflection of the clean hands doctrine.[286] As noted above, illegality does not lead to the lack of jurisdiction in all cases. For example, if illegality took place after the investment was made, the claims shall not be bared.[287]

The clear hands doctrine requires the parties to the dispute to appear before the court or tribunal with clean hands.[288] Consequently, illegal conduct might render the party without *locus standi in judicio*.[289] The doctrine equally applies to the acts of states and investors.[290] The application of clear hands doctrine might bar the consideration of claims that are related to investment wrongdoing.[291] Generally, this doctrine applies at the stage of admissibility.[292] International arbitral tribunals refer to this obligation, without mentioning the name of the doctrine.[293]

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[285] Moloo, "A Comment on the Clear Hands Doctrine in International Law," p.1.

[286] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.100.

[287] Ibid.

[288] Gerald Fitzmaurice, "The General Principles of International Law Considered from the Standpoint of the Rule of Law," in *Recueil Des Cours, Collected Courses, Volume 92 (2007)*, p.119; Bin Cheng, *General principles of law as applied by international courts and tribunals* (Cambridge; New York: Cambridge University Press, 2006), p.156.

[289] Fitzmaurice, "The General Principles of International Law Considered from the Standpoint of the Rule of Law," p.119.

[290] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.100.Myrzaev, p.100.

[291] Hwang and Lim, "Corruption in Arbitration - Law and Reality," p.67; Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.99; Moloo, "A Comment on the Clear Hands Doctrine in International Law," para. 1; Lisa J. Laplante, "The Law of Remedies and the Clean Hands Doctrine: Exclusionary Reparation Policies in Peru's Political Transition," American University International Law Review (2008): p.60.

[292] Hwang and Lim, "Corruption in Arbitration - Law and Reality," p.67.

[293] *World Duty Free Company Limited v Republic of Kenya*, para. 52.

In the *Yukos Case*, the respondent, the Russian Federation, argued that claims should have been rejected due to "unclean hands". The tribunal maintained jurisdiction and addressed the issue only on the merits stage.[294] Some authors suggest that this implied the consideration of effects of wrongdoings at the admissibility phase.[295] Arguably, if the investor commits wrongdoing, the claims will be inadmissible under the doctrine.[296]

The practice on the application of the clear hands doctrine is scarce in this context. However, based on the case above, it can be concluded that its violation would in most circumstances be addressed at the substantial stage and might lead to the inadmissibility of the claim.

4.3 Good Faith

Another principle that can be often found in the decisions regarding investment wrongdoings is the principle of good faith. Along with international law, the good faith principle is specifically applicable within the scope of international investment law.[297]

The principle of good faith in itself can be applied in investment arbitration in two distinct ways. Good faith might apply to the context and way in which investment was made.[298] This is regarded as material good faith. Secondly, observance of good faith might be relevant when filing a claim in international arbitral tribunal in pursuit of protection of investment. This is called procedural good faith.[299]

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[294] *Hulley Enterprises Limited (Cyprus) V. the Russian Federation*, para. 435; *Veteran Petroleum Limited (Cyprus) V. the Russian Federation*, para. 492; *Yukos Universal Limited (Isle of Man) V. the Russian Federation*, para. 436.

[295] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1486.

[296] Moloo, "A Comment on the Clear Hands Doctrine in International Law," p.[11].

[297] Lamm and Pham, "Fraud and Corruption in International Arbitration," p.718; *Abaclat and Others V. The Argentine Republic*, para. 646.

[298] *Abaclat and Others V. The Argentine Republic*, para. 647.

[299] Ibid.

When relying on material good faith, tribunals follow different approaches. Some consider the compliance with good faith at jurisdictional stage[300], while others apply good faith for assessing merits.[301] Good faith principle is linked with the issue of jurisdiction, where it relates to the consent. To be more precise, the tribunal might decline jurisdiction, if the consent of the host state does not extend to investments breaching the principle of good faith.[302] Good faith principle might apply to the merits, when the tribunal has established jurisdiction and considers whether investment shall benefit from standards of protection.[303]

Procedural good faith might be relevant for the stages of jurisdiction and admissibility. Good faith is regarded as an issue of jurisdiction, where procedural aspects are considered as key components for establishing the consent of the host state. Good faith is linked with admissibility, "*where the key question is the way in which the investor initiated the proceedings, although in accordance with the applicable provisions, aim to obtain a protection, which he is – under the principle of good faith – not entitled to claim.*[304]

The principle of good faith is rooted in international law[305] and carries vital importance for inter-state relations.[306] This principle is stipulated in a number of international instruments.[307] Good faith has been invoked when evaluating the obligations of states, as well as investors.[308] The arbitral tribunals have invoked the following definition of

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[300] See *Mobil Corporation and Others V. Bolivarian Republic of Venezuela*; *Phoenix Action, LTD. V. the Czech Republic*.

[301] See *Aguas Del Tunari, S.A. V. Republic of Bolivia* (ICSID ARB/02/3 2005); *The Rompetrol Group N.V. V. Romania* (ICSID ARB/06/3 2008).

[302] *Abaclat and Others V. The Argentine Republic*, para. 648.

[303] Ibid., para. 649.

[304] Ibid.

[305] *Plama Consortium Limited V. Republic of Bulgaria*, para. 107.

[306] J. F O'Connor, *Good faith in international law* (England, 1991), p.120.

[307] UN, *Vienna Convention on the Law of the Treaties*, 1969, Articles 28; 31; 46; 69; UNIDROIT and International Institute for the Unification of Private Law (UNIDROIT), *UNIDROIT principles of international commercial contracts.* (Rome: UNIDROIT, 2010), Article 1.7; 4.8.2; 5.1.2; 5.3.3; 5.3.4.

[308] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.94.

the good faith principle: "*…good faith means absence of deceit and artifice during the negotiation and execution of instruments that gave rise to the investment*. [309]

The role of the principle in the cases of wrongdoings is not as clear. The ambiguity arises as for the basis of applying the principle of good faith and consequences of its application. This part shall address two distinct ways in which the principle of good faith might appear in the decisions of international tribunals. The good faith principle might be the requirement applied to the acts of the host state in order to determine the compliance. Thus, the tribunal might find that the investor violated the principle with investment wrongdoing and subsequently, reject the jurisdiction, deny admissibility or refuse protection on the merits. Good faith principle might as well assist the investor to mitigate the results of its wrongdoings, once it established that the wrongdoing was committed as a good faith mistake.

4.3.1 Application

The decisions of international arbitral tribunals have resorted to different sources to bring in the principle of good faith. As a result, the arbitral case law has acquired controversial approaches towards its application.

The most debatable line of reasoning was introduced by the tribunal in the *Phoenix Case*. The tribunal stated that the definition of investment under the ICSID Convention required "*assets invested bona fide.*"[310] The tribunal noted that "*in accordance with the host state's law*" provisions do not alter the requirements under the ICSID convention. What they do is to explicitly state the requirement of investing in good faith.[311]

This approach was later overturned by the decision in *Saba Fakes Case*. The tribunal ruled that the principle of good faith could not be incorporated in the definition of

[309] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 231.

[310] *Phoenix Action, LTD. V. the Czech Republic*, para. 114.

[311] Ibid., para. 116.

investment under the ICSID Convention. The tribunal stated that investment might as well be illegal or carried out in bad faith, but it would still be qualified as investment.[312]

The tribunal in Inceysa case used another approach to bring in the principle of good faith. It stated that BIT, being the law of El Salvador under the constitution, was the law applicable to the investment. Thus, the legality should have been assessed *vis-à-vis* the BIT.[313] Since the BIT, in turn, made a referral to rules and principles of international law and national law of the host state, the tribunal decided to apply the former.[314] Consequently, the good faith applied as a principle of international law. The tribunal in the *Plama Case* held that the claimant's conduct was contrary to the principle of good faith both under Bulgarian and international law.[315]

4.3.2 Good Faith as a Requirement

The tribunal in the *Phoenix Case* stated that the investor cannot be given protection if it is against general principles of international law, including the principle of good faith.[316] In *Cementownia Case* the tribunal concluded that the claimant acted in violation of good faith and rejected jurisdiction. The tribunal also decided to order the payment of the costs to the claimant.[317] Violation of the principle of good faith, together with the national law of the host state, equally resulted in the rejection of jurisdiction in the Inceysa case.[318] The principle was violated by fraudulent acts during the public bidding.[319]

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[312] *Mr. Saba Fakes V. Republic of Turkey*, para. 112.

[313] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, paras. 219;220.

[314] Ibid., paras. 222; 224–228.

[315] *Plama Consortium Limited V. Republic of Bulgaria*, para. 144.

[316] *Phoenix Action, LTD. V. the Czech Republic*, para. 106.

[317] *Cementownia "Nowa Huta" S.A. v Republic of Turkey*, para. 159.

[318] *Inceysa Vallisoletana, SL V. Republic of El Salvador*, para. 239.

[319] Ibid.

Scholars suggest that the any violation could be construed as contradicting the principle of good faith. Investments that are illegal shall be deprived of the substantive protection. [320]

In accordance with the decision of the tribunal in the Fraport case, the favourable principles of international law are inapplicable where investor does not act in good faith.[321] Violation of the good faith principle was deemed to affect the right to benefit from substantive protection of the treaty in the *Plama Case*.[322]

The application of the good faith principle might benefit the integrity of investment arbitration; its application might encourage the parties to conduct their relations in a due manner. Nevertheless, the source of its application, as well as legal consequences shall be better defined. When referring to the principle of good faith, the ICJ observed that: "*[good faith] is not in itself a source of obligation where none would otherwise exist.*"[323] Therefore, the application and consequences of this principle require the proper level of substantiation from the tribunals.

4.3.3 Good Faith Mistake

The mistake committed in good faith can excuse investment wrongdoing and mitigate the consequences of violation.[324] The tribunal in the *Fraport Case* came up with two indicators that would justify application of good faith for excusing the investment wrongdoing.[325] The mistake would be made in good faith, when: (i) the responsible counsel fails to draw attention of an investor to the legal requirement; or (ii) the

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[320] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1487.

[321] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 396.

[322] *Plama Consortium Limited V. Republic of Bulgaria*, para. 321.

[323] *Border and Transborder Armed Actions Case (Nicaragua v Honduras)*, para. 105 (ICJ 1988).

[324] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.96.

[325] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 396.

wrongdoing "*was not central to the profitability of the investment*."[326] In the latter case it shall be proved that the level of profitability of investment would not be altered by compliance with the host state's law.[327] Hence, the investment wrongdoing that was exercised without bad faith intentions shall not leave the investor without protection of international investment law.[328] The judgment in the *Fraport Case* referred to the real circumstances, which might be confronted by the foreign investor in the host state.[329] The tribunal noted that the laws of the host state might lack clarity causing the good faith mistake of an investor.[330]

The reasoning of the tribunal in the *Fraport Case* found reflection in other decisions. The *Desert Line* Case referred to the *Fraport Case,* when dealing with the legality of investment under Oman-Yemen BIT.[331] The case reformulated the second indicator of the *Fraport* tribunal and questioned whether the investor would get the required certificate if it were aware of the necessity to do so.[332] The tribunal decided that if investor knew about the requirement it would have complied with it.[333] Therefore, the claimant was entitled to resort to arbitration[334] and the tribunal had jurisdiction.[335]

It is noteworthy that the level of legal culture, as well as bureaucracy and lack of transparency has often caused confusion or mistakes of investors.[336] The investor has a right to "*reasonable reliance*" with respect to the host state's understanding of its own laws.[337] In cases above the tribunals applied the legality clauses in the BITs, since their

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[326] Ibid.

[327] Ibid.

[328] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.96.

[329] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 396.

[330] Ibid.

[331] *Desert Line Projects LLC V. Republic of Yemen*, para. 116.

[332] Ibid., para. 117.

[333] Ibid.

[334] Ibid., para. 123.

[335] Ibid., p.68.

[336] *Metalclad Corporation V. The United Mexican States*, para. 88 (ICSID ARB(AF)/97/1 2000).

[337] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 392.

jurisdiction was restricted to legal investments only.[338] The application of good faith mistake without explicit legality provisions is not clear. Some authors consider that if legality does not stand as a limitation to jurisdiction, the good faith mistake shall apply to the admissibility of claim.[339]

The *rationale* behind mitigating investment wrongdoing, when investor did not intent to trespass the laws of the host state, seems reasonable. However, the application of the principle has not been substantially justified.[340] Invocation of mitigating circumstances "*from the air*"[341] might pose risks to the uniform application of this mitigating principle in the future.

In certain political systems the governments do not take actions for precluding the investment wrongdoing, even though they possess information about their conducts. Notwithstanding the violations, investors have the opportunity to continue their work without legal consequences.[342]

4.4 Estoppel

The application of some international principles might serve as the basis for avoiding the consequences of investment wrongdoing during arbitration. One of these principles is the estoppel.[343]

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[338] *Desert Line Projects LLC V. Republic of Yemen*, para. 92; *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 285.

[339] Moloo and Khachaturian, "The Compliance with the Law Requirement in International Investment Law," p.1496.

[340] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 396; *Desert Line Projects LLC V. Republic of Yemen*, para. 116.

[341] Yackee, "Investment Treaties & Investor Corruption: An Emerging Defense for Host States," p.17.

[342] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.98.

[343] Yackee, "Investment Treaties & Investor Corruption: An Emerging Defense for Host States," p.742.

The investor claims might be dismissed due to non-compliance with international legal principles. However, international law maxims might as well save the potentially unsuccessful claim of the party. In fact, principles of international law might mitigate the effects of investment wrongdoing. This issue is relevant with respect to the research question, since the application of the mitigating factors might affect the reasoning of the tribunal on jurisdiction or admissibility.

The concept of mitigation with respect to investment wrongdoing was firstly introduced in the *Fraport Case*. The tribunal stated that when assessing the compliance with the law of the host state, the jurisdiction *ratione materiae* could be defined in "*a more liberal way*". In view of the tribunal, this approach would be "*generous to the investor.*"[344] Together with framing the good faith mistake as a mitigating factor, the *Fraport* tribunal also referred to the estoppel. The tribunal noted that certain acts of the host state might be considered as an acceptance of the investment wrongdoing that violates the law.[345] The tribunal stated that application of the estoppel is required by the procedural fairness, where the government consciously ignored the violations of its laws and endorsed an investment.[346] In these circumstances the government must be estopped to invoke investment wrongdoing as a ground for challenging the jurisdiction of the arbitral tribunal.[347] Although the *Fraport* tribunal introduced two mitigating factors, it concluded that none of the two applied to the investor in that case.[348] The reasoning was based on the unawareness of the claimant's wrongdoing by the respondent. Thus, the estoppel could not apply.[349] The tribunal consequently denied jurisdiction *ratione materiae*.[350]

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[344] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, para. 396.

[345] Ibid., para. 387.

[346] Ibid., para. 346.

[347] Ibid., para. 401.

[348] Ibid.

[349] Ibid., para. 346.

[350] Ibid.

Provided that the state knew about the violations of its domestic laws and remained silent, it could not raise the argument of wrongdoing for its defence during arbitration.[351]

Some scholars are sceptical about the application of estoppel in investment arbitration, especially when dealing with serious wrongdoings, such as corruption. It is indeed questionable whether the state should be precluded from raising the issue of investment wrongdoing, if it was aware of this illegality or should have known about it.[352]

With respect to estoppel, corruption raises particular questions. Most corruption cases involve the public officials, implying that the state official is aware of the wrongdoing. If this awareness is attributed to the state, the investor could rely on estoppel for mitigating its illegal acts.[353] The escape from this unfair result might be the application of international/transnational public policy. Corruption is against the public policy, therefore, knowledge or involvement of a state official would not preclude the state to put forward the argument on investment wrongdoing. The consequence contrary to this would undermine the purpose of legality clauses.[354]

[351] Mirzayev, "International Investment Protection Regime and Criminal Investigations," p.105.

[352] Bottini, "The backlash against investment arbitration," p.309.

[353] Ibid.

[354] Ibid.

5 Concluding Remarks

The analysis presented above highlights that investment wrongdoing raises legal, as well as general policy considerations in investment arbitration. Even when ruling on procedural matters, the arbitral tribunals affect the development of arbitral practice and frame future trends of the field. The impact of the decisions concerning investment wrongdoing is not limited to the roles of investors and the host states during arbitration. In reality, the decisions might encourage or dispirit illegal practices within states and multinational corporations.

The importance of the role of arbitral practice in this field obviates the difficulty of the task. The arbitral tribunal has to reach balance between different values. It has to preserve the arbitral remedy for the investor and at the same time, provide adequate response for the violation of the rules of international and domestic law. The only tool that can assist in reaching the balance in these cases is the proper application of the procedural and substantive rules.

In order to ensure the in-depth analysis of the issue, three questions were presented at the outset. These questions approached the research issue from different angels, in order to fully address all possible implications.

i. How may investment wrongdoing affect the consent of the host state and subsequently, the jurisdiction of the arbitral tribunal?

The case law of international arbitral tribunals leads us to the conclusion that investment wrongdoing might become the basis for the rejection of jurisdiction due to the lack of consent. However, the distinction must be made between the consent

expressed in the arbitration agreement and the consent provided in the treaty. When the consent is presented in the contract or the compromise, the tribunal might reject jurisdiction upon establishing that the agreement to arbitrate was also obtained by the wrongdoing. The evidence to the contrary, would lead to the establishment of the jurisdiction, whereas the wrongdoing would only maintain relevance for the merits.

In cases where the respondent challenges the jurisdiction of the arbitration under the BIT, the tribunal would have to assess the scope of the consent. The case law leads us to the conclusion that the states are authorized to limit their consent to investments without wrongdoings. However, the scope of consent and the intentions of the parties upon conclusion shall be assessed.

ii. Does investment wrongdoing disqualify an investment for the purposes of jurisdiction of the arbitral tribunal?

The answer to this question stands as a cornerstone for the intersection of investment wrongdoing and arbitration. As for now, the case law can provide guidance about the potential conclusions that might be reached in the framework of different factual and legal backgrounds. The legality requirements in the BITs might lead to the rejection of the jurisdiction where the requirement is included in the definition of investment. This clause carries relevance for the establishment of jurisdiction, since the tribunal has to verify whether investment at hand meets the definition. However, if the requirement of legality is provided in other parts of BITs, it might solely limit the application of protection standards on the merits.

This thesis supports the view that the tribunals should be prone to maintain jurisdiction, where the law and facts so allow. The room for improvement in this regard lies within the set of decisions, where the legality requirements were applied on an implicit basis. The denial of jurisdiction devoid of stipulated basis, even when warranted by international principles, undermines the object and purpose of investment arbitration. These decisions introduce the trend of unpredictability, lack of substantiation and encourage unfair speculations from the parties. Indeed the wrongdoing shall be addressed. However, where there is no explicit requirement in the BIT or national

legislation, the tribunals shall only resort to the legality at the admissibility or merits stage.

The preservation of the object and purpose of investment arbitration and particular investment treaties require the careful examination of the severity of wrongdoing. Deprivation of an international legal remedy on the basis of minor errors, might lead to the far-reaching arguments from the host states. The tribunals shall view the severity of the wrongdoing as one of the determinant factors, where the predominant value shall lie within the maintenance of the remedy and consequently, jurisdiction.

iii. Which general principles apply to investment wrongdoing and what are the consequences of their application?

The case law demonstrates that the arbitral tribunals are inclined to apply international principles. The maxims of international law assist in framing the content and rationale behind the explicit or implicit requirements of legality. The application of international public policy, good faith or clear hands doctrine has not been uniformly linked to the admissibility stage. This thesis supports the view that the application of these principles shall be limited to the substantial consideration of the dispute. This is supported by the procedural, as well as policy considerations.

Where these principles apply as mitigating factors at jurisdictional stage, they might assist to limit the superfluous application of legality requirements. These principles provide the possibility of viewing the wrongdoing in the relevant context, which is crucial for reaching the accurate conclusion.

The outcome of the cases involving investment wrongdoing can be summarized in three basic points. When confronting investment wrongdoing, the tribunal might either deny jurisdiction or refuse to apply protection under the standards provided in the BIT. Provided that the wrongdoing does not deprive an investment of the substantive protection of the BIT, the host state might invoke the illegality in order to justify its

actions with respect to investment.[355] The investment wrongdoing should indeed be followed by adequate legal consequences, but so should the violations of the host state. The reasonable balance must be reached between avoiding the impunity and denial of the remedy to investor.[356]

This thesis identified the circumstances where the rejection of jurisdiction on the basis of investment wrongdoing might be justified by factual or legal considerations. However, in cases where the link between the jurisdictional requirements and wrongdoing is not established, this issue shall only be invoked for the purposes of admissibility or merits.

[355] Kriebaum, "Investment Arbitration - Illegal Investments," p.319.

[356] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, Dissenting Opinion of Arbitrator Cremades, para. 39.

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