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CORRUPTION AS A JURISDICTIONAL BAR IN INVESTMENT TREATY ARBITRATION: A STRATEGIC REFORM

by George Martsekis

I. INTRODUCTION

It comes with no surprise that illegality and corruption have now become particularly pervasive. As a recent OECD Report on Combating Corruption and Fostering Integrity reveals, there is a grave concern that OECD and non-OECD countries are infected with abuse of executive authority and manipulation of the legislature and judiciary with regard to legal and regulatory capture, as well as constraints on information access and transparency, all of which are pernicious to a robust rule of law.[1]

Despite a global convergence of rules and instruments that regulate and condemn corrupt practices, issues of corruption in investor-State arbitration are complex and frequent, as they typically involve difficult factual and legal allegations at almost every stage of the arbitral process.[2]

This article attempts to address these challenges in three parts. Section I explains that ISDS suffers from corruption not only in cases involving tainted global transactions but also by many host States' involvement in corrupt procurement schemes, which later invoke illegality defenses to derail proceedings. Moreover, it investigates the difference between illegality defenses in investment treaty arbitration and international commercial arbitration.

Section II examines the evolution of illegality defenses in case law to identify the different stages at which illegality (and specifically corruption) defenses exist.[3] The

[1] High-Level Advisory Group, *Report to the OECD Secretary-General on Combating Corruption and Fostering Integrity* Mar. 16, 2017, *available at* http://www.oecd.org/corruption/HLAG-Corruption-Integrity-SG-Report-March-2017.pdf.

[2] Michael Hwang S.C. & Kevin Lim, *Corruption in Arbitration Law and Reality*, 8 ASIA J. 1, 2 (2012).

[3] A distinguishing analysis between illegality variations and corruption will precede this examination.

distinction is significant, as the lawfulness of the acquisition of the investment is a condition precedent for the conferral of jurisdiction to the tribunal, whereas unlawful *ex post* acts involving an acquisition may pertain to the merits of the dispute.[4] Likewise, the question of whether a plea of illegality relates to a claim's admissibility or the jurisdiction or merits stage is a central one. Moreover, local authority investigations touch upon the jurisdiction of the tribunal and questions of *res judicata*.

Section III provides recommendations for strategic reform. It answers the vital question of whether there is a need to elevate the above-referenced principles to a jurisdictional threshold (similar to *ratione personae*, *ratione materiae*, *ratione voluntatis* and *ratione temporis*) to unify different approaches concerning the stage in which each illegality defense occurs. In doing so, tribunals would achieve greater consistency and be empowered to rule on pending criminal court investigations. Moreover, explicit anti-corruption language adopted in treaty text would enhance the rule of law.

The article concludes with practical considerations for investors and host States, in particular over whether a host State is permitted to procure a bribe and then rely on it to successfully dismiss the investor's claim on jurisdictional grounds, and whether any restitution or non-contractual remedy is available to the investor, notwithstanding its own participation in the bribery.

II. ILLEGALITY DEFENSES IN THE ISDS SYSTEM

There is relatively little guidance regarding how tribunals *should* handle corruption defenses given the recent reinvigoration of anti-corruption investigations, particularly in developed countries. Yet, a decent body of arbitral jurisprudence exists.[5] Before touching upon the issue, however, it is worth distinguishing between illegality and corruption defenses and how this contrast differs in international commercial arbitration.

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[4] Zachary Douglas, *The Plea of Illegality in Investment Treaty Arbitration*, 29 ICSID REVIEW 155, 156 (2014).

[5] Jason W. Yackee, *Investment Treaties and Investor Corruption: An Emerging Defense for Host States*, 52 VA. J. INT'L L. 723, 726 (2012).

A. *Distinction between Illegality and Corruption*

As the tribunal in *Hamester v. Ghana* held:

> An investment will not be protected if it has been created in violation of national or international principles of good faith; by way of corruption, fraud, or deceitful conduct; or if its creation as such constitutes a misuse of the system of international investment protection under the ICSID Convention. It will also not be protected if it is made in violation of the host State's law.[6]

What constitutes corruption and fraud or any other deceitful conduct as a manifestation of illegality merits further analysis. The ensuing confusion in drawing the line between corruption and illegality must be resolved. While the practical definition of corruption involves the promise of exchange of a benefit in return for an act or omission between a natural or legal person and a public official,[7] illegality is broader for two reasons. First, it extends by definition beyond corruption to cover bribery and fraud. Second and more importantly, its perception by host State laws differs. For instance, certain payments to government officials to expedite services are prohibited by the UK Bribery Act and national laws; on the other hand, these are not condemned by the OECD Convention. Not to mention such acts are expressly permitted under the U.S. Foreign Corrupt Practices Act 1977 ("FCPA").[8] Each jurisdiction therefore has a different interpretation of corruption.

The most important implication of the distinction between corruption and illegality is found in two key aspects. First, in *Metal-Tech v. Uzbekistan*, the Tribunal was sensitive to the active debate that corruption findings "come down heavily" on claimants while at the same time exonerating defendants that have participated in the corruption scheme.[9] This happens because corruption is more complex in nature than

[6] Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24, Award, ¶ 123 (Jun. 18, 2010).

[7] Florian Haugeneder & Christoph Liebscher, *Chapter V: Investment Arbitration - Corruption and Investment Arbitration: Substantive Standards and Proof*, *in* AUSTRIAN ARB. Y.B. 539, 539 (2009) (Christian Klausegger et al. eds.,2009).

[8] *See* HWANG & LIM, *supra* note 2, at 3.

[9] Metal-Tech Ltd. v. Republic of Uzbekistan, ICSID Case No. ARB/10/3, Award, ¶ 389 (Oct. 4,

illegality (*i.e.*, fraud), because it requires the involvement of multiple actors. In contrast, illegality involves only one participant and is therefore less troublesome. This was the case in *Inceysa v. El Salvador*, where the Tribunal found that the foreign investor's contract was based on forged financial documents and intentional misrepresentation and concealment, and therefore it could not benefit from an investment effectuated by illegal means and enjoy the protection of the host State.[10] As Professor Schill succinctly emphasizes, illegality "[d]oes not cover illegal conduct by the State itself or the latter's acquiescence into illegal conduct of the investor."[11]

Second, illegality in the form of fraud or another improper act under host State law is much easier to prove. Relevant jurisprudence typically examines the illegal act in accordance with host State law clauses in the applicable treaty. On the other hand, the clandestine or the *quid pro quo* concept of corruption is difficult to establish, at least *prima facie*, regardless of what should be the standard of proof for invoking it.[12] This is an inherent problem if someone contemplates the different legal approaches as to what constitutes corruption versus a valid commission fee.

B. *Why is Corruption Immense in Investment Treaty Arbitration? The Sword and the Shield*

Transparency International released its 2017 Global Corruption Barometer (GCB) Report on the corrosive impact of corruption. The findings suggest that it is a common worldwide phenomenon; nearly one in four public service users have to pay a bribe each year.[13] In public procurement, the European Commission estimates that

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2013).

[10] Inceysa Vallisoletana S.L. v. Republic of El Salvador, ICSID Case No. ARB/03/26, Award, ¶ 242 (Aug. 2, 2006).

[11] Stephan W. Schill, *Illegal Investments in International Arbitration*, Jan. 4, 2012, *available at* https://ssrn.com/abstract=1979734 or http://dx.doi.org/10.2139/ssrn.1979734.

[12] Florian Haugeneder, *Corruption in Investor-State Arbitration*, J. WORLD INV. & TRADE 323, 338 (2009).

[13] *Global Corruption Barometer: Citizen's Voices from Around the World*, TRANSPARENCY INTERNATIONAL, https://www.transparency.org/news/feature/global_corruption_barometer_citizens_voices_from_around_the_world.

approximately €120 billion ($163 billion) is lost each year to corruption.[14] It would be naive to think that corruption did not concern the ISDS system as a major pillar of stimulating and protecting foreign direct investment (FDI) and capital commitments. Over time, investment treaty arbitration has undoubtedly been an emerging space for the enforcement of international norms, including standards for transparency and anti-corruption.[15] In its ISDS chapter, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)[16] requires from its members a commitment to anticorruption; this is probably the pedigree necessary to combat corruption in the future. However, the danger of corruption is so pervasive that it curbs the effectiveness of ISDS. That said, early awards noted that corruption defenses have been used systematically as a "shield" by host State defendants to block claims on jurisdictional grounds.[17] As discussed below, these corruption defenses might undermine the valid jurisdiction of arbitral tribunals. As Professor Yackee indicates, allowing tribunals to weigh and assess the involvement of the investor and State in a corrupt transaction may encourage public officials to express their corrupt sentiments since their right to raise a corruption defense, despite the State's

[14] *Curbing Corruption in Public Procurement: A Practical Guide*, TRANSPARENCY INTERNATIONAL, https://www.transparency.org/whatwedo/publication/curbing_corruption_in_public_procurement_a_practical_guide.

[15] Danielle Young, *Is Corruption an Emerging Cause of Action in Investor-State Arbitration?* THE GLOBAL ANTI-CORRUPTION BLOG, Jan. 22, 2016, https://globalanticorruptionblog.com/2016/01/22/is-corruption-an-emerging-cause-of-action-in-investor-state-arbitration-2/.

[16] *Trans-Pacific Partnership*, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, *available at* https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text

[17] *Id.*; A well-known example in this regard is *World Duty Free v. Kenya*, whereby the investor delivered a personal donation of US $2 million to the President of Kenya to secure concessions in airports. When the claimant alleged expropriation of its contractual rights, Kenya invoked the bribe as a defense. The benefit of corruption defenses to a host State is blatantly evident in *Siemens v. Argentina*, where the multinational corporation won a US $200 million ICSID award against Argentina for the expropriation of its investment. When Argentina initiated annulment proceedings, it came into light that Siemens executives had induced public officials into bribing. *See* Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/08, Award (Feb. 6, 2007).

involvement, is endorsed by a tribunal.[18] Moreover, it could trigger public dissatisfaction with the current international investment system by inciting the misconception that the system is biased against the policy decisions of certain developing States.

Another controversial issue is the use of corruption as a "sword," meaning that corruption could comprise the foundation of a cause of action. This is true as far as the *Yukos v. Russian Federation* decision is concerned. The company's cause of action against Russia was based partly on "fabricated legal proceedings" and "fabricated evidence" as a result of corrupt Russian officials against the company and its chairman.[19] This suggests that investors may have a valid cause of action when a breach of "fair and equitable treatment"[20] overlaps with the corrupt conduct of public officials.[21] These legal phenomena therefore call for the radical reshaping of the ill-organized area of corruption defenses. Without such a reform, ISDS's design would inevitably be prone to misuse by disputing parties and eventually systematic failure.

C. *How Different is the Plea of Illegality in International Commercial Arbitration?*

The present analysis would be ineffectual without a rigorous examination of illegality in the context of international commercial arbitration. The doctrines of separability and *competence-competence* ensure that a tribunal will be deprived of jurisdiction to adjudicate illegality defenses in only a limited number of instances.[22]

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[18] Jason Yackee, *Investment Treaties and Investor Corruption: An Emerging Defense for Host States*? IISD, Oct. 19, 2012, https://www.iisd.org/itn/2012/10/19/investment-treaties-and-investor-corruption-an-emerging-defense-for-host-states/.

[19] *See* YOUNG, *supra* note 15.

[20] Which encompasses due process, transparency and the protection of investors' legitimate expectations.

[21] *Id.*; *See* Yukos Universal Ltd. (Isle of Man) v. The Russian Federation, PCA Case Rep. Case No. AA227, Final Award (2014).

[22] *See* DOUGLAS, *supra* note 4, at 160. Separability doctrine prescribes that the arbitration clause in the main contract is separate and distinct from the main contract and the validity therefore of the arbitration clause is not determined by the validity of the main contract and vice versa. JULIAN D M LEW, LOUKAS A MISTELIS & STEFAN M KROLL, COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION 6-9 (Kluwer Law International, 2003). By contrast, the doctrine of

Typically in commercial arbitration disputes, the economic effects of the transaction are negotiated and implemented at the same time based on a single instrument upon which the parties have deliberately and mutually agreed: the commercial contract.[23] Yet in investment arbitration, there is a physical and temporal disconnect between the investment commitment by the foreign investor and the host State and the conclusion of the agreement to arbitrate.[24] In other words, the foreign investor must have acquired assets in the host State that satisfy the requirements of an investment in accordance with the investment treaty.[25] The investment treaty includes the offer to arbitrate; by filing the notice of arbitration, the foreign national accepts the offer and the consent to arbitration is effectively established. Thus, it is crucial to emphasize that the doctrines of separability and *competence-competence* are likewise applicable in ISDS. Apart from the different way of formulating the arbitration agreement, the basic notion is the same. As the Tribunal in *Malicorp v. Egypt* opined:

> There is nothing to indicate that the consent to arbitrate, as distinct from the consent to the substantive guarantees in the [BIT], was obtained by misrepresentation or corruption or even by mistake. The allegations of the Respondent relate to the granting of the Concession. However, it is not the Contract that provides the basis for the right to arbitrate, but the State's offer to arbitrate contained in the [BIT] and the investor's acceptance of that offer. The offer to arbitrate thereby covers

competence-competence refers to this unique power of tribunals to rule on their own jurisdiction. This is endorsed in Article 23(1) of the UNCITRAL Arbitration Rules (2010), which pertinently reads:

The arbitral tribunal *shall have the power to rule on its own jurisdiction*, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause that forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null shall not entail automatically the invalidity of the arbitration clause.

A similar approach is reflected in Article 41 of the ICSID Convention: "(1) The Tribunal *shall be the judge of its own competence*. (2) Any objection by a party to the dispute that that dispute is not within the jurisdiction of the Centre, or for other reasons is not within the competence of the Tribunal, shall be considered by the Tribunal which shall determine whether to deal with it as a preliminary question or to join it to the merits of the dispute."

[23] *See* DOUGLAS, *supra* note 4, at 161.

[24] *Id.*

[25] *Id.*

> all disputes that might arise in relation to that investment, including its validity.[26]

However, in an ISDS context, the ground is more slippery than that encountered in international commercial arbitration. Unlike the separability doctrine effect in the commercial arbitration context, corruption defenses in investment treaty arbitration can impair consent mainly because the offer to arbitrate covers all disputes arising out of the investment including its validity.[27] What is more, corruption defenses are more difficult to prove where state executives and branches enjoy broad legitimization. Finally, the host State may gain an unequal advantage. In particular, investment contracts—which involve the State's power to act not only as respondent but also foreign investment protector and law-giver—manifest its sovereign power, which, under certain circumstances, negates the arbitrability of disputes on the basis of sovereign immunity. In this way, manipulative discretion of the host State often frustrates an investor's expectations to proceed with arbitration. Even worse, the investor may not have restitution remedies for its investment in the host State simply because the latter raised a successful jurisdictional objection regarding corruption and the tribunal dismissed the case at an early stage.[28] Correspondingly, the possibility to test *objective arbitrability* in international commercial arbitration, as provided in Article V(2)(b) of the New York Convention for corruption allegations contrary to public policy, does not exist in ISDS. ISDS is designed to provide a delocalized adjudication and enforcement mechanism, whereby the jurisdiction of domestic courts to review investment awards on public policy grounds, including corruption, is scarcely available.[29] That said, corruption is more pernicious in the ISDS framework.

III. THE ASSESSMENT OF THE PLEA OF ILLEGALITY BY TRIBUNALS

[26] Malicorp Ltd v. Arab Republic of Egypt, ICSID Case No ARB/08/18, Award, ¶ 119 (Feb. 7, 2011).

[27] *Id.*

[28] *See* HAUGENEDER, *supra* note 12, at 330.

[29] ICSID Convention, art. 54 (1): "Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State." The scope therefore for refusing enforcement on public policy grounds is limited.

This section elucidates how tribunals have treated corruption allegations to date and constructs a clear and useful formula for tribunals striving to accept or deny jurisdiction. The key determinants of corruption as a bar to jurisdiction and the interplay of domestic court investigations with the tribunal's decision-making comprise the heart of this section.

A. A *Fragmented Approach*

The relevant jurisprudence on corruption allegations in the making and performance of foreign investments has led to different and inconsistent outcomes.

In *Metal-Tech v. Uzbekistan*, Uzbekistan asserted that the claimant had violated Uzbek law by paying over US$4 million to government authorities in exchange for approving its investment and granting favorable treatment.[30] The tribunal considered this issue as a jurisdictional one. It determined that the BIT explicitly contained a legality requirement. It ultimately ruled that it lacked jurisdiction on the grounds that "the rights of the investor against the host State, including the right of access to arbitration, could not be protected because the investment was tainted by illegal activities, specifically corruption. The law is clear—and rightly so—that in such a situation the investor is deprived of protection.[31]

The Tribunal in *Inceysa v. El Salvador* followed the same reasoning. It denied jurisdiction due to lack of consent, illegality, fraud and good faith by stating:

> The foreign investor cannot seek to benefit from an investment effectuated by means of one or several illegal acts and, consequently, enjoy the protection granted by the host State, such as access to international arbitration to resolve disputes, because it is evident that its act had a fraudulent origin and, as provided by the legal maxim, "nobody can benefit from his own fraud."[32]

[30] Metal-Tech Ltd. v. Republic of Uzbekistan, ICSID Case No. ARB/10/3, Award, ¶ 279 (Oct. 4, 2013).

[31] *Id.* at ¶ 422 (emphasis added)

[32] *Inceysa*, *supra* note 10, at ¶ 242.

By falsifying the facts and forging financial documents, Inceysa did not make its investment in accordance with Salvadoran law. The majority of arbitral tribunals construe "in accordance with host State law" clauses as a jurisdictional matter.[33]

At the same time, the Tribunal in *Saba Fakes v. Turkey* held that the occurrence of illegality was a jurisdictional matter since the BIT contained a clause allowing investments only "in accordance with the laws and regulations in the host State."[34]

Other tribunals considered the issue of corruption and illegality at the admissibility stage. For example, *World Duty Free v. Kenya* is a landmark case. The investment had been procured by a bribe paid to the President of Kenya, however, the plea of illegality was not treated as an impediment to jurisdiction leading to the Tribunal's conclusion that "the Claimant is not legally entitled to maintain any of its pleaded claims in these proceedings on the ground of *ex turpi causa non oritur action.*"[35] In the Tribunal's view, the procurement of the investment violated international public policy. In particular, it considered that corruption by bribing state officials is one of the most egregious crimes, and as such, a state contract afflicted by corruption is legally unenforceable without offending the public conscience.[36] Thus, if the plea of corruption is successful based on a violation of international public policy, the claim shall be inadmissible.[37]

The rationale for examining this claim at the admissibility stage is related to the tribunal's responsibility to condemn any violation regardless of the applicable law so as

[33] *See* SCHILL, *supra* note 11.

[34] Saba Fakes v. Republic of Turkey, ICSID Case No. ARB/07/20, Award, ¶ 115 (July 14, 2010).

[35] A legal doctrine in Latin stating that an action cannot arise from a dishonorable cause; World Duty Free Co. Ltd. v. The Republic of Kenya, ICSID Case No. ARB/00/7, Award, ¶ 179 (Oct. 4, 2006); *see* DOUGLAS, *supra* note 4, at 180.

[36] *See* DOUGLAS, *supra* note 4, at 173 ("Corruption of a state officer by bribery is synonymous with the most heinous crimes because it can cause huge economic damage; and its long-term victims can be legion. The offence lies in bribing a person to exercise his public duty corruptly and not in accordance with what is right and proper for the state and its citizens. Like any other contract, a state contract procured by bribing a state officer is legally unenforceable, as an affront to the public conscience.").

[37] *Id.* at 180.

to make clear that the tribunal will not assist to vindicate any rights that violate public policy.[38]

The tribunal in *Churchill Mining v. The Republic of Indonesia* adopted a similar approach,[39] holding that claims arising under fraud and forgery are inadmissible as a matter of international public policy.[40]

Some tribunals have also addressed questions of corruption and illegality generally during the merits phase of the proceedings. This was true in *Kim v. Uzbekistan*, where the Tribunal concluded that issues pertaining to corruption after the initial investment were more "properly addressed at the merits stage."[41] In *Al Warraq v. Indonesia*, moreover, the Tribunal determined that the corruption assertions were a merits-based question, even though, at the merits phase, it held that the investor's claims were inadmissible due to a public interest provision contained in the treaty.[42]

Based on the analysis above, tribunals assess corruption allegations inconsistently and imprecisely, which creates confusion as to what criteria is relevant for

[38] *Id.*

[39] With respect to fraud and not corruption.

[40] Churchill Mining PLC v. Republic of Indonesia, ICSID Case No. ARB/12/14 and ICSID Case No. ARB/12/40, Award, ¶ 508 (Nov. 29, 2016).

[41] Mark W. Friedman, Floriane Lavaud & Julianne J. Marley, *Corruption in International Arbitration: Challenges and Consequences*, GLOBAL ARB. REV., Aug. 29, 2017, *available at https://globalarbitrationreview.com/insight/the-arbitration-review-of-the-americas-2018/1146893/corruption-in-international-arbitration-challenges-and-consequences.* *See also* Vladislav Kim v. Republic of Uzbekistan, ICSID Case No. ARB/13/6, Decision on Jurisdiction, ¶ 552 (Mar. 8, 2017).

[42] Mark W. Friedman, Floriane Lavaud & Julianne J. Marley, *Corruption in International Arbitration: Challenges and Consequences*, GLOBAL ARB. REV., Aug. 29, 2017, *available at https://globalarbitrationreview.com/insight/the-arbitration-review-of-the-americas-2018/1146893/corruption-in-international-arbitration-challenges-and-consequences.* *See also* Hesham Talaat M. Al-Warraq v. Republic of Indonesia, UNCITRAL, Award on Respondent's Preliminary Objections to Jurisdiction and Admissibility of the Claims, ¶ 99 (Jun. 21, 2012); Hesham Talaat M. Al-Warraq v. Republic of Indonesia, UNCITRAL, Final Award ¶¶ 683(6), 155 (Dec. 15, 2014).

determination. The challenge for a tribunal therefore is to determine which stage of the proceedings is most appropriate to address a corruption allegation.

B. *The Key Determinants of Corruption as a Bar to Jurisdiction*

This sub-section identifies the following distinguishing factors to ascertain whether corruption bars jurisdiction or alternatively becomes an issue examined at the admissibility and merits stage. Before illustrating the key determinants classifying corruption allegations in the three distinct stages discussed, it is important to understand the fundamental rationale for this distinction.

1. Distinguishing Jurisdiction from Admissibility

Jan Paulsson has offered some useful insights in this regard. If the reason for challenging a claim is to bar it from the particular forum, then it is a jurisdictional challenge; but if it is that the claim should not be heard at all, then the issue is one of admissibility.[43] The tribunal in *Waste Management v. Mexico* clearly differentiated between these two concepts: "Jurisdiction is the power of the tribunal to hear the case; admissibility is whether the case itself is defective-whether it is appropriate for the tribunal to hear it. If there is no title to jurisdiction, then the tribunal cannot act."[44] This is significant because mischaracterizing the issue would entail an unjustified expansion of the scope for challenging awards and frustrate the expectations of the parties for an effective resolution of their dispute.[45]

2. Corruption in the making and performance of the investment

Having in mind this principal distinction, corruption allegations are addressed as a jurisdictional issue if the illegality affects the consent of the parties to arbitrate.[46] To

[43] Jan Paulsson, *Jurisdiction and Admissibility*, *in* GLOBAL REFLECTIONS ON INTERNATIONAL LAW, COMMERCE AND DISPUTE RESOLUTION 613 (ICC Publishing, 2005).

[44] Waste Management, Inc v. Mexico, ICSID Case No ARB(AF)/00/3, Dissenting Opinion of Keith Highet, ¶¶ 57-58 (Apr. 30, 2014).

[45] *See* PAULSSON, *supra* note 44, at 601.

[46] *See* SCHILL, *supra* note 11.

establish jurisdiction after a valid consent to arbitrate is made, it is crucial that the investment's assets are acquired in accordance with host State law, otherwise no lawful investment exists.[47] Although it is possible that the investment has been lawfully acquired but for an illicit purpose, it would pose a high evidentiary burden for the defendant host State. In this case, there are two possibilities. The procurement of an investment for an illicit purpose—for example paying millions of dollars as a bribe to the public officials for the construction of a power plant, or serious accusations of money laundering, which contravenes international public policy—would be examined at the admissibility stage.[48] Otherwise, if the evidence available demonstrates it violates the law of the host State, then this would be characterized as an issue going to the merits of the dispute.[49]

Finally, some States sign BITs on the condition that there are certain registration requirements in the treaty without which the beneficiaries of the investment cannot be protected under the treaty. In that case, if a plea of corruption relates to such a requirement, the tribunal should examine it at the jurisdictional stage. On the other hand, if the plea of corruption concerns a registration requirement, which is not expressed in the treaty as such but is likely found in the host State law, or the subsequent use of the investment and its purpose contravenes the host State law, then it will be addressed during the merits.[50]

3. The "Clean Hands" Doctrine

A critical factor in whether corruption defenses are addressed in jurisdiction, admissibility, or merits phases is the doctrine of "clean hands." It captures the idea that "if some form of illegal or improper conduct is found on the part of the investor, his or her hands will be 'unclean', [and] his claims will be barred and any loss suffered will lie where it falls."[51] This principle reflects the legality requirement enshrined in

[47] *See* DOUGLAS, *supra* note 4, at 178.

[48] *Id.* at 184.

[49] *Id.*

[50] *Id.*

[51] Aloysius Llamzon, *Yukos Universal Limited (Isle of Man) v. The Russian Federation: The State*

the "in accordance with the law of host State" clause of many bilateral investment treaties. Tribunals have held that the substantive treaty protections cannot be provided once the investments are contrary to the law of the host State, as this is an issue of jurisdiction rather than admissibility.[52] The *Hamester* award offers an illustrative aspect although without making explicit reference to the doctrine:

> An investment will not be protected if it has been created in violation of national or international principles of good faith; by way of corruption, fraud, or deceitful conduct; or if its creation itself constitutes a misuse of the system of international investment protection under the ICSID Convention. It will also not be protected if it is made in violation of the host State's law.[53]

As a practical matter, it is worth noting that the doctrine could be invaluable where there is *not* an explicit legality requirement in the treaty. If there is any corruption defense raised in such a scenario, it shall be examined under the "clean hands" doctrine. Second, according to the *Yukos* Tribunal, the "unclean hands" doctrine is not a general principle of law within the meaning of Article 38(1)(c) of the ICJ Statute.[54] However, the Tribunal in *Fraport II* advocated the application of international legal principles, such as the "clean hands" doctrine or doctrines of the same effect, absent an express treaty provision barring illegal investments.[55] Given that the doctrine is part of international law, it is applicable under three cumulative criteria, according to the Tribunal in *Niko v. Bangladesh*: (1) the breach must concern a continuing violation; (2) the remedy must be employed to deter continuance in the future, not damages for past violations; and (3) a causation or reciprocity between the relief sought by the investor and the acts

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of the 'Unclean Hands' Doctrine in International Investment Law: Yukos as Both Omega and Alpha, 30 ICSID REVIEW 315, 316. (2015).

[52] Patrick Dumberry, *State of Confusion: The Doctrine of 'Clean Hands' in Investment Arbitration after the Yukos Award*, 17 J. WORLD INV. & TRADE 229, 233 (2016).

[53] Gustav F W Hamester GmbH & Co KG v. Ghana, ICSID Case No ARB/07/24, Award, ¶ 125 (June 18, 2010).

[54] *Yukos*, *supra* note 21, at 1358.

[55] Fraport AG Frankfurt Airport Services Worldwide v. Philippines, ICSID No ARB/01/01, Award, ¶ 328 (Mar. 31, 2014).

involving unclean hands as alleged by the host State.[56] Moreover, under international public policy, it would then be addressed as a ground for inadmissibility.[57] Ultimately, any explicit obligation to make the investment "in accordance with the host State law" clause, as incorporated in the treaty, should be treated as a jurisdictional matter under the "clean hands" doctrine. The situation may differ if there is an implicit obligation. If so, "such an implicit obligation should not be considered as a jurisdictional prerequisite,"[58] but the tribunal may nonetheless find an investor's claim related to "unclean hands" inadmissible.

C. *Domestic Court Investigations and the Power of the Tribunal*

Parties may (and often do) invoke domestic court findings on corruption schemes to manipulate the establishment or futility of the tribunal's jurisdiction, depending on their interests. Such instances raise the following issue: to what extent may a tribunal rely on local court proceedings to find jurisdiction or, on the other hand, denounce it on grounds of *res judicata*? In *Niko v. Bangladesh*, the Tribunal relied on the Supreme Court of Bangladesh's finding that the contract in question was not obtained by a "flawed process by resorting to fraudulent means."[59] It also relied on a related Canadian proceeding that found that "[Niko] company has never been convicted of a similar offence nor has it been sanctioned by a regulatory body for a similar offence."[60] The Tribunal acknowledged the local court proceedings' decisions to establish its jurisdiction over Niko's claim, which precisely reflects the importance of domestic court proceedings in ascertaining a tribunal's jurisdiction. Nonetheless, this is not always true. As seen in *Inceysa v. El Salvador*, the Tribunal declined to defer to local

[56] Niko Resources (Bangladesh) Ltd v. People's Republic of Bangladesh, ICSID Case No ARB/10/18, Decision on Jurisdiction, ¶¶ 481-83 (Aug. 19, 2013).

[57] Aloysius Llamzon & Anthony Sinclair, *Investor Wrongdoing in Investment Arbitration: Standards Governing Issues of Corruption, Fraud, Misrepresentation and Other Investor Misconduct*, *in* LEGITIMACY: MYTHS, REALITIES, CHALLENGES – ICCA CONGRESS SERIES NO. 18451, 515 (Albert Jan van den Berg ed., 2015)

[58] *See* DUMBERRY, *supra* note 53, at 236.

[59] *See Niko*, *supra* note 57, at 423.

[60] *Id.* at 427.

court proceedings to ascertain jurisdiction. In particular, the claimant argued that the Supreme Court of El Salvador upheld the bidding process (allegedly tainted by illegality in the respondent's view) and as a result, the Tribunal was bound by its determination. The Tribunal rejected this argument, emphasizing that the legality of the investment belonged to its own jurisdictional determination, and therefore *res judicata* did not apply.[61] Put otherwise, the Tribunal was free to determine its own jurisdiction. What is essential is that a tribunal will decide on its own competence, and any domestic proceedings on corruption do not impede its jurisdiction to rule on the merits.

IV. A STRATEGIC REFORM

The goal of this Section is twofold. First, it proposes a corrective reform of the ISDS system in light of the deleterious effects of corruption in foreign investments. Second, it offers practical recommendations on whether a State may raise corruption defenses or whether investors are availed of any remedies, notwithstanding their participation in the corrupt act.

A. *Urgency for Integrity of the System and the "Filtering Process"*

It is important to emphasize the need to protect the ISDS system from the corrosive effects of frequently employing a corruption defense to strike out an investor's claim. The need to preserve the integrity of the ISDS system emanates from the basic notion of illegality in national legal systems, namely that local courts do not become a forum to condone serious wrongdoing.[62] However, the fragmented approach among different tribunals regarding corruption defenses decreases predictability and reliability. Moreover, the scope of a tribunal's jurisdiction may be threatened by *res judicata* effects and pre-determination of domestic court proceedings. Under this prism, tribunals would benefit from a "filtering process" to appropriately assess corruption defenses and effectively purify the ISDS system.

[61] *See* FRIEDMAN, LAVAUD & MARLEY, *supra* note 45. *See also Inceysa*, *supra* note 10, at ¶¶ 53-63, 67, 209, 212, 209.

[62] *See* DOUGLAS, *supra* note 4, at 168.

First, an explicit reference to corruption and the need to deter illegal conduct are found in Article 26.7 of the TPP about measures to combat corruption: "In order to prevent corruption, each Party shall adopt or maintain measures as may be necessary, in accordance with its laws and regulations."[63] Article 26.8 also discusses maintaining the integrity of public officials: "To fight corruption in matters that affect trade and investment, each Party should promote, among other things, integrity, honesty and responsibility among its public officials."[64] Attaching an Annex to the ICSID Convention would similarly enhance transparency and uphold a policy of deterrence. In any case, this policy of deterrence would be safeguarded by "[respecting] the integrity of the law of the host State [that] is surely better assured by seeking to emulate on the international plane the consequences of an illegality in national law."[65]

Second, such a process would clarify issues of jurisdiction when a criminal investigation before local proceedings is underway. In such instances, a stay of proceedings by the tribunal would be appropriate. It seems doubtful, though, that the tribunal would be obstructed from engaging with the host State's criminal laws if jurisdiction is established.[66]

Third, an addition to the wording of ICSID Convention Rule 41(5), which prescribes that a preliminary objection that a claim is *manifestly without legal merit*,[67] would be

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[63] *The Trans-Pacific Partnership*, *Chapter 26: Transparency and Anti-Corruption*, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, *available at* https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text.

[64] *Id.*

[65] *See* DOUGLAS, *supra* note 4, at 169.

[66] *Id.* at 167-68.

[67] ICSID Rules of Procedure for Arbitration Proceeding, 2006 INT'L CTR. FOR SETTLEMENT INV. DISP., Rule 41(5) ("Unless the parties have agreed to another expedited procedure for making preliminary objections, a party may, no later than 30 days after the constitution of the Tribunal, and in any event before the first session of the Tribunal, *file an objection that a claim is manifestly without legal merit*. The party shall specify as precisely as possible the basis for the objection. The Tribunal, after giving the parties the opportunity to present their observations on the objection, shall, at its first session or promptly thereafter, notify the parties of its decision on the objection. The decision of the Tribunal shall be without prejudice to the right of a party to file an objection pursuant to paragraph (1) or to object, in the course of the proceeding, that a claim lacks legal merit.") (emphasis added).

beneficial if it referred to instances under which corruption defenses qualify as a jurisdictional bar. This filtering process would also elevate the adoption of corruption to a public policy threshold, similar to *ratione materiae*, and would facilitate the tribunal's inquiry as to when examination of corruption defenses is most appropriate in the proceedings. To the extent that this proposed reform does not suffer from overregulation, the integrity and efficiency of the system will be preserved.

B. *Practical Considerations for the Investor and the Host State*

Imagine that a Contractor (A) from a State (Y) enters into negotiations with the Minister of Economics and Development (B) of the host State (X) for the construction of a power plant generating public electricity. B lures A into the payment of a commission fee of 9% of the contract price, which guarantees the smooth and unimpeded performance of the contract.[68] The Contractor pays the agreed sum to the Minister, but the rights of A under the contract are later expropriated on public policy grounds (*e.g.*, environmental damage). A brings a claim against X, but X challenges the jurisdiction of the tribunal on the corruption scheme initiated by B, who has recently been prosecuted by local authorities. Can X invoke the corruption defense to thwart the investor's claim?

This is not an unusual phenomenon. Quite frequently the host State procures a bribe without hesitating later to rely on that bribe to prohibit a prospective investor out of its investment claim on jurisdictional grounds.

First, it should be mentioned that a State cannot hide behind any illegality to avoid its obligations to contracting parties. In *Siag v. Egypt*, the Tribunal construed the ILC Articles and prior ICSID awards to adopt a broad interpretation of state responsibility: "[T]he conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any

[68] International Institute for the Unification of Private Law (UNIDROIT), UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS 136 (2016), *available at* https://www.unidroit.org/english/principles/contracts/principles2016/principles2016-e.pdf. .

other functions."[69] The Tribunal further emphasized that illegal conduct and conduct exceeding the authority of the state organ is attributable to the State under international law.[70]

In addition, the Tribunal employed the doctrine of equitable estoppel to rule that a State cannot avail itself of the benefits of the underlying treaty when it is comfortable to do so and repudiate it once performance becomes onerous. In other words, a party cannot benefit from its omission to do due diligence. The claimants in that case while they were involved in the development of a project genuinely believed they were Egyptian nationals although they had lost at that time their Egyptian nationality. The Tribunal accepted claimants' submission that the conduct by which they acquired Egyptian passports and did business in Egypt was consistent with good faith and was not done with the intention of misleading Egypt. Egypt knew or should have known as a matter of Egyptian law that they had lost the Egyptian nationality and therefore the claimants could not be estopped from denying the Egyptian nationality at a later time.[71] More significantly, a State cannot benefit from its own wrongdoing. In that sense, the State cannot invoke the corruption defense,

[69] Waguih Elie George Siag v. The Arab Republic of Egypt, ICSID Case No. ARB/05/15, Award, ¶ 193 (Jun. 1, 2009), *in* Matt Reeder, *Estop That! Defeating a Corrupt State's Corruption Defense to ICSID Bit Arbitration*, 27 AM. REV. INT'L ARB. 311, 319 (2016).

[70] *Id.* at 195 (*quoting* RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 196 (Oxford Univ. Press, 1st ed., 2008)); *see also Draft Articles on Responsibility of States for Internationally Wrongful Acts*, [2001] 2 Y.B. Int'l L. Comm'n 26, art. 9, U.N. Doc. A/CN.4/SER.A/2001/Add.1 (Part 2), *available at* http://legal.un.org/ilc/publications/yearbooks/english/ilc_2001_v2_p2.pdf.

[71] As a creation of equity, estoppel is grounded in the notion that a person ought not to benefit from his or her wrongs. *See Siag*, *supra* note 70, at ¶ 483. Brownlie notes that "[a] considerable weight of authority supports the view that estoppel is a general principle of international law, resting on principles of good faith and consistency." IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 616 (Oxford Univ. Press, 6th ed., 2003). Sir Hersch Lauterpacht, in addition to the statement cited above, offered the view that "[a] State cannot be allowed to avail itself of the advantages of the treaty when it suits it to do so and repudiate it when its performance becomes onerous. It is of little consequence whether that rule is based on what in English law is known as the principle of estoppels or the more generally conceived requirement of good faith. The former is probably not more than one of the aspects of the latter." *See Siag*, *supra* note 70, at ¶ 483.

particularly when the wrongfulness of its organ, is attributable to the State itself. The State therefore cannot hide behind the illegality of inducing the investor in the corruption scheme, i.e., the commission fee.

The question then becomes when and how a State can safely invoke this defense—notwithstanding its participation in illegal arrangements—and how a future investor can be protected in asymmetrical scenarios in which the illegality defense works as an incentive for the host State to favor a corrupt act.[72] To prevent these phenomena from occurring in investment treaty arbitration and after a careful balancing of the interests of the parties, tribunals can arrive at three possible solutions:

(a) First, if the investigation finds that the investor corruptly procured the investment contract, the corruption defense creates an incentive for the host State to expropriate the investor's rights or renegotiate the contract on onerous terms.[73] The investor could be offered the opportunity to cure its wrongdoing by incorporating a treaty provision stating that, in case corruption or bribery renders the contract unenforceable, the host State relinquishes any right to invoke the corruption defense upon payment of damages to the host State. Consequently, arbitral proceedings will not become futile and investors may still retain access to a neutral forum to protect their assets.[74]

(b) Second, if the host State is culpable for luring the investor into a corruption scheme, as already explained, it will be barred from raising this defense by virtue of state responsibility and estoppel. However, the situation may be different if the host State gives assurances for the prosecution of the perpetrators and the imposition of criminal fines and disgorgement penalties.

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[72] Giacomo Rojas-Elgueta, *The Legal Consequences of Corruption in International Arbitration: Towards a More Flexible Approach?* KLUWER ARB. BLOG, Jan. 20, 2016, http://arbitrationblog.kluwerarbitration.com/2016/01/20/the-legal-consequences-of-corruption-in-international-arbitration-towards-a-more-flexible-approach.

[73] Michael A. Losco, *Streamlining the Corruption Defense: A Proposed Framework for FCPA-ICSID Interaction*, 63 DUKE L. J. 1200, 1236 (2014).

[74] *Id.* at 1238.

(c) Third, the investor might be able to bring a corruption claim directly against the host State. This is not a far-fetched scenario, as seen above, since a fair and equitable treatment examination by the tribunal may foster a cause of action in a corruption claim. Moreover, a potential investor may enjoy non-contractual remedies. For example, an investor may receive restitution notwithstanding its participation in the corrupt scheme, with the ultimate purpose of compensating the work done based on the value of the project. This approach may also deter unscrupulous host States from resorting to corruption defenses, which would put parties' incentives on equal footing on whether to access the ISDS system.

V. FINAL REMARKS

This article attempts to define the scope of corruption and illustrate why and how it interrelates with ISDS. Though a common phenomenon in international commercial arbitration, corruption is more perverse in the ISDS system because it systematically deals with the threefold power of the host State to act as respondent, lawgiver, and investment protector. In this way, the foreign investor is subject to its full sovereign power. Over time, tribunals have adopted different methods to assess corruption defenses, which has contributed to a fragmented approach concerning the proper evaluation of these defenses. This has propelled inconsistency and made the system more vulnerable to corruption defenses. Examining the different stages at which the plea of corruption and illegality arise, namely jurisdiction, admissibility, and merits, should be subject to further critical analysis and thus guide tribunals correctly in shaping the law. The argument based on the foregoing observations is supplemented by a strategic reform proposal, which would elevate corruption to at least a public policy and explicit threshold issue to eliminate party misuse of corruption defenses. Furthermore, the practical considerations included in the last section demonstrate under which circumstances the host State can rely (or not) on a corruption defense and what additional legal protection the investor may enjoy. It is not the author's intention to lean on either party's position. Rather, it is to provide equal footing for both the investor and the host State and to provide a comprehensive tool for tribunals

faced with corruption issues.

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