Analysing Obstacles and Challenges in Fighting Corruption in Cases of Illegal Investments: How to Bell the Cat?

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1. Introduction

Various mechanisms have been devised to address corrupt practices in international trade transactions and investment projects within the broader legal framework for fighting against corruption. Currently, three layers of legislation and practice have been developed. Yet, their suitability and effectiveness are questioned.

The first layer concerns the exclusion of illegal investments (as non-conforming with the host state legislation) from the protection afforded under investment treaties whereby illegal investments mean those which are made infringing the laws of the host state (which comprise not only the investment legislation but more broadly any laws applicable to the development of the investment project such as anti-corruption, anti-bribery laws and human rights laws). Following the criteria established in *Salini* (2001),[1] the need for the investment to be in conformity with the host state law refers to its validity. This was further confirmed in *Inceysa v. El Salvador* (2003)[2] and *Fraport v Philippines* (2010)[3] where the doctrine of unclean hands played a significant role in the interpretation of the legality of the investment. However, what remains controversial is the appropriate measures which should be adopted in consequence: the continuity of investment and avoidance of investment through the review/ revocation of licenses for illegal investments. To ensure the investors' accountability and an effective system, treaty making shows a trend moving from the inclusion of "in accordance with domestic law

[1] *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* [I], ICSID Case No. ARB/00/4 <https://www.italaw.com/cases/documents/959> Accessed on 29 May 2019
[2] *Inceysa Vallisoletana, S.L. v. Republic of El Salvador* (ICSID Case No. ARB/03/26), Award, 2 August 2006, para 238. https://www.italaw.com/sites/default/files/case-documents/ita0424_0.pdf accessed on 29 May 2019
[3] *Fraport A.G. Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, Award (16 Aug. 2007), para 306 <https://www.italaw.com/cases/456> accessed on 29 May 2019

clause" to the incorporation of specific "anti-bribery and anti-corruption provisions"; such as "in accordance with domestic law clause" in Bosnia and Herzegovina-Malaysia BIT (1994) and the anti-corruption clause embodied in the Morocco-Nigeria BIT (2016).

The second layer concerns the extraterritorial application of the anti-bribery legislation from the home country, e.g. facilitation of payments abroad regulated under the OECD Convention on Bribery[4] and the UK Bribery Act 2010.[5] Questions regarding the effects and effectiveness of the legislation governing criminal offences committed abroad arise. In a parallel development, the EU is exporting its anti-corruption standards to non-EU countries via the inclusion of ad-hoc clauses in trade agreements to prevent, detect and combat corrupt practices and reinforce international co-operation and information sharing. Notably, free trade agreements concluded by the EU contain an anti-fraud clause providing for a temporary withdrawal of tariff preference to tackle serious customs fraud and lack of cooperation. Nevertheless, the question posed is whether an appropriate level of homogeneity/consistency can be achieved through extra-territorial application and export of EU standards.

Finally, to prevent money laundering and protect strategic sectors, such as critical infrastructure, water, health, defence, and food security, screening of foreign investments is deployed through the newly proposed EU framework (2018). As a high level of international co-operation and peer pressure being required to ensure the success of this mechanism, the potential implications for anti-corruption measures requires further investigation.

[4] OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, signed on 17 December 1997 and in force since 15 February 1999. <http://www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf> accessed on 29 May 2019

[5] The Act received the Royal Assent on 8 April 2010.

The purpose of this article is to address the following obstacles: (i) the obstacles and challenges caused by the lack of definition of legality requirements and their relationship with "in accordance with the law of the host state", (ii) the obstacles and challenges faced by the international investment tribunals with the extra territorial effects of home state's anti-corruption laws, and (iii) Challenges to be contemplated by the international investment community to achieve effectiveness, efficiency of anti-corruption to promote integrity, accountability and proper management of public affairs and public property.[6]

The paper proceeds in four parts. First, the legal framework to prevent and punish corrupt practices in international investment law is analysed taking into consideration a broader definition of corruption. The second section deals with the obstacles in fighting corruption in cases of illegal investments. Third, the mandate of the tribunal in establishing and dealing with corruption is examined in the light of case law. The final part of the paper contains challenges that lie on the horizon refer to successfully alleging and proving corruption in cases of illegal investments and the ramifications of corrupt practices in international investment law extend to the proceedings. Central questions in this paper include the definition of "corruption" as understood in the context of international investment law in light of the various proceedings which have taken place.

2. Setting the scene: Corruption and International Investment Law

The legality of the foreign investor's conduct has increasingly been subject to scrutiny.[7] Frequently, the arbitral tribunal is confronted with host state's assertion that the investor

[6] Article 1, United Nations Convention against Corruption (2003) <https://www.unodc.org/documents/brussels/UN_Convention_Against_Corruption.pdf> accessed on 29 May 2019.

[7] Aloysius Llamzon and Anthony C. Sinclair, 'Investor Wrongdoing in Investment Arbitration: Standards Governing Issues of Corruption, Fraud, Misrepresentation and Other Investor Misconduct', in Albert Jan van den

committed corruption or bribery during the life time of investment contract. This can include an array of conducts such as the violation of the host state's laws, deceitful conduct, the misuse of the system of international investment protection, the violation of good faith or transnational public policy.[8]

The difficulty in harnessing an effective system to counteract corruption in international investment arbitration has been stressed by Haugeneder and Liebscher.[9] Despite this, the international community has expressed intolerance of such a practice. The former Secretary General of the United Nations Kofi Annan stated that the 'international community is determined to prevent and control corruption which betrays the public trust, undermines the core values in the community, disrespect for the rule of law.'[10] Doing so, it will increase the 'accountability, and transparency in promoting development and making the world a better place for all.'[11]

Internationally, Conventions combating corruption include UN Convention against Corruption[12] and OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.[13] Further regional efforts have been made to introduce

Berg (ed), *Legitimacy: Myths, Realities*, Challenges, ICCA Congress Series, Volume 18 (KluwerLaw International 2015) 451 – 530, 451

8 *Ibid*. 452

9 Florian Haugeneder and Christoph Liebscher, 'Investment Arbitration - Corruption and Investment Arbitration: Substantive Standards and Proof', in Christian Klausegger, Peter Klein, et al. (eds), *Austrian Yearbook on International Arbitration*, Manz'sche Verlags- und Universitätsbuchhandlung 2009) 539 – 564; 544, 556, 557

10 Kofi Annan, Foreword, United Nations Convention against Corruption (2003), iii, <https://www.unodc.org/documents/brussels/UN_Convention_Against_Corruption.pdf> accessed on 29 May 2019.

11 *Ibid.*

12 United Nations Convention against Corruption (n 6)

13 OECD Convention on Combating Bribery of Foreign Public Officials (n 4)

specific treaties such as Convention on the Fight Against Corruption Involving Officials of the European Communities or Officials of Member States of the European Union,[14] Council of Europe Civil Law Convention on Corruption,[15] Council of Europe Criminal Law Convention on Corruption,[16] African Union Convention on Preventing and Combating Corruption,[17] and the earlier Inter-American Convention Against Corruption.[18]

From an interdisciplinary perspective, corruption perception indexes such as those elaborated by Transparency International and the World Bank reveal a correlation between corruption and development showing considerable differences across countries. Examples of corrupt practices as reported by foreign investors include 'the solicitation of bribes to obtain foreign exchange, import, export, investment or production licences or to avoid paying tax, although for international investors that sort of extortion amounts to an extra tax'.[19] These extra-costs dissuade potential foreign investment. In the extensive research conducted by Ades and di Tella, they found that corruption discourages investment, particularly so, in an environment where red tape inherently detrimental to investment is low.[20] In contrast, some economists have argued that corruption would enable business in heavily bureaucratic systems and semi-

[14] Convention on the Fight Against Corruption Involving Officials of the European Communities or Officials of Member States of the European Union (1997) Official Journal C 195 of 25 June 1997, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:C:1997:195:TOC> accessed on 29 May 2019

[15] Civil Law Convention on Corruption (1999) ETS No.174 (Date of entry 01/11/2003), < https://www.coe.int/en/web/conventions/full-list/-/conventions/treaty/174> accessed on 29 May 2019

[16] Criminal Law Convention on Corruption (1999) ETS No.173 (Date of entry 01/07/2002), <https://www.coe.int/en/web/conventions/full-list/-/conventions/treaty/173> accessed on 29 May 2019

[17] African Union Convention on Preventing and Combating Corruption (2003) (Date of Entry 05 August 2006; Date of last signature 26 December 2018), <https://au.int/en/treaties/african-union-convention-preventing-and-combating-corruption> accessed on 29 May 2019

[18] Inter-American Convention Against Corruption, 29 March 1996, <http://www.oas.org/en/sla/dil/inter_american_treaties_B-58_against_Corruption.asp> accessed on 29 May 2019

[19] OECD Convention on Combating Bribery of Foreign Public Officials (n 4)

[20] Alberto Ades and Rafael Di Tella, `The New Economics of Corruption: A Survey and some New Result' (1997) 45 496-515, 501

closed economies while other authors have found a positive relationship between corruption and FDI, with corruption acting as a stimulus for FDI[21], but the results are inconclusive.[22]

Returning to the legal issues, corruption in the international investment arbitration is construed around the notion of illegal investment. A main obstacle faced with fighting against corruption is the lack of uniform definition on "corruption" in the international community. For instance, the *travaux préparatoires* for the United Nations Convention against Corruption[23] expressed that the definition of corruption belongs to the "domain réservé". Subparagraph (b) of the commentary on article 7 of the Convention states:

> While the definition of corruption must be subject to national law, it should be understood to encompass the commission or omission of an act in the performance of or in connection with one's duties, in response to gifts, promises or incentives demanded or accepted, or the wrongful receipt of these once the act has been committed or omitted. [24]

Llamzon and Sinclair attempted to define corruption in comparison with other types of wrongdoing falling into the scope of illegality. They pointed out the bilateral nature of corruption, frequently involving intermediaries. This placed corruption in a different form from other types of unilateral acts of wrongdoing.[25] They stated:

[21] Peter Egger and Hannes Winner, 'Evidence on Corruption as An Incentive for Foreign Direct Investment' (2005) 21(4) European Journal of Political Economy, 932-952, 949
[22] 1-10 with 10 least red tape, see www.integrity-index.org
[23] Adopted by the General Assembly in its resolution 58/4 of 31 October 2003, < https://www.unodc.org/unodc/en/treaties/CAC/travaux-preparatoires.html> accessed on 29 May 2019
[24] *Ibid.* xiv
[25] Llamzon and Sinclair (n 7) 461

> Corruption is used almost uniformly to describe bribery between an investor's employee or intermediary and a public official of the host State. Fraud is often used in a generic sense and can further be subdivided into deceit (i.e., a form of fraud that involves the intent to deceive the host State to the investor's advantage) and to misrepresentation (which need not delve into whether there existed wilful intent to deceive). … the lack of good faith in the making of an investment and two of its manifestations – abuse of process and abuse of rights. International law and various domestic legal systems recognize "good faith", broadly conceived, and to some extent the provenance of these terms can be traced to customary international law and general principles. They possess commonality in that they are framed in order to avoid misuse of the law.[26]

The concept of "domain réservé" is also noted in the definition of public officials as set out in Article 8 of the Convention which referred to an additional reference to the definition to be provided 'in the domestic law and as applied in the criminal law of the State party in which the person performs that function.'[27] Similar reference to the domestic law is also noted in Article 2(a) of the Convention.[28] On the issue of burden of proof, the Convention requires the state parties to fulfil the burden in establish the offences claimed in host state's domestic law. However, with many domestic laws addressing corruption or bribery to the foreign public officials designed with extra-territorial effects, questions arise.

[26] *Ibid.* 453

[27] Travaux préparatoires (n 23) xxx

[28] It reads: "Public official" shall mean: (i) any person holding a legislative, executive, administrative or judicial office of a State Party, whether appointed or elected, whether permanent or temporary, whether paid or unpaid, irrespective of that person's seniority; (ii) any other person who performs a public function, including for a public agency or public enterprise, or provides a public service, as defined in the domestic law of the State Party and as applied in the pertinent area of law of that State Party; (iii) any other person defined as a "public official" in the domestic law of a State Party. However, for the purpose of some specific measures contained in chapter II of this Convention, "public official" may mean any person who performs a public function or provides a public service as defined in the domestic law of the State Party and as applied in the pertinent area of law of that State Party.

This prompts the discussions on the issue of legality of investment as one tribunal stated that an economic transaction which may quality factually and financially as an investment may still falls outside of the tribunal's jurisdiction due to its illegality.[29] The next section intends to extend the debates to "in accordance with" the laws of the home state by examining (1) the sources of the requirement, (2) the stages when corruption and bribery occurred, and (3) how the domestic legislations should be brought into consideration. After that, the authors will explore the role played by the duty of due diligence and good faith in both guiding and determining the issues of legality requirement in international investment disputes and their consequences in terms of "in accordance with" the laws of the host state.

2. The definition of the legality requirement

The legality requirement touches on the central nerve system of foreign investment arbitration. Citing *Tokios Tokelės v. Ukraine*,[30] Polkinghorne and Volkmer[31] argued that 'investments be made in compliance with the laws and regulations of the host state is a common requirement in modern BITs'.[32] They also pointed out that the issue of legality of investment which covers

[29] *Fraport v. Republic of the Philippines* (n 3) para 306. Although Fraport decision was later annulled by the ad hoc committee, the committee still rejected Fraport's argument concerning the tribunal's misinterpretation of the definition of investment Article 1(1) of the Germany – Philippines BIT.
[30] *Tokios Tokelės v. Ukraine,* ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 Apr. 2004), < https://www.italaw.com/cases/1099> accessed on 29 May 2019
[31] Michael Polkinghorne and Sven Volkmer, 'The Legality Requirement in Investment Arbitration', (2017) 34(2) Journal of International Arbitration, 149 – 168; 150
[32] *Tokios Tokelės v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 Apr. 2004), para 84, < https://www.italaw.com/cases/1099> accessed on 29 May 2019

corruption and bribery in respect of the admission of investments, investment carried by circumventing the regulations of host state[33] or admission due to misrepresentation.[34]

Unfortunately, the words of "any legal dispute arising directly out of an investment" provided in Article 25 of the ICSID Convention does not offer a clear guidance on this issue. The main difficulty related to the legality requirement is that the definition of "legality of investment" may or may not contained in bilateral investment treaties (BITs) and International Investment Agreements (IIAs). Few treaties embody a direct or an explicit reference to the legality of an investment. From a broader perspective, comprehensive trade agreements (also incorporating an investment chapter) have paved the way to further regulate on corruption in the context of international investment law. A new trend favouring the inclusion of anti-corruption provisions is emerging due to the proactive stance taken by the United Nations and the European Union in the regulation of corruption.[35]

Different models are thus observed. First, there are treaties linking legality of the investment to compliance with the host state legislation articulated around the requirement of "in accordance with host state law".[36] Second, there are treaties which despite not including a specific clause implicitly contain implicit references to the legality of the investments. Third,

[33] *Fraport v. Republic of the Philippines*, (n 3)
[34] Michael Polkinghorne and Sven Volkmer, 'The Legality Requirement in Investment Arbitration', (2017) 34(2) Journal of International Arbitration 149 – 168, 151
[35] United Nations Convention against Corruption (n 6); European Commission, *Anti-corruption provisions in EU free trade and investment agreements: Delivering on clean trade*, April 2018, available at http://www.europarl.europa.eu/RegData/etudes/STUD/2018/603867/EXPO_STU(2018)603867_EN.pdf access on 29 May 2019
[36] Christina Knahr, 'Investments "in accordance with host state law"', TDM 5 (2007) Investor-State Disputes - International Investment Law; Jarrod Hepburn, 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration', November 19, 2014 , available at https://www.iisd.org/itn/2014/11/19/in-accordance-with-which-host-state-laws-restoring-the-defence-of-investor-illegality-in-investment-arbitration/ accessed 29 May 2019.

treaties embodying specific anti-corruption clauses such as new provisions in international investment treaties can be observed.

3.1. "In accordance with the law of host state" requirement

In international investment arbitration, the legality requirement can be dealt with by the tribunal as a jurisdictional or merit issue. For both, the tribunals were frequently asked to examine the concept and practice of "in accordance with the laws of the host state".

The importance of the laws and regulations of the host state is stressed by various commentators. Francioni highlighted that the extensive penetration of foreign investment guarantees into the areas of national regulation reserved to domestic jurisdiction can only be counter-balanced or met if the investor pursues "legitimate" public policy objectives. [37] While Dolzer and Shreuer spoke about how foreign investment may reach far into the "domain reserve" in domestic law against the concerns over the preservation of national sovereignty and the democratic legitimacy of the process of foreign investment.[38] Kriebaum argues for the gravity of violation of domestic regulations, setting a threshold for an infringement to be considered serious enough to invalidate the investment. [39]

Procedurally, the definition of investment determines the tribunal's jurisdiction to deal with the intended kind of investment agreed under the BITs. Nevertheless, the fast pace of economic activities prompts Contracting Parties to BITs to develop BITs models to include investment

[37] Francesco Francioni, Access to Justice, Denial of Justice, and International Investment Law, in *Human Rights in International Investment Law and Arbitration*, Pierre-Marie Dupuy, Francesco Francioni and Ernst-Ullrich Petersmann (eds) (OUP 2010) 63-81, 81
[38] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (OUP 2008) 84.
[39] Ursula Kriebaum, Investment Arbitration – Illegal Investments, (2010) Austrian Yearbook on International Arbitration, 307, 319

in all possible kinds. In some BITs, the inclusive definition of investment offers a link to the "domain reserve" of the host state laws. As discussed previously, not all BITs address the issue of legality requirements. Where appropriate, BITs usually prescribe and restrict treaty protections only to the specific types of legal investment where the host states would like to attract in order to benefit their economic and social environment. Under these circumstances, BITs may prescribe legality requirement that can appear in the definition of investment, the admission clause or both.

Where BITs fail to provide clarity, the vagueness of "domain reserve" of the host state laws raised in arbitration proceedings would have to rely on the interpretations given by the tribunal to set the boundaries on the sources and definition of legality requirement. In the decisions made by the tribunals in *Inceysa* and *Metal-Tech* cases, the tribunals highlighted the prerequisites of "state's consent to be subject to arbitration" and "defined investment in compliance with local law" before the tribunal would exercise jurisdiction.[40] This corresponds with Cosar's view that state's consent to arbitration included in the BITs is only conditional and depends on whether the investment disputes falling into the definition of legal investment.[41]

This approach was also taken up in *Achmea B.V. v Slovak Republic*.[42] The respondent objected to the tribunal's jurisdiction *ratione materiae* because the investment was made in violation of

[40] *Metal-Tech Ltd. v. The Republic of Uzbekistan* (ICSID Case No. ARB/10/3), Award, 4 October 2013, 373; https://www.italaw.com/sites/default/files/case-documents/italaw3012.pdf; *Inceysa Vallisoletana* (n 2) para 238

[41] Utku Cosar, 'Claims of Corruption in Investment Treaty Arbitration: Proof, Legal Consequences and Sanctions', in Albert Jan van den Berg (ed), *Legitimacy: Myths, Realities, Challenges*, ICCA Congress Series, Volume18 (Kluwer Law International 2015) 531 - 556; 540

[42] *Achmea B.V. v Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (formerly Eureko B.V. v. The Slovak Republic). The case concerned the interpretations of the Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Republic, which was signed

the law of the Slovak Republic.[43] The tribunal ruled that, Article 2 of the Treaty 'did not purport to qualify the definition of an investment … Article 1(a) of the Treaty, unlike provisions in certain other bilateral investment treaties, does not contain a requirement that investments be made "in accordance with the laws and regulations" of the host State.'[44] Furthermore, it stated that 'the Tribunal is not free to rewrite the Treaty: it must interpret and apply the text adopted by the Parties; and it cannot decide their dispute as *amiable compositeur* or *ex aequo et bono.*'[45] Nevertheless, following the principle of good faith stipulated by Articles 31-33 of the Vienna Convention on the Law of Treaties, the tribunal decided that 'it is in the view of the Tribunal entirely reasonable to interpret the terms of Article 1(a) without reading in a requirement that there must be no infraction of the host State's law in the course of the making of the investment, if the investment is to be within the scope of the Treaty protection.'[46] Since the investor's licence was not revoked, there was no illegality in this case. The tribunal suggested a distinction between compliance with laws that limit the scope of permissible investments and compliance with each and every law of the host State must be made. It stated: 'it is in the view of the Tribunal entirely reasonable to interpret the terms of Article 1(a) without reading in a requirement that there must be no infraction of the host State's law in the course of the making of the investment, if the investment is to be within the scope of the Treaty protection.'[47] The question is whether such a distinction is necessary since the accepted view is that foreign investments are only protected by the international law or the general principles of law when they are made in accordance with the legislation of the host State

on 29 April 1991 and entered into force on 1 October 1992, <https://www.italaw.com/sites/default/files/case-documents/italaw3206.pdf.> accessed on 29 May 2019

[43] *Ibid.* para 162
[44] *Ibid.* para 166
[45] *Ibid.* para 168
[46] *Ibid.* para 169
[47] *Ibid.* para 172

3.2. Is legality an implicit requirement?

More often, BITs prefer to use a vague language to ensure the flexibility in interpreting the provisions of the BITs during their lifetime. To impose the legality requirements, an indirect approach may have to be used. Such an indirect approach can be applied through the admission clause, scope of protection clause or implied duty to comply with the law of the host state. In the case of an admission clause, the Contracting Parties may agree to have to protection extended to investment made before its entry into force by the investors … in accordance with the laws of the host state.[48] The second source of the legality requirement may need to be found in the scope of protection clause where the host state declares its duty to protect investment made by investors in accordance with its legislation.[49]

For instance, the legality requirement was discussed in *Fraport*[50] where the illegality was claimed to take place during the procurement and subsequent negotiations of the concession agreement. This was against the Philippines Anti-Dummy Law. The tribunal placed emphasis on legality by referring to 'investment …. accepted in accordance with the respective laws and regulations of either Contracting State' required by Article 1(1) of the BIT between Germany and the Philippines.[51] In this case, the Philippine Constitution and the BOT Law required that the project proponent of public utility project involving foreign investment must be a Filipino or a corporation registered with the SEC and owned up to a least 60% by Filipinos and at most 40% owned by foreign investors. This requirement was also stressed in Article 2 of the Protocol of Agreement to the BIT.[52]

[48] For example, Article 2 of the Spain – El Salvador BIT.
[49] For example, Article 3 of the Spain – El Salvador BIT.
[50] *Fraport v. The Republic of The Philippines* (n 3)
[51] *Ibid.* para 300
[52] *Ibid*. para 336

The operation of the investment was alleged being in breach of the Anti-Dummy Law[53] which imposed nationality restrictions on the employment of foreign nationals and members of the Executives and management. In terms of the timing of legality requirement, the tribunal's analysis of the language of both Articles 1 and 2 of the BIT stressed the compliance of the law of the host state at the "initiation of the investment" provided a ground for the tribunal's jurisdiction.[54] The tribunal stated:

> If, at the time of the initiation of the investment, there has been compliance with the law of the host state, allegations by the host state of violations of its law in the course of the investment, as a justification for state action with respect to the investment, might be a defense to claimed *substantive* violations of the BIT, but could not deprive a tribunal acting under the authority of the BIT of its Jurisdiction.[55]

The efforts to extend the legality requirement may require the tribunal to look for the real intention of the Contracting Parties from the *travaux préparatories* and the actions taken by both States at the negotiation stage as the *Inceysa* tribunal did.[56] In the absence a clear treaty language prescribing legality in the BITs, the tribunal used "general recognised rules and principles of international law" to add its interpretation of the legality requirement. The tribunal pointed out the link between the investor's deliberate misrepresentation of its financial status and experience contravene with the good faith required in international law. For investment

[53] *Ibid.* para 309
[54] *Ibid.* para 345
[55] *Ibid*. para 345
[56] *Inceysa Vallisoletana* (n 2) paras 192-196

made with an illegal manner is viewed as a breach of international public policy, good faith principle, unjustified enrichment, and non- profiting from illegal actions.

3.3. The broader perspective: anti-corruption clauses in trade and investment agreements

The proliferation of comprehensive Regional Trade Agreements (RTAs) including an investment chapter has brought in new anti-corruption provisions which range from transparency clauses to specific tailored-made provisions aligned with the "Singapore agenda".[57] The EU has advocated for an inclusion of topics with a bearing in corruption: investment, competition and transparency in government procurement. Yet, reaching consensus on a multilateral level has turned to be increasingly difficult due to the reluctance of some states to implement "deep provisions" into areas which may limit their sovereignty.[58]

Contemporary RTAs address regulatory areas such as transparency and anti-corruption provisions alongside environmental and labour standards.[59] An unprecedented trend starting in 2000 reveals that more than 40 per cent of RTAs concluded since 2000 incorporate anti-corruption and anti-bribery commitments.[60]

[57] WTO, 'Singapore Agenda'
[58] I. Lejárraga (2014-10-17), 'Deep Provisions in Regional Trade Agreements: How Multilateral-friendly? An Overview of OECD Findings', OECD Trade Policy Papers, No. 168, OECD Publishing, Paris http://dx.doi.org/10.1787/5jxvgfn4bjf0-en. Lamy, P., 'Pascal Lamy on Trade Agreement Generations', New Perspectives on Global Economic Dynamics, Berstelsmann Foundation, 2015. < https://ged-project.de/topics/international-trade/effects_of_regional_trade_agreements/pascal-lamy-on-trade-agreement-generations/> Accessed on 29 May 2019
[59] M. Jenkins, 'Anti-Corruption and Transparency Provisions in Trade Agreements', Transparency International, 2017. < https://www.transparency.org/files/content/corruptionqas/Anti-corruption_and_transparency_provisions_in_trade_agreements_2017.pdf> accessed 29 May 2019.
[60] Lejárraga (n 58) 15

A clear example of anti-corruption provisions is found in DR-CAFTA, which regulates the matter in parallel to transparency (Article 18, Section B). Article 18.7 takes on the additional obligation of the state parties to eliminate bribery and corruption in international trade and investment. In turn, Article 18.8(1) refers to a series of corruption-related situations which shall be regulated by each Party through necessary legislative or other measures 'to establish that it is a criminal offense under its law, in matters affecting international trade or investment'. Nevertheless, Article 18.8(2) grants state parties a considerable margin to determine which procedures and penalties they should adopt to enforce criminal measures. Article 18.8(3) guarantees that enterprises are sanctioned for corruption-related conducts even if they are not criminal.

Article 18.8 deals with Anti-Corruption Measures, setting forth three underlying activities that affect international trade or investment, which require necessary legislative (or other) measures including the definition of criminal offenses. These are: for public officials to materially gain from an act in exchange for an act or omission in the performance of a public function; for a person to bribe, either directly or indirectly, a public official for personal gain or advantage; for a person of one country to bribe a foreign official of another in order that the official act or refrain from acting in relation to the performance of an official duty, in order to obtain or retain a business or other improper advantage in the conduct of international business. Conspiring to undertake any of the aforementioned activities is also considered a criminal offence.

There is also a reference to appropriate penalties which should be put into effect to address these criminal measures. Furthermore, Article 18.8(4) incentivizes protection for whistle-blowers protecting those that in good faith report acts of bribery or corruption. Finally, the state parties set forth to work jointly to encourage and support appropriate initiatives in relevant

international fora (Art.18.9). Although having such provisions included in comprehensive RTAs would contribute a more coherent approach, the main caveat is that no cases concerning these provisions have been settled so far.

4. Main challenges in fighting corruption in International Investment Law

Different challenges have been observed in fighting against corruption from an international investment law viewpoint. First, challenges which relate to procedural hurdles to effectively deal with corruption in arbitral proceedings. Second, there are those substantive questions that emerge from the application of due diligence and the principle of good faith. Finally, arbitral tribunals are confronted with the challenges that arise from the extra-territorial effects of domestic legislation and the standard of proof required in corruption cases.

4.1. Procedural obstacles encountered in arbitral proceedings

As discussed, the legality requirement can be dealt with by a tribunal as a jurisdictional or merit issue in international investment arbitration. The decision depends on the tribunal's interpretation of the legality requirement or its consideration of procedural efficiency, if the practice of corruption was raised by the host state at the proceedings for the resolution of substantive issue. The challenge is a particularly acute one if the illegality claimed by the host state overlaps with the breach of substantive protections argued by the investors. This is because as an accepted universal rule in arbitration, the merit of an award is not subject to challenge by the losing party; hence concerns over dealing with the legality requirement at the merit stage was expressed. Paulsson highlighted that the use of admissibility as a ground for legality requirement may run the risk of 'an unjustified extension of the scope for challenging

awards' on the basis of jurisdiction.[61] Nevertheless, others suggested the application of the threshold of "scale of illegality" to deal with such an issue. In accordance with the scale of illegality, it was invoked that an obvious fault in illegality was seen as a jurisdictional issue[62] whereas a minor breach would not exclude the investors' access to the substantive provisions and protections and should be dealt with at the merit stage.

The issue of "scale of illegality" is also linked to estoppel on the host state's part. The challenge arising from estoppel issue lies in the tribunal's gatekeeping role in terms of jurisdiction and a likelihood of moving the disputes into the merit stage of the dispute resolution. The estoppel was discussed in *Mamidoil v Albania*[63] where the issue of illegality was also raised by Albania. Albania asserted Mamidoil's failure in obtaining required permits for the investment.[64] The claimant replied on *Tokios Tokelės v. Ukraine*[65] and *Desert Line v. Yemen*[66] where the tribunals viewed that minor errors and 'a failure to observe the bureaucratic formalities of the domestic law" did not breach illegality requirement'[67] in *Tokios Tokelés,* and the issuance of certificate would undoubtedly have been issued upon request 'both because of the general endorsement of the investment at the highest level of the State'[68] in *Desert Line.* The claimant claimed that formality defects such as the failure to obtain a permit which would have been granted, are not sufficient to constitute illegality.[69] The tribunal confirmed its jurisdiction and decided to deal

61 Jan Paulsson, 'Jurisdiction and Admissibility' in G. Aksen et al. eds, *Global Reflections on International Law, Commerce and Dispute Resolution – Liber Amicorum in Honour of Robert Briner* (ICC Publishing 2005) 601
62 *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, (Award, 15 Apr. 2009), para 104, < https://www.italaw.com/cases/850> accessed on 29 May 2019
63 *Mamidoil* Jetoil Greek Petroleum Products Societe S.A. ***v***. Republic of *Albania*, ICSID Case No. ARB/11/24 < https://www.italaw.com/cases/3003> accessed on 29 May 2019
64 *Ibid.* para 208, 239
65 *Tokios Tokelés v. Ukraine* (n 30)
66 *Desert Line* Projects LLC *v*. The Republic of *Yemen*, ICSID Case No. ARB/05/17. Award, para 104 < https://www.italaw.com/sites/default/files/case-documents/ita0248_0.pdf> accessed on 29 May 2019
67 *Tokios Tokelés v. Ukraine*, (n 30) para 297
68 *Desert Line Projects (n 66)* para 117
69 *Mamidoil v*. Republic of *Albania*, (n 63) para 304

with the disputes at the merit stage because the host state informed the investor of the cure the illegalities. Although the tribunal agreed that a host state cannot be expected to consent to arbitration for investments made not in accordance with the law of the host state, it can accept the jurisdiction of an arbitral tribunal when, in that State's own appreciation, the illegality of the investment was susceptible of being cured, as that State's legalization offers show. In such circumstances, the legal significance of the absence of permits is to be determined as a question of merits – namely whether Respondent's international responsibility is engaged in the face of claimant's violation of Albanian law – rather than the tribunal's jurisdiction.[70]

This led the tribunal in *Malicorp* to bring good faith[71] into its interpretation in legality requirement by examining the parties' performance prior to the illegality took place; such as mutual assumption.[72] Applying good faith, the tribunal decided to examine the issue at the second stage, 'from the standpoint of the merits, in relation to the validity of the investment.'[73] Considering the principle of autonomy of the arbitration agreement, varied grounds of invalidity of an investment and the factual analysis of case,[74] it stated: '[i]n order for an ICSID arbitral tribunal to be able to render an award against a State for breach of obligations concerning the protection of an investment, such investment must be valid. That is why the issue of the possible application of the principle of good faith is then considered as part of the issues on the merits.'[75]

[70] *Ibid.* para 492
[71] *Malicorp Ltd. v. Egypt*, ICSID Case No. ARB/08/18, (Award 7 Feb. 2011) para 118, < https://www.italaw.com/cases/660> accessed on 29 May 2019
[72] *Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award (8 Apr. 2013) para 376 where article 1(1) of the France-Moldova BIT expressed provided 'in accordance with the legislation …, on the territory or maritime area of which the investment is made'.
[73] *Malicorp Ltd. v. Egypt* (n 71), para 117
[74] *Ibid.* para 119
[75] *Ibid.* para 117

Nevertheless, considering Paulsson's assertion on the undesirability of closing the door to the grounds for challenge, confusion can arise from such an approach taken by the tribunals. In practice, the inclusion of "in accordance with the law" in the BITs which has been argued as constituting a jurisdictional issue which requires the tribunal to make a preliminary award before proceeding to the merit stage.[76] To illustrate, the arbitral tribunal in *Phoenix* approached the legality requirement at the jurisdictional stage with its interpretation of the principle of good faith from the standpoint of Article 25 of the ICSID Convention. This approach was commented as a 'judicial common sense to deal with issues of jurisdiction at the outset of investment arbitrations.'[77] Cosar similarly suggested that, in practice, tribunals have generally accepted legality requirements as a jurisdictional impediment[78] which impacted on the scope of claims an investor may have.

The tribunals in *Mamidoil v Albania*,[79] *Tokios Tokelės v. Ukraine*[80] and *Desert Line v. Yemen*[81] confirmed their respective jurisdiction and proceeded to the merit stage of the dispute resolution. Combining the principle of good faith in transnational public policy and the unclean hands doctrine, the legality requirement can be decided at the post jurisdictional stage when both investors and host state have access to the claims related to have the substantive rights addressed by the tribunal. When the tribunal deals with the requirement of legality at merit stage of dispute resolution, the tribunal's decision virtually closes door to any procedural challenges against the award under Article V of the New York Convention and Article 52 of the ICSID Convention.

[76] *Inceysa Vallisoletana* (n 2) paras 142-145
[77] See the Respondent's submission in *Malicorp Ltd. v. Egypt* (n71), para 98
[78] Cosar (n 41) 540
[79] *Mamidoil v*. Republic of *Albania* (n 63)
[80] *Tokios Tokelés* v. *Ukraine* (n 30)
[81] *Desert Line v. Yemen*, (n 66) para 104

4.2. Exploring the links between due diligence and fight against corruption

Due diligence in international investment law is construed around the requirement under the definition of investment that it should be made "in accordance with the law of host state".[82] In the case where BITs contain express legality requirement, due diligence is subsumed in the legality requirement. Tailor-made provisions on due diligence are relatively new. Due diligence associated with the host state's conduct and the effective implementation of FET, however, a growing trend in international arbitration indicates that it is a two-way street placing responsibilities on foreign investors.

Early arbitration cases consider due diligence in relation to the legality requirement. The due diligence of the foreign investor is assessed against the nature of the domestic law processes and provisions infringed. Expressed legality was addressed in *Inceysa* where the arbitral tribunal examined the requirement in light of the wording of the BIT between El Salvador and Spain.[83] Also, in terms of the threshold for the legality requirement, arbitral tribunals determined that the breach of fundamental legal principles of the host state determines its seriousness as discussed in *LESI* & *Alstadi v Algeria*. In a long string of cases, arbitral tribunals have looked into the seriousness of the breach and lack of due diligence on the part of the investor, such as *Rumeli v Kazakhstan, Phoenix, Tokios & Tokeles, Hochtief v Argentina*[84] and *Metalpar v Argentina,*[85]where the foreign investor's fault in registering company at appropriate

[82] Eric De Brabandere, Host States' Due Diligence Obligations in International Investment Law," (2015) 42(2) Syracuse Journal of International Law and Commerce, Article 4. Available at <https://surface.syr.edu/jilc/vol42/iss2/4> accessed on 29 May 2019.
[83] *Inceysa Vallisoletana* (n 2) paras 46 and 47.
[84] *Hochtief AG v. The Argentine Republic*, ICSID Case No ARB/07/31 <https://www.italaw.com/cases/538 > accessed on 29 May 2019
[85] *Metalpar S.A. and Buen Aire S.A. v*. The *Argentine* Republic, ICSID Case No. ARB/03/5 <https://www.italaw.com/cases/680> accessed on 29 May 201

point was viewed as a minor fault which does not exclude the investors from the protection available under the BIT.[86]

Due diligence exercised by Host States in revoking reallocation of licence,[87] amending the law after the entry point of the investment,[88]also saw tribunals confirm their own competence in dealing with the substantive issues. Interestingly, in *Fraport*,[89]the claim of illegal investment alluded to an illegal secretive shareholder's agreement overruled the assumption of favouring investors. In the tribunal's view that the arrangement for the profitability of the investment was not central to the profitability of the investment[90]; references were made to good faith[91] but not due diligence; the question of estoppel was discussed but did not occurred.[92]

The host state's lapse due to its unawareness or necessities in addressing illegality may not amount to consent to illegality. This was addressed in a number of cases. In *Tecmed v Mexico* (a case relating to waste management), though the host state could not be unaware of the illegality but the inherent procedures which took six months to close gaming facilities is not an estoppel. Consequently, it did not prevent the state to rely on "in accordance with the law".[93] By application of the good faith, consent would not be given had the host state been aware of

[86] *Ibid.* Decision on Jurisdiction (27 Apr. 2006) However, this view is different from the one held by the tribunal in *Alasdair Ross Anderson et al. v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award (19 May 2010), 50 I.L.M. 23 (2011) para 57. The tribunal in *Anderson v Costa Rica* held the view that all regulatory requirements must be complied with in order to establish the true ownership of the investment as the tribunal was required to establish its jurisdiction ratione materiae; also see *Quiborax S.A., Non Metallic Minerals S.A., & Allan Fosk Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Award on Jurisdiction (27 Sept. 2012), where the tribunal did not distinguish between minor or major non-compliance of the law of host state, para 240. (The words 'any kind' of investment was used in Article 1(2) of the Bolivia-Chile BIT.)

[87] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2 < https://www.italaw.com/cases/484> accessed on 29 May 2019

[88] *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL ARB/99/2 < https://www.italaw.com/cases/571 > accessed on 29 May 2019

[89] Fraport (n 3)

[90] *Ibid.* para 396.

[91] *Ibid.* paras 396-397.

[92] *Ibid.* aras 346-347, 387.

[93] *Técnicas Medioambientales* Tecmed, *S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2 < https://www.italaw.com/cases/1087> accessed on 29 May 2019

the facts was discussed. Cases involving misrepresentation include *Plama*, *Inceysa* and *Desert Line v Yemen* where host state argued for no formal acceptance due to misrepresentation or fraud. Equally, the principle of estoppel was discussed in bribery cases such as *World Duty Free*.[94]

Clearly, legitimate expectation poses a big question to due diligence; such as *Phoenix*[95] in which the arbitral tribunal considered that the legal modification of state law after investment should not lead to a limitation of tribunal's jurisdiction.[96] In *Kardassopoulos*, the arbitral tribunal decided that Georgia had exceeded its own authority, arguing that foreign investors should be allowed to have a legitimate expectation if it is a state enterprise received a licence and operated for some many years. In *SSP v Egypt*, *OKO Pankki v Estonia* and *Swem Balt v Latvia*[97] the host states were viewed to have given express or implied consent to illegal investment.

In *SAUR International SA v. Argentina*, the Claimant alleged that when a BIT imposes a condition of legality on the investment, the violation of legality requirement deprives the arbitral tribunal of jurisdiction. The claimant argued that the illegality must have been committed by the investor at the time of making the investment, citing *Fraport*, *Rumeli* and *Saba Fakes* in support of this thesis.[98] In an evolution of the arbitral jurisprudence, in *Álvarez* the arguments revolved around the question of due diligence. The host state argued that the investment was illegal and that the claimants did not act with the 'due diligence of a prudent

[94] *World Duty Free Company Limited v. The Republic of Kenya*, ICSID Case No. ARB/00/7 paras 184-185 <https://www.italaw.com/documents/WDFv.KenyaAward.pdf > accessed on 29 May 2019
[95] *Phonix* (n 62)
[96] *Phonix* (n 62) paras 102-104.
[97] *Swem Balt v Latvia*, UNCITRAL Case, 23 October 2000, paras 34 35.
[98] *SAUR International SA v. Republic of Argentina*, ICSID Case No. ARB/04/4, para 241 < https://www.italaw.com/cases/1456> accessed on 29 May 2019

and reasonable investor'.[99] The arbitral tribunal determined that the purchase of indigenous lands was plagued with irregularities.[100] Specifically, the investment took place in indigenous territory (Comarca Ngöbe-Buglé) which is protected by article 127 of Panama constitution and guaranteed as collective property and not subject to private property. [101] The arbitral tribunal stated that illegality was an implicit requirement and that in the case, the foreign investor has breached it thus precluding the possibility to be protected under the BIT.

4.3. Is the principle of good faith enforceable?

In arbitration cases, the principle of good faith is also used to measure the claims of illegality. In *Inceysa,* the arbitral tribunal gave a particular importance to the exchanges of notes between Contracting States, as well as the various draft treaties prior to the final version. In relation to the principle of good faith, the arbitral tribunal rely on this principle to determine the jurisdiction of the Centre.[102] Referring to *Amco,* the tribunal emphasised the need to interpret the relevant normative provisions in good faith; i.e. in an objective manner to define whether or not a certain dispute is submitted to the jurisdiction of the Centre.[103] Furthermore, the tribunal mentioned that the principle should be interpreted in a twofold way:

> (i) in the good faith with which the Arbitral Tribunal must act when making its jurisdictional analysis and (ii) said analysis must start from the premise that the consent of the parties was manifested in writing and given in good faith and, therefore, at the

[99] *Álvarez y Marín Corporación S.A. and others v. Republic of Panama*, ICSID Case No. ARB/15/14, para 95, < https://www.italaw.com/cases/3989> accessed on 29 May 2019
[100] *Ibid.* para 229 and 318.
[101] *Ibid.* para 319.
[102] *Inceysa Vallisoletana* (n 2) paras 179.
[103] *Inceysa Vallisoletana* (n 2) paras 180.

time they manifested their consent, the parties did so with the sincere intent for it to produce all of its effects under the circumstances agreed upon by them.[104]

The unclean hands doctrine has emerged in the consideration of the Fair and Equitable Standard.[105] In cases like *LESI and Alstadi v Algeria*,[106] arbitral tribunals have referred to the interpretation of the doctrine of unclean hands[107] through indirect provisions on promotion, admission and protection of investments. The tribunal confirmed an implicit duty of legality and precluded investors from relying on treaty protection.

The *Inceysa* tribunal positioned good faith principle as the 'supreme principle, which governs legal relations in all ... aspects and content' of foreign investment.[108] The tribunal also stated that good faith requires the "absence of deceit and artifice".[109] The duration of good faith starts from the negotiation to the execution of instruments that gave rise to the investment representing 'loyalty, truth and intent to maintain the equilibrium between the reciprocal performance of the parties.'[110] Following this analogy, good faith is viewed as a generally accepted rule or standard requires parties to act within the scope of legality requirement when entering into and during the duration of the legal relation.[111] Falsifying documents related to

[104] *Inceysa Vallisoletana*, paras 181.
[105] Peter Muchlinski, 'Caveat Investor? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard', 55 INT'L & COMP. L. Q. 527 (2006).
[106] *L.E.S.I. S.p.A. and ASTALDI S.p.A. v. République Algérienne Démocratique et Populaire*, ICSID Case No. ARB/05/3 < https://www.italaw.com/cases/618> accessed on 29 May 2019
[107] Patrick Dumberry, The Importation of the FET Standard through MFN Clauses: An Empirical Study of BITs, ICSID Review (2016) 1–22.
[108] *Inceysa Vallisoletana* (n 2) para 230
[109] *Ibid.* para 231
[110] *Ibid.*
[111] *Ibid.* para 233

investment is not an act of good faith because the parties 'would have never entered into the legal relation in question providing the accurate information were provided.'[112]

The tribunal used the word "implicit confidence" to describe the essential requirement of good faith in a legal relation such as foreign investment. The tribunal believed that without good faith 'with which the parties must act when entering into the legal relation, and which is imposed as a generally accepted rule or standard'[113] would see the commitment being breached. It made a substantial link between misrepresentation and breach of the principle of good faith; concerning Inceysa's attempt to present false financial information as part of the tender made by it to participate in the bid, false representations in its experience and capacity during the bidding process, and false representation of the experience of its team members. The tribunal ruled that 'by falsifying the facts, Inceysa violated the principle of good faith from the time it made its investment and, therefore, it did not make it in accordance with Salvadoran law' and El Salvador would not have allowed Inceysa to make its investment, had it known the violations on Inceysa's part.[114] Consequently, the tribunal was of the viewpoint that it did not have competence and jurisdiction to hear the dispute because 'EI Salvador gave its consent to the jurisdiction of the Centre, presupposing good faith behavior on the part of future investors.'[115]

Furthermore, lacking good faith during the negotiations and the execution of the agreement on Inceysa's part saw the tribunal upheld the maxim of *"Ex dolo malo non oritur actio"* (an action

[112] *Ibid.* para 232
[113] *Ibid.* para 233
[114] *Ibid.* para 237
[115] *Ibid.* para 238

does not arise from fraud)[116] and ruled that Inceysa could not benefit from investment by means of its fraudulent acts, let along the investment protection provided in the BIT. This was to ensure that justice was delivered by the tribunal whose obligation is to see '[n]o legal system based on rational grounds allows the party that committed a chain of clearly illegal acts to benefit from them.'[117] Furthermore, the tribunal stated: 'the inclusion of the clause "in accordance with law" in the agreements for reciprocal protection of investments follows international public policies designed to sanction illegal acts and their resulting effects.'[118]

Apart from the expressed "in accordance with the law of the Host State" provision(s),[119] the good faith principle in international law was again discussed in *Gustav F.W. Hamester v Ghana,*[120] where the tribunal ruled that lack of good faith in the entry and operation of investment on the investor's part would act as the second layer of exclusion or a tacit condition[121] seeing the investor being excluded from the protection provided by the BIT.[122] It was ruled in *Gustav F.W. Hamester & Co KG v. Republic of Ghana*[123] that investors do not enjoy absolute protection. The tribunal stressed that imposition of compliance of laws and regulations is within the power of the host state as 'States may specifically and expressly condition access of investors to a chosen dispute settlement mechanism, or the availability of substantive protection.'[124] In the absence of such an express provision, the performance of good faith in carrying out investment project was also highlighted. Following *Phoenix*, the

[116] *Ibid.* para 240
[117] *Ibid.* para 244
[118] *Ibid.* para 247
[119] *Gustav F.W. Hamester GmbH & Co. K.G. v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award (18 June 2010) para 125 accessed on 29 May 2019
[120] *Ibid.*
[121] *SAUR* (n 98) para 308; Polkinghorne and Volkmer (n 31) 157
[122] *Gustav Hamester (n 119)* , paras. 123-124
[123] *Ibid.*
[124] *Ibid.*

tribunal refused the investor's access to protections under the ICSID dispute settlement mechanism as the investment was not made in good faith.[125] While the Phoenix tribunal stressed the implicit link between the purpose of investment protection through ICSID Arbitration and legality requirement by the laws of the host, it stated:

> If a State, for example, restricts foreign investment in a sector of its economy and a foreign investor disregards such restriction, the investment concerned cannot be protected under the ICSID/BIT system. These are illegal investments according to the national law of the host State and cannot be protected through an ICSID arbitral process. And it is the Tribunal's view that this condition – the conformity of the establishment of the investment with the national laws – is implicit even when not expressly stated in the relevant BIT.[126]

The *Gustav F.W. Hamester* tribunal further clarified the types of actions which could be viewed as a breach of the principle of good faith by the tribunals involving illegal investment. The tribunal made a substantial link between the breach of the principle of good faith and a violation of the law of the host state by stating:

> 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.[127]

[125] *Ibid.* para 123; *Phoenix* (n 62) para 106
[126] *Phoenix* (n 62) para 106
[127] *Gustav Hamester* (n119) para 123

The tribunal in *Desert Line Projects LLC* v. *The Republic of Yemen*[128] pointed out that good faith principle like "fundamental principles of the host State's law" is required. It further pointed out that "according to its laws and regulations" is intended to ensure 'the legality of the investment by excluding investments made in breach of fundamental principles of the host State's law, e.g. by fraudulent misrepresentations or the dissimulation of true ownership.'[129]

The lack of wording "conformity of a particular law" in the BITs or the ECT does not mean there is a scope for illegal investment. The investor's implicit duty to comply with the law of the host state was highlighted as an essential element in the integrity of foreign investment.[130] There was a legality requirement with a *bona fide* investment initiation[131] as a pre-condition for claiming the protections. By stating that a non-*bona fide* investment breaches both the BIT and Article 25 of the Washington Convention, the tribunal actually extended the application of good faith into Article 25 of the ICSID Convention.

Despite the lack of a clear language in Article 1 of the Netherlands and Turkey BIT and Article 25(1) of the ICSID Convention, in *Saba Fakes v Turkey*[132] and *Metal-Tech v. Uzbekistan*[133] the tribunals extended the legality requirement to the issues of consent and whole protection. In *Phoenix*, the tribunal further underlined that the imposition of good faith can ensure the protections being provided to the investment which are worthwhile being protected and being

128 *Desert Line* (n 68)
129 *Ibid.* para 104
130 *Phoenix* (n 62) para 101
131 *Ibid.* para 142
132 *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award (14 July 2010) para 114. The investor's claim was dismissed due to a lack of legal title to the share certificates related to the investment in dispute.
133 *Metal-Tech v. Republic of Uzbekistan* (n 40) para 127, See Article 1(1) of the Israel-Uzbekistan BIT.

kept within the system of foreign investment.[134] However, this extension should only be limited to the BIT but not Article 25(1) of the ICSID Convention as tribunal was of the opinion that the imposition of good faith would significantly change the intention of the provision.[135] It is worth noting that this view is different from the position taken in *Phoenix*[136] and *Aguas del Tunari S.A. v Bolivia*[137] where the tribunals refused implicit requirement.

4.4. Extra-territorial effects of domestic anti-corruption legislation and the mandate of arbitrators

Following the UN Convention Against Corruption[138] and OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions,[139] domestic jurisdictions have grown an increasing intolerance of corruptive behaviours of their own nationals within and outwith its own jurisdiction. Such Acts prescribe an extra-territorial effect over its own nationals even though the illegal acts were carried out of its own jurisdiction. Taking UK as an example, according to s 6(1) of the UK Bribery Act, 'A person ("P") who bribes a foreign public official ("F") is guilty of an offence if P's intention is to influence F in

134 *Phoenix* (n 62) para 113
135 *Saba Fakes v. Turkey* (n 132) para 113.
136 Other cases include: *Salini* (n 1) where the host stat's claim of corruption was rejected; *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24 <https://www.italaw.com/cases/857>; *Gas Natural SDG, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/10, <https://www.italaw.com/cases/documents/477>; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29 <https://www.italaw.com/cases/131>; *Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia*, <https://www.italaw.com/cases/documents/726>; L.E.S.I. (n 106); *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07 <https://www.italaw.com/cases/951>; *Desert Line* (n 68) *David Minnotte & Robert Lewis v. Republic of Poland*, ICSID Case No. ARB (AF)/10/1 <https://www.italaw.com/cases/707>; *Yaung Chi Oo Trading Pte. Ltd. v. Government of the Union of Myanmar*, ASEAN I.D. Case No. ARB/01/1 <https://www.italaw.com/cases/documents/1174>, accessed on 29 May 2019.
137 *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3 < https://www.iisd.org/pdf/2005/AdT_Decision-en.pdf > accessed on 29 May 2019
138 United Nations Convention against Corruption (n 6)
139 OECD (n 4)

F's capacity as a foreign public official.'[140] Put this provision in the context of foreign investment activities, a UK investor who bribes a foreign public official of the Host State would be caught by the intended extra –territorial effect and being accused of guilty of a criminal offence if the investor's intention is to influence the official in his capacity as a foreign public official.[141] . In the case of the United Kingdom, such an effect would also lead to the application of the Proceed of Crimes Act 2002.[142] The potential cross-paths between arbitration and criminal law became a reality due to the extra-territorial effect on investors and would cause the compatibility issue in domestic jurisdictions. An examination of the different standards of proof applied in criminal and arbitration systems as well as arbitrator's mandate in foreign investment dispute resolution is required

In criminal evidential/procedural laws, it is widely accepted that the standard of proof should be "beyond reasonable doubt". Davidson suggested that "beyond reasonable doubt" is a phrase which is impossible or at least dangerous to attempt to define.[143] By way of example, similarly in England, 2.1 Burden and Standard of Proof in the English Judicial Studies Board requires the prosecution to carry the burden of proving the defendant's guilt. The burden can only be discharged if the evidence allows the jury 'making you sure of it. Nothing less than that will do.'[144] Evidence in a circumstantial nature will not meet the threshold.

[140] UK Bribery Act, s 6(1).
[141] A foreign public official is defined as someone who holds a legislative, administrative or judicial position of any kind, whether appointed or elected, of a country or territory outside the United Kingdom or exercises a public function for the host state outside the United Kingdom or acted for any public agency or public enterprise of the Host State or acted as an official or agent of a public international organisation.
[142] https://www.legislation.gov.uk/ukpga/2002/29/contents
[143] Fraser Davidson, *Evidence* (2007 SULI), para 4.78
[144] Specimen Directions in Jury Trail, 2.1 <https://keithhotten.files.wordpress.com/2014/05/sdjt.pdf>; The Crown Court Compendium, June 2018 page 19-8 https://www.judiciary.uk/wp-content/uploads/2018/06/crown-court-compendium-pt1-jury-and-trial-management-and-summing-up-june-2018-1.pdf accessed on 29 May 2019

Interestingly, in cases involving corruption, the UK Serious Fraud Office may elect to pursue the accused in a civil action. In a civil recovery, the application of the UK Proceeds of Crime Act 2002[145] may see the application of a lower threshold of evidential rule – the balance of probability. This would see the 'admission of different types of evidence that would not be admissible at a criminal trial, including inferences from silence, previous behaviour, illegally obtained evidence and abuse of process, and hearsay evidence.'[146] Lord Denning pointed out that 'proof beyond reasonable doubt does not mean proof beyond the shadow of a doubt' and 'a case is proven beyond reasonable doubt if the evidence is so strong against a man as to leave only a remote possibility in his favour and 'nothing short of that will suffice.'[147]

He also stated that to discharge of a burden of proof in a civil case the degree required is a reasonable probability. Furthermore, the balance of probability requires evidence to be "more probable than not", however "if the probabilities are equal" or "evenly balance", the burden is not discharged.[148] It is suggested that proof on a balance of probabilities is a variable standard.[149] However, '[a] civil court, when considering a charge of fraud, will naturally require for itself a higher degree of probability than that which it would require when asking if negligence is established. It does not adopt so high a degree as a criminal court, even when it is considering a charge of a criminal nature, but still it does require a degree of probability which is commensurate with the occasion.'[150] Furthermore, an allegation of fraud in a civil

[145] Part 5 of the Proceeds of Crime Act 2002
[146] J Hendry and CP King How Far Is Too Far? Theorising Non-Conviction-Based Asset Forfeiture, International (2015) 11 (4) Journal of Law in Context, 398-411, 399; Alldridge, Peter (2014) 'Proceeds of crime law since 2003 – two key areas' Criminal Law Review 171-188, 185
[147] *Miller v Minister of Pensions* [1947] 2 All ER 372, 373
[148] *Ibid.*
[149] Mike Redmayne, 'Standards of Proof in Civil Litigation', (1999) 62(2) The Modern Law Review 167-195, 168; Fraser Davidson, Evidence (2007 SULI), para 4.78
[150] *Bater v Bater* [1951] P. 35, 37

court must be proven by 'a preponderance of probability, but the degree of probability depends on the subject-matter. In proportion as the offence is grave, so out the proof to be clear.'[151]

In the context of foreign investment disputes, the standard of proof applied by an arbitral tribunal to an investment allegedly tainted by corruption has its own critical importance.[152] It is a common understanding that the tribunal's decision to ascertain the corruptive practice will have a determining factor on the investor's access to substantive protections provided under the relevant BITs. Unfortunately, most investment treaty, customary international law, applicable procedural laws contain no provisions on the stand of proof.[153] No uniform standard is established to prove corruption. Citing Redfern,[154] Reed et al.,[155] and Scherer,[156] Cosar stated that 'international arbitration tribunal are not bound to adhere to strict judicial rules of evidence.'[157] She further claimed that such a level of flexibility allowing the tribunal 'consider all relevant aspects steams from the wide discretionary power tribunals are granted on matters of evidence' and 'such flexibility has been confirmed by awards; tribunals have generally found that claims of corruption may be proven solely by circumstantial evidence'.[158]

The loosely defined standard of proof on corruption in foreign investment is a common practice according to Haugeneder and Liebscher. They highlighted that the tribunal has "relative factual freedom" in determining which standard of certainty is necessary to prove an allegation of

[151] *Blyth v Blyth* [1966] AC 643, 669
[152] Haugeneder and Liebscher, (n 9) 546
[153] Article 24(1) of the UNCITRAL Arbitration Rules mentioned that each party shall have the burden of proving the facts relied on to support his claim or defense. Nevertheless, no threshold is prescribed.
[154] Alan Redfern, 'The Practical Distinction Between the Burden of Proof and the Taking of Evidence – An English Perspective', (1994) 10 Arb. Int'l, 317, 321
[155] . Lucy Reed, Jan Paulsson and Nigel Blackaby, *Guide to ICSID Arbitration*, 2nd edn. (Kluwer Law International 2011) 142
[156] Matthias Scherer, 'Circumstantial Evidence in Corruption Cases Before International Arbitral Tribunals', (2002) 5 Int'l Arb. L. Rev. 29, 31.
[157] Cosar (n 41) 532
[158] Cosar (n 41) 534

corruption.'[159]Little discussion was carried out by the tribunals in practice on the different standards of proof which should be applied to determine the matter of corruption.[160] Accordingly, the approach taken by the tribunal is to 'avoid basing a decision solely on the burden and standard of proof and will try to establish the relevant facts with reasonable certainty irrespective of the burden and standard of proof.'[161] Tribunals used the "sufficient evidence" adduced by the parties to determine the facts without having to refer to rules of evidence.[162] As a result, the standard of proof was rarely discussed in arbitral awards. They even claimed that it is widely spread practice among the tribunals 'view that the evidentiary standards in different jurisdictions in practice lead to the same result.'[163] Partasides spoke of "an adequate evidentiary".[164] Cosar[165] argued for the practice of "the balance of probabilities standard" which focuses on "an overall assessment of the accumulated evidence", rather than "evidence on its own" as highlighted in *Rompetrol*.[166]

In practice, both tribunals in *Metal Tech*[167] and *Rompetrol*[168] held that 'corruption was established to an extent sufficient to prove a violation.' The standard of the balance of probabilities was applied to the generality of the factual issues and the need to adopt "a more nuanced approach".[169] Bearing such an approach in mind, it stated that the rule requires the tribunal to undertake an active role in taking a formal note of "any reasons" given by a party

[159] Haugeneder and Liebscher (n 9) 547
[160] *Ibid*. 546; Cosar (n 41) 534
[161] *Ibid* 539 – 564, 546
[162] *Ibid*
[163] *Ibid*
[164] Constantine Partasides, 'Proving Corruption in International Arbitration: A Balanced Standard for the Real World', (2010) 25 ICSID Review— Foreign Investment Law Journal 47, 60.
[165] Cosar (n 41) 538
[166] *The Rompetrol Group N.V. v. Romania* (ICSID Case No. ARB/06/3), 6 May 2013, para 223; https://www.italaw.com/cases/920 Accessed on 29 May 2019
[167] *Metal-Tech Ltd. v. Uzbekistan* (n 133) para 372. In this award, the tribunal looked at evidence of amount of payments, qualifications of consultants and the relationship with the Government.
[168] *Rompetrol* (n 166) para 186;
[169] *Ibid*. para 183

for its failure to comply[170] and produce evidence in order to cooperate within the dispute resolution process. Accordingly, the view is that a failure on the party's part would prompt an automatic response from the tribunal who should be readily draw adverse inferences from such failure, furthermore, 'a tribunal may take particular factual allegations as "proved" for the purpose of the arbitration.'[171]

The question that arises is whether the tribunal should apply the standard of "beyond reasonable doubt" or "proof of balance of probabilities" in the context of extra-territorial effect on the investor's corruptive practices committed abroad. In *BSG Resources Limited v. Guinea*[172] the arbitral tribunal referred to the impossibility of adopting the standard of "beyond reasonable doubt" in arbitration. In this case, after the introduction of the Mining Code 2011, the Technical Committee concluded its investigation by stating that BRGR Guinea had allegedly obtained the concessionary rights by corruption and other unlawful means in an ICSID arbitration.[173] Guinea claimed "in accordance with the law of the Host State". Hence 'such corrupt practices nullify the mining titles and the mining agreement held by VGB'[174] because BSGR did not follow the law in reaching a deal with Vale.[175] Responding to BSGR's claim on unjustified withdrawal[176] of BSGR's investments,[177] Guinea alleged corruptive practice conducted by BSGR.

[170] *Ibid.* para 185
[171] *Ibid*. para 184
[172] *BSG Resources Limited v. The Republic of Guinea* ICSID Case No. ARB/14/22 <https://www.italaw.com/sites/default/files/case-documents/italaw7735.pdf> accessed on 29 May 2019
[173] *Ibid.* p.5
[174] *Ibid.* para 136;
[175] *Ibid.* para 136; VBG-Vale BSGR Sarl was formed by Vale S.A. (with 51% of shares in BSGR Guernsey) and BSGR (with 51% of shares in BSGR Guernsey)
[176] *BSG Resources Limited v. The Republic of Guinea* ICSID CASE No. ARB/14/22; <https://www.italaw.com/sites/default/files/case-documents/italaw7378.pdf> para 162
[177] This includes the terminations of Zogota Mining Concession, Blocks 1 and 2 Permits and the Base Convention for the investment, paras 146-148

On the issue of standard of proof, in a separate LCIA Arbitration, though the tribunal had found that BSGR made fraudulent misrepresentations and false statements on the group's shareholding structure and false statements during the due diligence process on Vale's use of the relevant consultants and agents. The tribunal stated that limited inquiry should be conducted into the episodes of allegations of bribery as investigating private corruption by local businessmen and 'the nature of payments is not the tribunal's task assigned by the parties.' The tribunal also highlighted that, without full coercive powers, it would be extremely difficult for the tribunal to establish the genuine practice of corruption satisfactorily.[178]

BSGR tribunal's comments on lacking a full coercive power seems to correspond with the observation made by Haugeneder and Liebscher who criticised the imposition of an unduly high standard of proof in arbitration because:

> Establishing corruption is, as a matter of fact, difficult. The evidence is usually not readily available. The opposing party will usually not cooperate to establish the facts, even if the production of evidence is ordered by the arbitral tribunal. Putting an additional burden on the party alleging corruption may unduly disadvantage this party and endanger the equality of the parties. Arbitral tribunals applying such higher standards may, however, simply have expressed their view that there are no lower standards for the establishment of corruption, even if corruption is difficult to prove.[179]

They further argued for effect civil remedies which is sufficient to address public policy concerns and the civil consequences of corruption.

[178] Global Arbitration Review https://www.clearygottlieb.com/-/media/files/award-in-guinean-bribery-dispute-made-public-pdf.pdf accessed on 29 May 2019. Although the LCIA tribunal concluded that there was insufficient evidence on the alleged bribery, the allegation did spark criminal investigations in the US, Switzerland and Israel where one saw the agent received two- year custodial sentence in the US for obstruction of justice.
[179] Haugeneder and Liebscher (n 9) 547. They also raised the possibility of violation of due process if the alleged corruptive practice was laid down to rest on the basis of diplomatic reasons.

More recently, the Petrobras case seems to suggest that corruption can be cured by the subsequent agreement which fulfilled legality requirement. On 20 May 2019, the District Court Southern District of Texas Houston Division upheld the *Vantage v. Petrobras* award favouring Vantage against Petrobras on the basis of insufficient evidence of bribery and corruption.[180] Being governed by English law, the contract between the parties contain a "compliance with law" clause[181] required Vantage to comply with all applicable law, including all applicable law in each of the countries, in connection with the services performed.[182] The contract prescribed English law as the applicable law.[183]

On the issues of bribery and corruption, Petrobras (the respondent) alleged that Vantage violated Good Oil and Gas Field Practices for failing to monitor fluid volumes, hence breach of contract. [184] It also asserted misrepresentation, illegal information, failure in carrying on background check and these constituted breaches of non-bribery and non-operational requirements. [185] Petrobras further asserted illegal payment being made or offered to its officials with the claimant's knowledge for the purpose of inducing the contract.

Vantage (the claimant) claimed that Petrobras had failed to meet the burden of proof for the assertions on bribery and corruption. [186] The tribunal was required to determine the

[180] *Vantage Deepwater Company and Vantage Deepwater Drilling, Inc. v. Petrobras America, Inc., Petrobras Venezuela Investments & Services, bv, and Petroleo Brasileiro S.A. —Petrobras* United States District Court Southern District of Texas Houston Division, Civil Action No. 18-cv-2246; https://globalarbitrationreview.com/article/1193157/petrobras-award-upheld-despite-bribery-claims
[181] Clause 10.15 reads: 'Contractor acknowledges and agrees that it will be transporting the Drilling Unit between the Countries and conducting Drilling Operations in each of the Countries. Contractor shall comply with all Applicable Law, including all Applicable Law in each of the Countries, in connection with the Services performed by Contractor.'
[182] *Vantage Deepwater Drilling* (n 180) page 13
[183] *Ibid.* p. 16
[184] *Ibid.* p. 50
[185] *Ibid.* p. 50, award para 229
[186] *Ibid.* p. 54, award para 252

consequences of Petrobras's repeats ratifications of the Novations. Vantage claimed that a contract with defects is not void as claimed by Petrobras, but voidable at Petrobras's discretion. Petrobras's decision to ignore the defects and ratify the subsequent Novations led to estoppel.[187] Hence repeated ratification, waiver and estoppel defeated Petrobras's contractual defenses.[188]

The tribunal sided with the claimant[189], stressing that no convincing evidence showed that Vantage was aware of the bribery[190] and that Petrobras failed to present sufficient evidence to prove bribery and corruption in this case.[191] The tribunal ruled that it did not need to look into these assertions because 'such alleged breaches were waived or ratified by Petrobras entering into the Second Novation and Third Novation.'[192] This is because the tribunal agreed with the claimant's view and ruled that a contract procured by bribery called for a wider category of contracts. Such category demands contracts to be voidable, not void.[193] The fact that Petrobras's decision to ratify the subsequent Novations means that 'the anti-waiver clauses can be waived by a party's silence and inaction over a lengthy period of time'.[194] The tribunal concluded that without sufficient evidence and the estoppel, Petrobras failed its burden in proving its allegation on Vantage's commission of bribery and corruption.[195]

5. Conclusion: The way forward

[187] *Ibid.* page 55, Claimants' Summary of Claims and Defenses, at p. 5. award para 257-258,
[188] *Ibid. p*age 56, para 267; Claimants' Summary of Claims and Defenses, at p. 5.
[189] *Ibid.* page 53, award para 247
[190] *Ibid.* page 59 para 286
[191] *Ibid.* page 60 para 292
[192] *Ibid.* page 60 para 358
[193] *Ibid.* page 73 para 372
[194] *Ibid.* page 73 para 374
[195] *Ibid.* page 42 para 173

The use of international investment law mechanisms to address corruption has been based on a reactive approach articulated around the notion of "illegal investment". However, the manner in which this category is construed varies from one arbitral tribunal to the next. Although some consistency has been reached as demonstrated in the substantive analysis of the cases examined, some discrepancies subsist in procedural and substantive terms. The array of provisions embodied in BITs and IIAs include sometimes the requirement of "in accordance with the host state law". Yet, there are definitely more questions to be asked, such as those concerning the relevance of the legislation of the home state in defining illegality.

Procedurally, the hurdles in asserting a uniform standard of proof together with the nature of the arbitrator's mandate and a lack of coercive evidential power further confirm the difficulties in taking a coherent approach. Even if there is evidence of corruption, cases are caught in a procedural trap.

Anti-corruption clauses advance the cause of good governance on the international level. This poses the question about different ways in which international investment law can be deployed to promote anticorruption measures. In turn, this also entails dealing with the definition of anti-corruption clauses and their effects. Although the inclusion of specific provisions represents progress, states are still reluctant to fully agree on the so-called "deep provisions".