INVESTOR MISCONDUCT IN INTERNATIONAL INVESTMENT ARBITRATION: CAN THE UNCLEAN HANDS DOCTRINE BE A CURE?

Uluslararası Yatırım Tahkiminde Yatırımcı Suistimali: Kirli Eller Doktrini Bir Çare Olabilir Mi?

Dr. M. Üzeyir KARABIYIK*

Research Article

Abstract

The vast majority of international investment treaties enable foreign investors to bring claims against their host states without having to exhaust local remedies or to seek espousal from their home states. These international agreements form the backbone of the modern investor-state dispute settlement (ISDS) system, which has been subject to harsh criticism by states due to its chronic issues such as contentious legitimacy, inconsistency and unpredictability. Along with its structural deficiencies, asymmetries and pro-investor bias in the ISDS system have contributed to the proliferation of investor misconduct in international investment arbitration proceedings. These wrongful conducts involve not only abuse of process but also illegal conduct such as corruption and fraud. This article, in the first part, identifies the characteristics of the functional types of investor misconduct. Second part discusses the unclean hands doctrine in the context of public international law, in particular its applicability in cases involving investor misconduct.

Keywords: ISDS, unclean hands doctrine, abuse of process, corruption, fraud

Özet

Çeşitli ülkelerde belirli dönemlerde gerçekleştirilen iUluslararası yatırım anlaşmalarının büyük çoğunluğu yabancı yatırımcılara ev sahibi devlet aleyhine iç hukuk yollarını tüketmek veya kendi devletlerinin desteğini istemek zorunda kalmadan dava açma imkânı vermektedir. Bu uluslararası anlaşmalar meşruiyet sorunları, tutarsızlık ve öngörülemezlik gibi kronik hususlar nedeniyle eleştiri konusu olan yatırımcı-devlet uyuşmazlık çözümü sisteminin (ISDS) bel kemiğini oluşturmaktadır. Yapısal eksiklikler ile birlikte ISDS sistemindeki asimetriler ve yatırımcı yanlısı önyargı uluslararası yatırım tahkiminde yatırımcı suistimallerinin artmasına katkı sağlamıştır. Bu suistimallerin içinde sadece sürece ilişkin suistimaller değil aynı zamanda yolsuzluk ve hile gibi kanun dışı eylemler de yer alır. Bu makale, ilk kısımda, yatırımcı suistimalinin fonksiyonel çeşitlerinin özelliklerini ortaya koymaktadır. İkinci kısım ise kirli eller doktrinini uluslararası kamu hukuku bağlamında ele almakta ve özellikle doktrinin yatırımcı suiistimalini barındıran davalarda uygulanabilirliğini değerlendirmektedir.

Anahtar Kelimeler: ISDS, kirli eller doktrini, usulün suistimali, yolsuzluk, hile

* T.C. Cumhurbaşkanlığı, Raportör,
e-mail: uzeyirkarabiyik@hotmail.com, ORCID ID: 0000-0002-4806-0673

Submitted:19.04.2021 / Revision Requested: 23.05.2021
Last Version Received: 24.05.2021 / Accepted:11.06.2021

INTRODUCTION

In the early days of the investor-state disputes, the traditional method of resolution was state-to-state; the home state of an investor aggrieved at the host state's hands would engage in diplomacy or even war with the host state.[1] Investors who preferred not to seek espousal by their home states for diplomatic intervention simply ignored the conflict and accepted bad treatment from the host state as a cost of doing business or as a reasonable political risk.[2]

Treaties of commerce granting investment-related guarantees have been concluded between states for centuries. The first international adjudications on foreign investment conflicts date back to 1794, the year in which the Treaty of Amity between the United States and Great Britain was signed.[3] Under this treaty, to settle the debts to British creditors, mixed arbitral commissions were established.[4] After the Second World War, developed western countries exerted substantial effort to institute multilateral instruments with a view to protect their interests and properties in the countries recently liberated from colonization.[5] After lengthy negotiations and international conferences, the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (hereinafter ICSID Convention) was signed on 18 March 1965.[6] The ICSID Convention allowed aggrieved investors to invoke arbitration against host states without having to request the intervention of their home countries.[7] Today this protection is granted in almost all international investment agreements and lies at the heart of the contemporary investor-state dispute resolution.

Over the years, states have been increasingly expressing concerns over the structural deficiencies of the system such as unpredictability and inconsistency of awards, lack of transparency in the investment tribunals' procedures, poor treaty interpretation by tribunals and pro-investor bias. Despite all these concerns, developing states have been quite reluctant to pull themselves out entirely due to the concern that withdrawal would diminish the flow of foreign direct investment to their country that was attracted by active participation in this system. Whether the benefits of the ISDS system outweigh its costs,

1 CAMPBELL MCLACHLAN, LAURENCE SHORE & MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (2 ed. 2017).

2 NATHAN JENSEN & GLEN BIGLAISER, POLITICS AND FOREIGN DIRECT INVESTMENT (2014).

3 Treaty of Amity, Commerce and Navigation, U.S.-Great Britain, 19 November1794

4 Sergio Puig & Gregory Shaffer, *Imperfect Alternatives: Institutional Choice and the Reform of Investment Law*, 112 American Journal of International Law 361–409 (2018), at 363.

5 *Id.*

6 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 18 March 1965, 17 UST 1290, 575 UNTS 192.

7 Puig, *supra* note 4, at 363.

including the chilling effect on the regulatory organs of a state, has been a debated matter. It has been common within the past decade for developing countries with vulnerable economies not to enact specific much-needed laws in fear of corporate retaliation through investor-state arbitration.[8]

The view that transnational companies exploit the investor-state arbitration system to make more profit at the expense of the host states' citizens has started to receive more sympathy.[9] In the same vein, encouraged by the pro-investor nature of the ISDS system, investors have been adapting some of the procedural tactics inherent in domestic litigations to the investor-state arbitration to undermine respondent states as well as to increase their chances of getting a favorable award.[10] These tactics have amounted to misconduct that threatens the reliability and the reputation of the international investment arbitration system beyond its chronic structural issues.[11]

This article first seeks to identify the types of investor misconduct and then discusses the applicability of the unclean hands doctrine as a tool to remedy it. The first part of this article deals with identifying and defining functional types of investor misconduct: corruption, fraud and abuse of process. The second part delves into the role of unclean hands doctrine in addressing investor misconduct in investor-state arbitration practice.

8 Julia G. Brown, International Investment Agreements: Regulatory Chill in the Face of Litigious Heat, 3 W. J. Legal Stud. [i] (2013). In this article, the author discussed the tension between the foreign mining companies carrying out open-pit mining operations in the forested areas in Indonesia. A new Indonesian government formed after the fall of the New Order Regime in 1999. The new administration enacted new environmental protection laws that prohibited open-pit mining in protected forests. The old administration had signed contracts with certain mining companies granting them specific privileges. These contracts had insulated the companies from future changes in the law. Relying on these privileges, the mining companies alleged that the new law would not apply to them and wanted to continue their open-pit mining operations. Public outcry led the government to stop these mining activities. Investors responded by threatening the government with international arbitration. The government caved in and made exceptions to the related forestry law that allowed 22 companies to continue their open-pit operations in protected forest areas.

9 The article titled "Arbitration Game" published on 11 October 2014 in the Economist explained plainly: "If you wanted to convince the public that international trade agreements are a way to let multinational companies get rich at the expense of ordinary people, this is what you would do: give foreign firms a special right to apply to a secretive tribunal of highly paid corporate lawyers for compensation whenever a government passes a law to, say, discourage smoking, protect the environment or prevent a nuclear catastrophe. Yet that is precisely what thousands of trade and investment treaties over the past half century have done, through a process known as 'investor-state dispute settlement', or ISDS." Available at: https://www.economist.com/finance-and-economics/2014/10/11/the-arbitration-game (last visited 11 January 2021)

10 Emmanuel Gaillard, *Abuse of Process in International Arbitration,* ICSID Review, 2017, pp. 1–22, at 1.

11 *Id.*

PART I

FUNCTIONAL TYPES OF INVESTOR MISCONDUCT

Offering a typology of categories of investor misconduct requires an arduous effort in distilling investors' conduct, mostly due to the intertwined nature of the means and tactics employed by investors in their endeavor to manipulate the ISDS system to their fraudulent advantage.

In an attempt to minimize duplications and mischaracterizations in drawing a typology, in addition to examining available analogies, it is preferred in this article to make a distinction between the conducts that are *prima facie* illegal and those manifesting themselves in the form of abuse of process, which technically cannot be deemed illegal. This article examines corruption and fraud as forms of illegal misconduct. They both amount to breach of the host state law in almost every jurisdiction and need to be analyzed individually in-depth as they have frequently been referred to in arbitral awards.[12]

The conduct that is not regarded *prima facie* illegal denote abuse of process; a concept closely correlates with the lack of *bona fide*. This articles groups abuse of process into three categories: Devising plans to secure jurisdiction under an investment treaty, employing multiple arbitral proceedings to increase the likelihood of success, and bringing frivolous claims that have a low likelihood of success.

1. Corruption

In the context of international investment arbitration, corruption points out an illicit relationship between a foreign investor and a public official of the host state, which involves payments or other types of advantages in exchange for a favorable public decision.[13] In other words, corruption denotes bribery of an official of the host state to secure favorable treatment. The terms "corruption" and "bribery" have been used interchangeably in ISDS.

[12] Some of the prominent awards addressing corruption and fraud are as follows: *Inceysa Vallisoletana v. Republic of El Salvador*, ICSID Case No. ARB/03/26), Award, 2 August 2006; *World Duty Free Company Limited v. The Republic of Kenya*, ICSID Case No. ARB/00/7, Award, 4 October 2006; *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008; *Cementownia "NowaHuta" S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/06/2, Award, 17 September 2009; *Europe Cement Investment amp; Trade S.A. v. Republic of Turkey*, ICSID Case No.ARB(AF)/07/2, Award, 13 August 2009; *Libananco Holdings Co. Limited v. Republic of Turkey*, ICSID Case No. ARB/06/8, Award, 2 September 2011.

[13] Aloysius Llamzon & Anthony C.Sinclair, *Investor Wrongdoing in Investment Arbitration: Standards Governing Issues of Corruption, Fraud, Misrepresentation and Other Investor Misconduct,* in Albert Jan van den Berg (ed), Legitimacy: Myths, Realities, Challenges, ICCA Congress Series, Volume 18 (© Kluwer Law International; Kluwer Law International 2015) pp. 451 – 530, at 460.

The bilateral nature of corruption distinguishes it from the other types of investor misconduct that usually point to investors' unilateral acts targeting host states. Corruption involves an agreement between an investor and a public official of the state. This agreement is a pre-condition of the consummation of corruption.[14]

Although corruption allegations are quite common in investor-state disputes, it is "notoriously difficult to prove"[15] due to the parties' mutual incentives to conceal the evidence of their illicit agreement. Yet, occasionally, although rare, evidence of corruption could be revealed. In these circumstances, parties usually prefer to settle their disputes behind closed doors rather than making their collusive activities available to the scrutiny of arbitral tribunals and trigger criminal investigations by national prosecutors.[16]

Corruption can be invoked both as a claim by the investor or as a defense by the host state. Compared to host states, investors invoke corruption far less frequently. It is mainly because the circumstances in which an investor invokes corruption without indicting himself are limited to unconsummated corruption.[17] Put differently, only in rare occasions, investors opt for initiating arbitration due to corruption before an international panel when they face extortions or bribe solicitations from public officials of the host state. This would be the case, in particular, where an investor suffers from damages stemmed from the public officials' retaliation for non-payment.[18]

Solicitation or extortion of a bribe from a foreign investor by a state official would constitute a violation of the states' obligations under the related corruption treaties as well as of that state's domestic law. Still, foreign investors have been quite hesitant to resort to arbitration in cases of corruption due to various considerations. Firstly, taking a contentious posture against the host state, let alone officially accusing it of corruption, would "poison the well" and could give rise to a break between the investor and the host State.[19] In most cases, severing the ties with a state is an undesirable avenue for foreign investors

[14] *Id.* at 461.

[15] *EDF (Services) Ltd. v. Romania,* ICSID Case No. ARB/05/13, Award, 8 October 2009, ¶ 221.

[16] Carolyn B. Lamm & Andrea J. Menaker, 'Chapter 31: *Consequences of Corruption in Investor State Arbitration*, in Meg Kinnear, Geraldine R. Fischer, et al. (eds), Building International Investment Law: The First 50 Years of ICSID, (© Kluwer Law International, 2016), at 435.

[17] Llamzon, *supra* note 13, at 464.

[18] Florian Haugeneder, *Corruption in Investor-State Arbitration*, 10 J. World Investment & Trade 323 (2009), at 332.

[19] Bruce W. Klaw, *State Responsibility for Bribe Solicitation and Extortion: Obligations, Obstacles, and Opportunities*, 33 Berkeley J. Int'l L. 60 (2015), at 89.

as it could limit investment options for the disputant investor party while competitor investors step into action to fill the investment gap in that particular state. Secondly, due to the bilateral nature of corruption, fear of exposure to criminal or civil liability under the laws of both sending and host states is a factor that deters investors from bringing corruption claims against host states. If a foreign investor already paid a bribe, regardless of being solicited to pay it or not, resorting to arbitration would make little sense for him.[20] Lastly, the extortionate costs of international investment arbitration could be a deterrent factor for foreign investors as well.

With regard to the timing of corruption allegations, most of the arbitral institutions have rules requiring respondents to raise jurisdictional objections at the initial stages of the proceedings.[21] However, in the instances where new facts revealed at later stages, respondent states may be allowed to raise jurisdictional objections later on.[22] In the same vein, in bifurcated ICSID proceedings, it is a common practice that parties may put forward the corruption allegations at both the jurisdictional and merits phases.[23] Moreover, Article 51 of the ICSID convention allows the respondent party to apply for the revision of the award in the circumstances where the evidence of corruption was discovered after the award's issuance.[24]

20 *Id,* at 90.

21 Thomas Kendra & Anna Bonini, *Dealing with Corruption Allegations in International Investment Arbitration: Reaching a Procedural Consensus,* Journal of International Arbitration vol. 31, no. 4 (August 2014): p. 439-454., at 443.

22 Article 23(2) of the UNCITRAL Rules on Arbitration directly deals with the issue. According to the article: "A plea that the arbitral tribunal does not have jurisdiction shall be raised no later than in the statement of defence or, with respect to a counterclaim or a claim for the purpose of a set-off, in the reply to the counterclaim or to the claim for the purpose of a set-off. … A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings. The arbitral tribunal may, in either case, admit a later plea if it considers the delay justified."

23 Kendra, *supra* note 21, at 444; *See* also *SGS Societe Generale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction, 6 August 2003, ¶ 141. The tribunal stated in the award: "The Respondent therefore reserved the right to argue—in the event that it is found in those proceedings that the PSI Agreement had been procured through bribery and corruption— that this Tribunal does not have jurisdiction over the claims set forth in the Request for Arbitration submitted to the ICSID on the additional ground that the claimant SGS had not invested "in accordance with the laws and regulations" of Pakistan as required by Article 2 of the BIT."

24 Article 51(1) of the ICSID Convention reads: "Either party may request revision of the award by an application in writing addressed to the Secretary-General on the ground of discovery of some fact of such a nature as decisively to affect the award, provided that when the award was rendered that fact was unknown to the Tribunal and to the applicant and that the applicant's ignorance of that fact was not due to negligence."

INVESTOR MISCONDUCT IN INTERNATIONAL INVESTMENT ARBITRATION: CAN THE UNCLEAN HANDS DOCTRINE BE A CURE?
Dr. M. Üzeyir KARABIYIK

2. Fraud

A description of the concept of fraud is as follows: "Fraud consists of some deceitful practice or willful device, resorted to with intent to deprive another of his right, or in some manner to do him an injury. As distinguished from negligence, it is always positive, intentional."[25] The overuse of the word "fraud" has produced excessive intellectual as well as terminological chaos. There has been no consensus on what the term "fraud" connotes in investor-state arbitration. In this field, "fraud" is frequently used out of the legal context in a loose manner and meant to encompass almost all sorts of undesirable conduct, including abuse of process, corruption, and breach of host states' laws.[26]

It is fair to propound that an investor's conduct involving an act of pure fraud cannot be categorized as abuse of process. Unlike the way abuses of process are tackled, it can be addressed by employing established legal tools.[27] Separation of fraud and abuse of process matters, especially in the context of legal consequences attributed to them. When it comes to distinguishing fraud from corruption, fraud's unilateral nature comes to the fore in the first place. While corruption needs a shared understanding and action of the parties, only one party's acts or omissions are sufficient for fraud to take place. The other party's participation in the act is not necessarily required. Realistically, if the other party knowingly or tacitly participates in the fraudulent conduct, it would be doubtful if that party was really defrauded.[28]

Except for rare circumstances,[29] fraud has been invoked by host states as a defense against investor claims. In their evaluation of such a defense,

25 Black's Dictionary, Online, 2nd ed. (last accessed 22 January 2021), https://thelawdictionary.org/fraud/

26 Llamzon, *supra* note 13, at 470.

27 Gaillard, *supra* note 10, at 6.

28 Llamzon, *supra* note 13, at 471.

29 This was the case when Egypt concluded an agreement with two Belgium companies to have the Suez Canal dredged (*Jan de Nul N.V. amp; Dredging International N.V. v. Egypt*, ICSID Case No. ARB/04/13, Award, 6 November 2008). Uncommonly, the investor claimed that the host State "made fraudulent misrepresentations at the tender stage about the scope and nature of the contract works, thereby inducing the Claimants to a loss-making investment […]" (¶ 112). In addition, the investor also asserted that the Suez Canal Authority (contracting government entity) intentionally withheld vital information from it by "failing to disclose that it had engaged into pre-dredging activities on the lot" and "failing to provide correct information to the bidders on geology and volumes […]"(¶ 210). To properly address the claims the tribunal examined Egypt's anti-fraud laws and find out that the intent was a necessary element for fraud to be occurred. The tribunal stated: "The Tribunal understands, however, from the Egyptian rules on fraud that intent is a necessary element and that there is no fraud when the alleged victim could have known about the relevant facts by another means" (¶ 208). The tribunal examined each fraudulent conduct allegation and ruled that the evidence was not sufficient to prove the fraud allegations in the case.

tribunals examine the host state's anti-fraud laws should the applicable bilateral investment treaty (hereinafter BIT) to the case contains a legality clause. Today, a majority of the BIT's have legality clauses that are referred to by the tribunals when examining the compliance of the conduct of the investors with national anti-fraud laws violation of which might have an international legal effect.[30] The following provision of the Canada – Trinidad and Tobago BIT sets an example of a typical legality clause:

> "' investment' means any kind of asset owned or controlled either directly, or indirectly through an investor of a third State, by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the latter's laws […]"[31]

The result of examining the compliance of the challenged conduct with municipal law of the host state carries substantial weight over the determination as to whether the investment is entitled to protection under the applicable treaty.[32] In the cases where the relevant treaty does not contain a legality clause, tribunals may examine whether the alleged fraudulent conduct constitutes a violation of international or transnational public policy.[33] Tribunals usually refer to the maxim *nemo auditur propriam turpitudinem allegans* (no one can be heard to invoke his own turpitude) when they examine fraud allegations in the absence of legality clauses.[34]

Timing and types of the breach of the host state law and their effect on the legality of the investment have been frequently discussed in investment arbitration practice. As to the timing, it is widely accepted in current investor-state arbitration practice that the legality requirements, in other words, the "in accordance with law" clauses, concern national laws that govern not only the establishment of the investment but also its operation thereafter.[35] At this point,

30 Thomas, Obersteiner, *"In Accordance with Domestic Law" Clauses: How International Investment Tribunals Deal with Allegations of Unlawful Conduct of Investors.* Journal of International Arbitration 31, no.2 (2014): 265-288; *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, Award, 16 August 2007, ¶ 394.

31 Article 1(f) of the Agreement between the Government of Canada and the Government of the Republic of Trinidad and Tobago for the Reciprocal Promotion and Protection of Investments; *See* also the definition of investment in the Article 1.4 of the Indian Model BIT, which reads: "'Investment' means an enterprise constituted, organised and operated in good faith by an investor in accordance with the law of the party in whose territory the investment is made […]"

32 Llamzon, *supra* note 13, at 471.

33 *Id.*

34 *Id.*; *See* also *Plama Consortium Limited v. Bulgaria,* ICSID Case No. ARB/03/24, Award, 27 August 2008, ¶¶ 138-146.

35 *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award, 14 July 2010, ¶ 119; Similarly, *Quiborax* tribunal suggested: "The Tribunal considers that the BIT's legality requirement has both subject-matter and temporal limitations. The subject-matter scope of the legality requirement is limited to (i) non-trivial violations of the host State's legal order (ii) violations of the host State's foreign investment regime (iii) fraud – for instance, to secure the investment or profits. Additionally, under this BIT, the temporal scope of the legality requirement is limited to the establishment of the investment; it does not extend to the subsequent performance." (*Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction, 27 September 2012, para. 266.)

the *Hamester* tribunal makes an interesting suggestion. Relying on Germany-Ghana BIT, the tribunal found that violation of the domestic laws that govern the establishment of the investment was an issue of jurisdiction, while breaking the laws that apply to the continuous operations of the investment could be an issue that needs to be addressed at the merits phase.[36] Simply put, following this logic, if the alleged fraud of investor perpetrated during the operations of the investment, tribunals would not find for the respondent state in the case of an objection to the jurisdiction of the tribunal.

3. Abuse of process

Procedural abuses in legal proceedings have been a common preoccupation for states. Different jurisdictions adopted different laws and strategies to tackle it. For instance, in France, various laws allow judges to impose fines in situations where an abusive request is made.[37] Depending on the law prohibiting abuse of process and the jurisdiction, the types of sanctions differ.[38] However, the possibility of these sanctions affecting the exercise of certain fundamental procedural rights makes states to use them quite carefully.[39]

According to Lowe, in international law, abuse of process is a doctrine that allows tribunals to decline exercising jurisdiction for vexatious actions such as frivolous or manifestly groundless claims and claims aimed at harassing the other party.[40] Another prominent commentator, Zimmermann, considers abuse of process as a special application of the principle of prohibition of abuse of rights.[41] To him, abuse of process points to misuse of rights or some procedural instruments for purposes that are incompatible with those for which the rights or instruments were established.[42] These purposes would include those with

36 *Gustaf F. W. Hamester GmbH amp; Co KG v. Republic of Ghana,* ICSID Case No. ARB/07/24, Award, 18 June 2010, ¶ 127.

37 Herve Ascensio, *Abuse of Process in International Investment Arbitration*, 13 Chinese J. Int'l L. 763 (2014), at 765.

38 *Id.*

39 *Id.*

40 Vaughan Lowe, *Overlapping Jurisdiction in International Tribunals*, AYBIL, Volume 20, 1999, at 203.

41 ZIMMERMANN ET AL., THE STATUTE OF THE INTERNATIONAL COURT OF JUSTICE: A COMMENTARY (2006). p. 831.

42 *Id.*

procrastinatory, frivolous, and fraudulent natures as well as purposes of causing harm or obtaining an illegitimate advantage.[43]

As opposed to other types of investor wrongdoings such as corruption and fraud, parties' conduct that amounts to abuse of process does not necessarily have to be illegal *per se*. Abuses of process in investor-state arbitration are mostly regarded as adapted versions of abusive litigation tactics peculiar to states' domestic judicial procedure.

Abuse of process in investor-state arbitration manifests itself in an array of types of conduct. These conducts can be classified into three categories: Manufacturing jurisdiction through corporate restructuring, initiating multiple arbitrations to maximize the chance of success, and bringing frivolous claims.

3.1. Manufacturing jurisdiction under an investment treaty

One can expect from a prudent international investor to take measures to have maximum protection for her investment in a foreign jurisdiction. These measures mainly aim at either obtaining treaty protection or expanding the already existing protection through making use of multiple investment treaties at the same time. Designing or changing the corporate structure in a way to secure such protection, according to arbitral case law, has accounted for a vast majority of the said measures.[44] Different expressions have been used to refer to this kind of practice such as "treaty shopping", "nationality planning", "treaty planning", and "corporate maneuvering."[45] Some commentators also called it "treaty abuse"[46]. Arbitral case law points out that "the mere fact of restructuring an investment to obtain BIT benefits is not *per se* illegitimate."[47]

43 *Id.*

44 Although it is rarely seen, an investor could also transfer his or her treaty claims to a country that is a party to the same international investment treaty with his or her home state. *See, e.g., Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/00/2, Award, 25 March 2002; *Loewen Group Inc and Raymond Loewen v. United States of America*, ICSID Case No ARB(AF)/ 98/3, Award, 26 June 2003.

45 JORUN BAUMGARTNER, TREATY SHOPPING IN INTERNATIONAL INVESTMENT LAW (2016), at 7-8.

46 *Id.*; *See* also George Kahale III, '*The new Dutch sandwich: The issue of treaty abuse'*, Columbia FDI Perspectives, No: 48, 10 October 2011, available at: http://ccsi.columbia.edu/files/2014/01/FDI_48.pdf; (last accessed 10 January 2021. Referring to the term "Dutch sandwich" that was used for the process of corporate restructuring to benefit from the investor friendly tax regulations in Netherlands, Kahale pointed out international investors' increasing use of the same method to take advantage of large network of Dutch BITs.

47 *Philip Morris Asia Limited v. Commonwealth of Australia*, UNCITRAL, PCA Case No 2012-12, Award on Jurisdiction and Admissibility,17 December 2015, ¶ 540; The *Tidewater* tribunal noted: "It is a perfectly legitimate goal and no abuse of an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host State in this way", *Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., Twenty Grand Offshore, L.L.C., Point Marine, L.L.C., Twenty Grand Marine*

However, restructuring an investment to acquire treaty protection that did not exist before has different dynamics as a result of which abuse of process may come into play.

Although some concerns related to the principle of reciprocity and legitimacy have been voiced against treaty shopping, it remains an acceptable practice for investors who seek enhanced legal protection.[48] Nevertheless, it also forms a convenient basis for treaty abuse. Reorganizing the structure of their corporations in an attempt to obtain treaty protection illicitly has been one of the most frequently employed abusive conduct of the investors. As indicated above, arbitral case law permits corporate restructuring unless it is abusive. But, how can a legitimate corporate restructuring be distinguished from the one that is done with *mala fide* and therefore constitutes an abuse of process? Where does the dividing line between them lie?[49] The answers to these questions mainly relate to the timing of the restructuring and foreseeability of a specific dispute at that moment. Tribunals have had divergent approaches in addressing these concepts.

The lack of *ratione temporis* jurisdiction of the arbitral tribunals is one of

Service, L.L.C., Jackson Marine, L.L.C. and Zapata Gulf Marine Operators, L.L.C. v. The Bolivarian Republic of Venezuela, ICSID Case No. ARB/10/5, Decision on Jurisdiction, 8 February 2013, ¶ 184; In a similar vein, the Levy tribunal observed: "In the Tribunal's view, it is now well-established, and rightly so, that an organization or reorganization of a corporate structure designed to obtain investment treaty benefits is not illegitimate per se, including where this is done with a view to shielding the investment from possible future disputes with the host State", *Renée Rose Levy and Gremcitel S.A. v. Republic of Peru*, ICSID Case No. ARB/11/17, Award, 9 January 2015, ¶ 184; The *Mobil* tribunal adopted the same approach: "The aim of the restructuring of their investments in Venezuela through a Dutch holding was to protect those investments against breaches of their rights by the Venezuelan authorities by gaining access to ICSID arbitration through the BIT. The tribunal considers that this was a perfectly legitimate goal as far as it concerned future disputes.", *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petróleos, Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, 10 June 2010, ¶ 204; Similarly, Aguas del Tunari tribunal noted: "…to the extent that Bolivia argues that the December 1999 transfer of ownership was a fraudulent or abusive device to assert jurisdiction under the BIT, that:... (d) it is not uncommon in practice and—absent a particular limitation—not illegal to locate one's operation in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT", *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, 21 October 2005, ¶ 330.

48 BAUMGARTNER, *supra* note 45, at 39, 49.

49 The *Aguas* tribunal noted: "it is not uncommon in practice and – absent a particular limitation – not illegal to locate one's operation in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.", *Aguas, supra* note 189, ¶ 330(d).

the most invoked arguments in host states' jurisdictional objections. Related arbitral case law points out that if an investor redesigns the structure of his corporation after the date of the challenged conduct of the host state with a view to acquiring treaty protection that he did not have before, the tribunal would lack *ratione temporis* jurisdiction.[50] Put another way, an investor's attempt to transform a pre-existing dispute with the host state into an arbitration claim may culminate in dismissal of the claim due to lack of jurisdiction. As arbitral case law demonstrates, this type of conduct constitutes an abuse of process.[51]

In light of the arbitral case law it is fair to say that the examination of *ratione temporis* jurisdiction is of a factual nature. It has no concern with the investor's foresight as to a future dispute or with his knowledge of an actual one. The question concerns the existence of an actual dispute at the time of corporate restructuring. If that is the case, there would be no need to consider abuse of process as the claim would be dismissed due to lack of jurisdiction. There is no place for subjectivity here. When it comes to foreseeability, however, an investor's ability to perceive a future dispute comes into play. The subjective nature of foreseeability has complicated tribunals' work as to determining if abuse of process took place. Tribunals' interpretations of the concept of the foreseeability of a future dispute have remained to be somewhat inconsistent to date. This inconsistency provides comfort to investors who engage in abusive corporate restructuring.

In analyzing host states' treaty violations, in the form of either a one-off measure or a continuous one, tribunals' level of reliance on the parties' subjective perceptions as to the occurrence of the dispute is critical as it has a substantial effect over the proceedings. In cases where corporate restructuring is involved, investors tend to employ tactics to move forward the date on which the dispute came about to sometime later than the date of restructuring to avoid dismissal of their claims due to the lack of *ratione temporis* jurisdiction. Along the same lines, one may expect from a respondent state to try to pre-date the dispute to make it look like it occurred before the restructuring so that it can raise jurisdictional objections as well. Admittedly, it is not entirely realistic to expect a tribunal to isolate itself from parties' subjective perceptions as to the timing of the dispute. Still, giving more weight to objective criteria rather than relying mainly on parties' perceptions and assertions would help a tribunal to disallow the parties' aforesaid maneuvers manipulating the dispute in question.

[50] *E.g., Vito G Gallo v. The Government of Canada*, NAFTA, UNCITRAL Case No: 55798, Award, 15 September 2011; Libananco *Holdings Company Limited v. Republic of Turkey*, ICSID Case No. ARB/06/8, Award, 2 September 2011.

[51] *Phoenix Action, supra* note 183.

3.2. Employing multiple arbitral proceedings simultaneously to increase the likelihood of success

It is only natural for a prescient investor to submit his or her claims to a venue from where he could obtain the most favorable award, as long as the said venue is permissible under the terms of the parties' agreement to arbitrate. However, in contemporary international investment arbitration practice, where litigiousness has been increasing considerably, investors have tended to simultaneously initiate multiple arbitral proceedings before multiple arbitral fora concerning the same dispute to increase the likelihood of success. This is a strategy that may amount to abuse of process. Putting this strategy into practice against the respondent states is rather injurious as they would be required to defend themselves before multiple arbitral tribunals for the same dispute.[52] It brings along additional costs, procedural unfairness, delays, and risk of multiple recoveries for the same damage. Furthermore, the divergent interpretations of different ISDS tribunals lead to contradictory outcomes arising from the same facts and thus engender lack of consistency.[53]

In contemporary international investment practice, cross-border investments are generally made by way of multinational corporations, the structures of which involve several layers of entities. The ISDS system allows these entities to bring treaty claims against the host state individually. Being protected by the same treaty does not affect the main corporation's and sub-entities' ability to commence separate claims. Again, these entities' claims do not necessarily have to originate from the violation of the same treaty either. Depending on their nationality, different entities within the same corporate structure can initiate claims under different BITs. Moreover, they also can employ the mechanisms for dispute resolution provided in the investment contract.

In addition to initiating the arbitration himself directly, an investor may bring claims through a locally incorporated company he controls, as well as through a subsidiary operating under his company.[54] In these kinds of circumstances, the investor's chance of prevailing would be much higher than the chance of the respondent state. This unfair advantage of investors goes against party equality and procedural justice in an investment arbitration setting. To illustrate, if an investor initiated three arbitrations for the same dispute and if three different tribunals constituted accordingly, the respondent state would need to convince the majority of each tribunal, which would require the affirmative vote of six

[52] *Id,* at 7.

[53] UNCITRAL, Working Group III (Investor-State Dispute Settlement Reform), Possible reform of investor-State dispute settlement (ISDS) Multiple proceedings and counterclaims, Note by the Secretariat, (Document No: A/CN.9/WG.III/WP.193), 22 January 2020, at 2.

[54] Article 25(2)(b) of the ICSID Convention allows a foreign controlled locally incorporated company to initiate arbitral proceedings against the respondent state.

out of nine arbitrators.[55] On the other hand, the investor would need to convince only two arbitrators.[56] In other words, while the respondent state needs to prevail in all three arbitrations to be able to avoid paying compensation, the investor needs to win in just one to get paid.

3.3. Filing frivolous claims

Frivolous claims are the claims that lack legal merit. This fault manifests itself in various ways such as lack of a basis to establish jurisdiction and inadequacy of legal arguments. Determining whether a claim is frivolous typically necessitates a case-by-case evaluation. If the claim is originated from a violation of a settled rule, this evaluation process would be relatively straightforward for arbitrators. Nonetheless, imprecise standards reign in investor-state arbitration procedures, which complicates arbitrators' job to determine if a claim truly lacks legal merit. This complication creates a fertile ground for an unscrupulous investor who is disposed to exploit the arbitration process.

Although lacking palpable legal merit, frivolous claims are still able to harm the respondent states.[57] They also impair the efficiency of the ISDS system.[58] Since these claims are deprived of legal merit, they could be easily created and initiated by investors who seek to abuse the system.[59] An UNCTAD note frames these concerns:

> "The significant increase in investment disputes over the last decade has given rise to the concern that investors may abuse the system. Investors may be eager to claim as many violations of the applicable IIA as possible in order to increase their chances of success. This may take a heavy toll in terms of time, effort, fees and other costs, not only for the parties to the dispute, but also for the arbitral tribunal. It is within this context that several countries have advocated a procedure to avoid "frivolous claims" in investment-related disputes, namely claims that evidently lack a sound legal basis."[60]

55 Emmanuel Gaillard, *Chapter 9: Concurrent Proceedings in Investment Arbitration*, in Patricia Shaughnessy and Sherlin Tung (eds), The Powers and Duties of an Arbitrator: Liber Amicorum Pierre A. Karrer, (© Kluwer Law International; Kluwer Law International 2017) pp. 79 – 92, at 87.

56 *Id.*

57 Tsai-Fang Chen, *Deterring Frivolous Challenges in Investor-State Dispute Settlement,* 8 Contemp. Asia Arb. J. 61 (2015), at 65.

58 *Id.*

59 *Id.*

60 UNCTAD, *'Investor–State Dispute Settlement and Impact on Investment Rulemaking'* (UNCTAD/ITE/ IIA/2007/3), at 82, available at: https://unctad.org/en/Docs/iteiia20073_en.pdf, (last accessed 20 February 2021)

Identifying a frivolous claim in an ISDS setting poses some difficulties due to various reasons. First, instead of periodically receiving a predetermined salary, arbitrators are generally paid per hour or case.[61] This form of remuneration might entice arbitrators to exercise their discretion to interpret the "frivolousness" of the claims in their best interests and proceed with them as if they are legitimate. In so doing, they ensure the continuity of their remuneration, which is generally commensurate with the time they spend on the case. Second, arbitrators are not bound by the way the states interpret investment treaties. Therefore, there is always a possibility that arbitral tribunals' interpretations of a treaty provision are at variance with the intent of the states that drafted the said provision.[62] Simply put, a claim may be frivolous in the eyes of the states, while tribunals may think otherwise. Third, since there is no binding precedent or appeal practice in investor-state arbitration, a rejected claim due to lack of legal merit may be raised again without being barred.[63] All these grounds hand the opportunity of bringing frivolous cases to investors on a silver platter.

61 Brooke Guven & Lisa Johnson, *The Policy Implications of Third-Party Funding in Investor-State Dispute Settlement*, Columbia Center on Sustainable Investment, CCSI Working Paper (2019), at 22.

62 *Id.* at 21.

63 *Id.* at 22.

PART II

THE UNCLEAN HANDS DOCTRINE

Many national legal systems contain, in one way or another, the unclean hands doctrine, which manifests itself through the maxim, "he who comes into equity must come with clean hands."[64] The doctrine's primary aim is safeguarding the integrity of a judicial system.[65] It also promotes justice and the public interest.[66] It allows barring a claimant's claims that are connected with the claimant's improper or illegal conduct.[67]

A due analysis requires, in the first instance, a review of the status of the doctrine at the international level. Article 38(1)(c) of the statute of the International Court of Justice (hereinafter ICJ) lists "the general principles of law recognised by civilised nations" as a source of international law. Since the unclean hands doctrine is welcomed in a large number of countries' domestic legal orders, it was suggested in regard to the said article that the doctrine qualifies as a "general principle of law."[68] However, there have been different approaches to the application and the status of the doctrine in international law. For example, despite having had opportunities, the ICJ has not upheld the doctrine of unclean hands via a majority opinion so far.[69] James Crawford, United Nations International Law Commission's Special Rapporteur on State Responsibility, noted in his report that the unclean hands doctrine would not operate "as a circumstance precluding wrongfulness or responsibility" and concluded that "It is not possible to consider the 'clean hands' theory as an institution of general customary law."[70]

The ICJ did not reject, however, the existence of the doctrine in the form of a general principle of international law either. Although the existence of the

64 Aloysius Llamzon, *'Chapter 2: On Corruption's Peremptory Treatment in International Arbitration'*, in Domitille Baizeau and Richard H. Kreindler (eds), Addressing Issues of Corruption in Commercial and Investment Arbitration, Dossiers of the ICC Institute of World Business Law, Volume 13 (© Kluwer Law International; International Chamber of Commerce (ICC) 2015) pp. 32 – 50, at 37.

65 Caroline Le Moullec, *The Clean Hands Doctrine: A Tool for Accountability of Investor Conduct and Inadmissibility of Investment Claims,* The International Journal of Arbitration, Mediation and Dispute Management, Volume 84, Issue 1, February 2018, at 15.

66 William J. Lawrence, *"Application of the Clean Hands Doctrine in Damage Actions"* (1982), Volume 57, Issue 4, Notre Dame L. Rev. 673, at 675.

67 Llamzon, *supra* note 13, at 508.

68 *Id.* at 511.

69 *Id.* at 512.

70 James Crawford, Second Report on State Responsibility, 1999, DOCUMENT A/CN.4/498, at 83, paras. 333, 334, 336. Available at http://legal.un.org/ilc/documentation/english/a_cn4_498.pdf , (last accessed 12 January 2021)

doctrine has never been explicitly recognized by any of the international courts or arbitral tribunals, several judges, arbitrators, and commentators endorsed the doctrine. To illustrate, in the *Case Concerning the Diversion of Water from the River Meuse,* judge Ottmer pointed to the weight of the doctrine in international law by noting that " a tribunal bound by international law ought not to shrink from applying a principle of such obvious fairness."[71]

The dissenting opinion of judge Schwebel in the *Nicaragua* case before the ICJ is another example of a depiction of the nature and the scope of the unclean hands doctrine in international law.[72] To him, misleading the court regarding its wrongful conduct was sufficient to accept that Nicaragua had unclean hands, and therefore, its claims needed to fail.[73] In his opinion, judge Schwebel also referred to the comments of Fitzmaurice who, before his election to the ICJ, had noted: "Thus a State which is guilty of illegal conduct may be deprived of the necessary *locus standi in judicio* for complaining of corresponding illegalities on the part of other States, especially if these were consequential on or were embarked upon in order to counter its own illegality-in short were provoked by it."[74]

1. The unclean hands doctrine in international investment arbitration

The ISDS system safeguards foreign investments against host states by holding the governments accountable in the circumstances where they misuse their sovereign powers over investors. Bearing in mind the fact that the ISDS system was designed to protect foreign investors, the argument according to which investors with unclean hands should not be granted their claims in arbitral proceedings may not be easy to substantiate. Ascertaining if investors'

71 Mojtaba Dani & Afshin Akhtar-Khavari, *Rethinking the Use of Deference in Investment Arbitration: New Solutions against the Perception of Bias,* 22 UCLA J. Int'l L. Foreign Aff. 37 (2018), at 60.

72 Carolyn B. Lamm, Hansel T. Pham, et al., *'Fraud and Corruption in International Arbitration'*, in Miguel Angel Fernandez-Ballester and David Arias (eds), Liber Amicorum Bernardo Cremades, (© Wolters Kluwer España; La Ley 2010) at 724.

73 *Id.* Judge Schwebel stated: "Nicaragua has not come to Court with clean hands. On the contrary, as the aggressor, indirectly responsible — but ultimately responsible — for large numbers of deaths and widespread destruction in El Salvador apparently much exceeding that which Nicaragua has sustained, Nicaragua's hands are odiously unclean. Nicaragua has compounded its sins by misrepresenting them to the Court. Thus both on the grounds of its unlawful armed intervention in El Salvador, and its deliberately seeking to mislead the Court about the facts of that intervention through false testimony of its Ministers, Nicaragua's claims against the United States should fail."

74 Case Concerning Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v. United States of America), Judgment of 27 June 1986, Dissenting Opinion of Judge Schwebel, I.C.J. Reports 1986 at 394, § 271, available at https://www.icj-cij.org/files/case-related/70/070-19860627-JUD-01-09-EN.pdf (last accessed 26 February 2021)

actions were conducted with unclean hands could be rather complicated as the relevant provisions of the applicable treaties differ.[75] In the same vein, the ISDS system's notoriety as to investor obligations also complicates invoking the unclean hands doctrine.[76] Still, host states have repeatedly invoked the doctrine as a fulcrum in their quests to hold the investors accountable for their wrongdoings.

Arbitral tribunals' have adopted three approaches in their assessment of the cases involving unclean hands defenses against investors: (i) dismissal due to the lack of jurisdiction, (ii) dismissal due to inadmissibility, and (iii) addressing the issue at the merits phase.[77] To date, the majority of the tribunals have taken the first two approaches. The third approach was adopted by the *Yukos* tribunal that denied the doctrine's existence as a general principle of international law.[78] In some instances, tribunals prefer not to use the term "unclean hands" in their awards in which they apply the doctrine. Instead, they refer to a number of Latin maxims deemed as expressions or manifestations of the doctrine.[79] In this sense, the principle *"nemo auditur propriam turpitudinem allegans"* is regarded as one of the most frequently applied ones by tribunals.[80]

75 Le Moullec, *supra* note 65, at 7.

76 *Id.*

77 Dani, *supra* note 71, at 58.

78 *Yukos Universal Limited (Isle of Man) v The Russian Federation*, UNCITRAL, PCA Case No AA 227, Final Award, 18 July 2014, ¶¶ 1358, 1359.

79 Patric Dumberry, *State of Confusion: The Doctrine of 'Clean Hands' in Investment Arbitration After the Yukos Award*, 17 Journal of World Investments and Trade (2016), 229-259. at 235.; See also *Inceysa, supra* note 12, ¶ 240, The tribunal stated a number of Latin maxims that apply to the case before it: *Ex dolo malo non oritur actio"* (an action does not arise from fraud), *"Malitiis nos est indulgendum"* (there must be no indulgence for malicious conduct), *"Dolos suus neminem relevat"* (no one is exonerated from his own fraud), *"In universum autum haec in ea re regula sequenda est, ut dolos omnimodo puniatur"* (in general, the rule must be that fraud shall be always punished). *"Unusquique doli sui poenam sufferat"* (each person must bear the penalty for his fraud), *"Nemini dolos suusprodesse debet"* (nobody must profit from his own fraud); See also Aloysius Llamzon, *'Yukos Universal Limited (Isle of Man) v The Russian Federation: The State of the "Unclean Hands" Doctrine in International Investment Law: Yukos as Both Omega and Alpha'* ICSID Review, Vol. 30, No. 2 (2015), pp. 315–325, at 316, in the footnote 8 Llamzon gives examples of the Roman maxims from which the unclean hands doctrine stemmed: "ex delicto non orituractio (an unlawful act cannot serve as the basis of an action at law), nemo ex suo delicto meliorem suam conditionem facit (no one can put himself in a better legal position by means of a delict), ex turpi causa non oritur (an action cannot arise from a dishonourable cause), inadimplenti non est adimplendum (one has no need to respect his obligation if the counter-party has not respected its own) and nullus commodum capere potest de in juria sua propria (no one can be allowed to take advantage of his own wrong)."

80 *E.g., Inceysa, supra* note 12; *Plama, supra* note 34.

2. The Unclean hands doctrine and investor misconduct

Arbitral case law points to a correlation between the unclean hands doctrine and "in accordance with the law" clauses in investment treaties.[81] Following this, some commentators argue that the doctrine manifests itself in the form of the legality requirement.[82] In other words, to them, tribunals need to apply the unclean hands doctrine in considering if an investment is under the protection of an investment treaty containing an "in accordance with the law" clause.[83] As per this interpretation, the doctrine could be invoked by a host state against an investor whose conduct is of an illegal nature. Hence, it is fair to say that arbitral case law points to the employment of this doctrine in relation to corruption and fraud allegations.

On the other hand, the *Hamester* tribunal took a broader approach according to which the unclean hands doctrine can also be invoked where the conduct in question is not illegal but violates the principle of good faith.[84] The tribunal suggested that an investment established in violation of the principle of good faith would not be protected by international investment agreements.[85] This reasoning of the *Hamester* tribunal opened the door for the possibility that the doctrine could be invoked by aggrieved host states as a remedy for almost any type of investor misconduct, including abuse of process, committed at the time of the making of the investment.

In order to perform a due analysis of the role the doctrine plays in remedying investor misconduct, salient examples of relevant arbitral case law need to be studied. The *Niko Resources* tribunal discussed the doctrine thoroughly.[86] The tribunal expressed doubt as to whether the doctrine was a part of international law and noted that its content was ill-defined.[87] The tribunal observed: "The

81 *E.g., Inceysa, supra* note 12, ¶ 195; *World Duty Free, supra* note 12.

82 Dumberry, *supra* note 79, at 232.

83 *Id.* at 235.

84 *Hamester, supra* note 36.

85 *Id.* ¶ 123. The tribunal noted that "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."

86 *Niko Resources (Bangladesh) Ltd. v. Bangladesh Petroleum Exploration & Production Company Limited ("Bapex") and Bangladesh Oil Gas and Mineral Corporation ("Petrobangla")*, ICSID Case No. ARB/10/11 and ARB/10/18, Decision on Jurisdiction, 19 August 2013.

87 *Id.* ¶ 477. The respondent state invoked the doctrine as "jurisdiction should be denied because the Claimant has violated the principles of good faith and international public policy, in a manner intimately linked to the alleged investment. The Tribunal is empowered to protect the integrity of the ICSID dispute settlement mechanism by dismissing a claim which represents a violation of fundamental principles of law. The Claimant does not bring

principle of clean hands is known as part of equity in common law countries. The question whether the principle forms part of international law remains controversial and its precise content is ill defined."[88] In its assessment, the tribunal partly relied upon the award issued by a United Nations Convention on the Law of the Sea (hereinafter UNCLOS) tribunal in the *Guyana v. Surinam* case.[89] The tribunal noted that there was no generally accepted definition of the unclean hands doctrine in international law, and its application had been inconsistent.[90] The *Niko Resources* tribunal preferred to shy away from the contentions involving issues such as transnational public policy, bad faith, and the doctrine being a general principle of international law. Instead, it noted that the doctrine required reciprocity between the relief the investor seeks and the investor's past actions characterized as involving unclean hands by the host state.[91] In other words, in the tribunal's view, if the misconduct is not related to the investor's claims before the tribunal, the doctrine would not be triggered.[92] The tribunal employed a legal test made up of three elements that were used by the abovementioned UNCLOS arbitral tribunal and concluded that the respondent government failed the test.[93]

As has been discussed above, per arbitral case law, the unclean hands doctrine relates to "in accordance with law" clauses.[94] *Inceysa* is a notable

this claim with clean hands." ¶ 376.

88 *Id.* ¶ 477.

89 *Guyana v. Suriname*, PCA, Award of 17 September 2007 (under UNCLOS Ch VII). The Tribunal was composed of Judge Dolliver M. Nelson, Professor Thomas Franck, Dr. Kamal Hossain, Professor Ivan Shearer and Professor Hans Smit.

90 *Niko Resources*, *supra* note 86, ¶ 477. The tribunal quoted the following observation of the Guyana v. Surinam UNCLOS tribunal: "No generally accepted definition of the clean hands doctrine has been elaborated in international law. Indeed, the Commentaries of the ILC Draft Articles on State Responsibility acknowledge that the doctrine has been applied rarely and, when it has been invoked, its expression has come in many forms. The ICJ has on numerous occasions declined to consider the application of the doctrine, and has never relied on it to bar admissibility of a claim or recovery. However, some support for the doctrine can be found in dissenting opinions in certain ICJ cases, as well as in opinions in cases of the Permanent Court of International Justice ('PCIJ'). [...] These cases indicate that the use of the clean hands doctrine has been sparse, and its application in the instances in which it has been invoked has been inconsistent."

91 *Niko Resources*, *supra* note 86, ¶ 483.

92 Llamzon, *supra* note 13, at 516.

93 *Niko Resources*, *supra* note 86, ¶ 481. To the tribunal the components of the test was as follows: "(i) the breach (investor's conduct said to engender unclean hands) must concern a continuing violation, (ii) the remedy sought must be 'protection against continuance of that violation in the future', not damages for past violations and (iii) there must be a relationship of reciprocity between the obligations considered."; See also *Guyana v. Suriname*, Award of 17 September 2007, ¶¶ 420-421.

94 Dumberry, *supra* note 79, at 232.

example of the interpretation and the application of this clause.[95] The tribunal examined whether an investment made in violation of the host state law qualifies as an investment under the relevant treaty. In response to the investor's claims, objecting to the jurisdiction of the tribunal, the government argued that the claimant had obtained the concession contract by defrauding the government in the bidding process and therefore violated the legality clause contained in the BIT. In its investigation, the tribunal found out that the claimant intentionally lied about the identity, experience, and capacity of its strategic partner with the intention of making the government believe that its partner was qualified enough to comply with the terms of the contract.[96] The tribunal explained:

> "Applying the first principle indicated above to the case at hand, we can affirm that 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.'"[97]

The tribunal decided that Inceysa's investment violated the principle *"nemo auditur propriam turpitudinem allegans"* and noted: "No legal system based on rational grounds allows the party that committed a chain of clearly illegal acts to benefit from them."[98]

In *Inceysa,* the tribunal considered the application of unclean hands doctrine through the legality clause in the relevant BIT. Yet, how do the tribunals consider the applicability of the doctrine in the situations where the applicable treaty does not contain an express "in accordance with the law" provision? The consideration of the *Plama* tribunal constitutes a good illustration of a case where the applicable treaty is the Energy Charter Treaty (hereinafter ECT), a treaty that does not have a legality clause.[99] The tribunal ruled that the absence of legality clause in the ECT did not necessarily mean that it covers the investments made contrary to domestic or international law. The tribunal noted that the claimant made the investment with a deliberate concealment that amounted to fraud.[100] In lieu of mentioning the term "unclean hands" in its award, the tribunal, as was the case in *Inceysa*, preferred to refer to the *"nemo auditur propriam turpitudinem allegans"* principle: "The Tribunal is of the view that granting the ECT's protections to Claimant's investment would be

95 *Inceysa, supra* note 12.

96 Llamzon, *supra* note 13, at 475; *Inceysa, supra* note 12, ¶¶ 111-118, 236.

97 *Inceysa, supra* note 12, ¶ 242.

98 *Id.* ¶¶ 240, 244.

99 *Plama, supra* note 34.

100 *Id.* ¶¶ 134, 135.

contrary to the principle nemo auditur propriam turpitudinem allegans […]"[101] By referring to a principle that is deemed a manifestation of the clean hands doctrine, the tribunal implicitly applied the doctrine.

The *Yukos* tribunal, however, adopted a drastically different approach in assessing the status of the unclean hands doctrine in international law.[102] The tribunal, stressing the controversy over the issue, rejected the existence of the clean hands doctrine as a general principle of law:

> "The Tribunal is not persuaded that there exists a 'general principle of law recognized by civilized nations' within the meaning of Article 38(1)(c) of the ICJ Statute that would bar an investor from making a claim before an arbitral tribunal under an investment treaty because it has so-called 'unclean hands.' General principles of law require a certain level of recognition and consensus. However, on the basis of the cases cited by the Parties, the Tribunal has formed the view that there is a significant amount of controversy as to the existence of an 'unclean hands' principle in international law."[103]

The *Yukos* tribunal preferred to base its decision mostly on the issue of legality and noted that, as was in *Plama*, the lack of a legality clause in the treaty would not rule out the requirement that investments need to be made in accordance with the law of host state.[104] In this context, some commentators argue that the tribunal recognized the unclean hands doctrine, with a limited range.[105]

The *Al-Warraq* tribunal, rendering its decision only six months after the *Yukos* award, had a different perspective.[106] The claim was filed under the UNCITRAL Arbitration Rules and Agreement on the Promotion, Protection and Guarantee of Investments among Member States of the Organization of Islamic Conference (hereinafter OIC Agreement). Neither of them contains

[101] *Id.* ¶ 143.
[102] *Yukos, supra* note 78, ¶¶ 1358, 1359.
[103] *Id.*
[104] *Id.* ¶ 1352. The tribunal noted: "In imposing obligations on States to treat investors in a fair and transparent fashion, investment treaties seek to encourage legal and *bona fide* investments. An investor who has obtained an investment in the host State only by acting in bad faith or in violation of the laws of the host state, has brought itself within the scope of application of the ECT through wrongful acts. Such an investor should not be allowed to benefit from the Treaty."
[105] Dumberry, *supra* note 79, at 239; Andrea K. Bjorklund & Lukas Vanhonnaeker, *Yukos: The Clean Hands Doctrine Revisited* (2015) vol. 9:2 Diritti umani e diritto internazionale, pp. 365-386, at 372.
[106] *Hesham Talaat M. Al-Warraq v. Indonesia,* Arbitration under the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference, Final Award ,15 December 2014.

a legality requirement clause. The tribunal noted that the claimant violated the OIC Agreement by failing to abide by the Indonesian laws and therefore was not entitled to the protection by OIC Agreement.[107] Using the term "clean hands doctrine" in the award, the tribunal concluded that the claims were inadmissible as a result of the application of the unclean hands doctrine.[108] The tribunal opined:

> "The tribunal is of the view that the doctrine of 'clean hands' renders the Claimant's claim inadmissible. […] The Tribunal finds that the Claimant's conduct falls within the scope of application of the 'clean hands' doctrine, and therefore cannot benefit from the protection afforded by the OIC Agreement."[109]

This author believes that limiting the invocation of unclean hands doctrine to the instances where a violation of the "in accordance with the law" clauses at stake would reduce the scope and effectiveness of the doctrine by leaving out the instances of abuse of process. After all, an abusive conduct of an investor has nothing to do with the "in accordance with the law" clause in the applicable treaty as the said conduct is not illegal *per se.* Although the reasoning of the *Hamester* tribunal is a positive step in a broader application of the doctrine, it is not enough since it refers to the principle good faith only at the time of the making of the investment.[110] If the tribunal's referral involved the operational period of the investment, the doctrine would cover a larger variety of investor misconduct.

3. Can the unclean hands doctrine remedy investor misconduct?

A due examination of the status of the doctrine in international law is needed in the first place to answer this question. Whether the doctrine is among the general principles of law is of great importance as these principles serve as a source of international law.[111] Undoubtedly, tribunals do not have the luxury of being indifferent to these principles. In other words, recognition of the unclean hands doctrine as a general principle of law would enable an arbitral tribunal to apply it when deciding the cases involving investor misconduct. Bassiouni put it wisely:

[107] *Id.* ¶ 645.
[108] *Id.* ¶¶ 646, 647.
[109] *Id.* The tribunal referred to the decision of Lord Mansfield in Holman v. Johnson (1775) tribunal. The relevant part of the said decision reads: "No court will lend its aid to a man who founds his cause of action upon an immoral or illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise ex turpi causa, or the transgression of a positive law of this country, there the court says he has no right to be assisted."
[110] *Hamester, supra* note 36, ¶ 123.
[111] M. Cherif Bassiouni, *A Functional Approach to "General Principles of International Law*, 11 Mich. J. Int'l L. 768 (1990), at 768.

> "how could one redress an *abus de droit* without resort to "General Principles"? A pragmatic approach to this function of "General Principles" is that the judge, in the absence of an applicable rule of international law, in order to fill a legal gap, may rely on a principle derived from the national legal systems which represent the major systems of jurisprudence in the world, or from those systems whose legal traditions more particularly apply to the specific case at hand."[112]

The *Yukos* tribunal clearly expressed that being deemed a general principle of law requires a certain level of recognition and consensus.[113] Still, where should we seek this recognition and consensus? Article 38(1)(c) of the ICJ points out that the general principles of law are those that are recognized by civilized nations. Similarly, *Inceysa* tribunal noted that the general principles of law "are rules of law on which the legal systems of the states are based."[114] This begs the question: How many states need to endorse the doctrine for it to be considered as a general principle of law? Bassiouni says no quantitative or numerical test exists for states in this sense and universal acceptance is not needed for a rule to be deemed a general principle of law.[115] The doctrine's application rests in the interpretation of the tribunals in this regard. There exist substantial arguments supporting the status of the doctrine as a general principle of law.

As the *Yukos* award put it correctly, the status of the unclean hands doctrine in international law is not well-established. International courts and arbitral tribunals have had different considerations, and there has been unwillingness as to the recognition of the existence of the doctrine.[116] Still, as indicated above, there has also been a considerable amount of support for the application of the doctrine. A vast number of scholars regard the doctrine a general principle of law.[117] Even when they do not directly refer to "unclean hands doctrine", tribunals referred the Latin maxims that are used as manifestations of the doctrine. Besides, prominent judges endorsed the doctrine. A large number of states included the doctrine in their domestic law as well.[118]

CONCLUSION

The ISDS system was established in an attempt to provide foreign investors with substantial protections and rights against host states in which they operate.

[112] *Id.* at 779.
[113] *Yukos, supra* note 78, ¶¶ 1358, 1359.
[114] *Inceysa, supra* note 12, ¶ 227.
[115] Bassiouni, *supra* note 111, at 788; *See* also Dumberry, *supra* note 79, at 248.
[116] Dumberry, *supra* note 79, at 246.
[117] *Id.* at 250.
[118] *Id.*

INVESTOR MISCONDUCT IN INTERNATIONAL INVESTMENT ARBITRATION: CAN THE UNCLEAN HANDS DOCTRINE BE A CURE?
Dr. M. Üzeyir KARABIYIK

These protections were secured through international investment treaties. Despite the system's asymmetries favoring foreign investors, states have signed bilateral and multilateral treaties in the expectation that these treaties would contribute to attracting foreign investment and cash flow therewith to their land. Within the last two decades, investor-state arbitration has become more popular than ever. Taking advantage of the pro-investor nature of the system as well as its structural defects, investors have increasingly resorted to wrongful conduct to maximize their profits or achieve favorable results in their disputes with host states. Moreover, investors are using ISDS as leverage to extract favorable concessions or payoffs. This article has categorized investor misconduct as corruption, fraud and abuse of process; then discussed the applicability of the unclean hands doctrine as a cure.

Arbitral case law points to the inconsistent application of the doctrine by tribunals. Despite its unsettled nature, the unclean hands doctrine remains a useful tool for tribunals to curb investor misconduct especially where there is no legality clause in the applicable treaty. In cases where legality clauses in treaties do not matter much due to the fact that investor misconduct in question is not *prima facie* illegal, the doctrine is functional as it helps arbitrators to effectively employ fundamental values such as justice, integrity and the public interest when deciding a case. These values play a vital role in addressing *mala fide* conduct including investors' abusive practices.

REFERENCES

Andrea K. Bjorklund & Lukas Vanhonnaeker, *Yukos: The Clean Hands Doctrine Revisited* (2015) vol. 9:2 Diritti umani e diritto internazionale.

Aloysius Llamzon & Anthony C.Sinclair, *Investor Wrongdoing in Investment Arbitration: Standards Governing Issues of Corruption, Fraud, Misrepresentation and Other Investor Misconduct,* in Albert Jan van den Berg (ed), Legitimacy: Myths, Realities, Challenges, ICCA Congress Series, Volume 18 (© Kluwer Law International; Kluwer Law International 2015)

Aloysius Llamzon, *'Chapter 2: On Corruption's Peremptory Treatment in International Arbitration'*, in Domitille Baizeau and Richard H. Kreindler (eds), Addressing Issues of Corruption in Commercial and Investment Arbitration, Dossiers of the ICC Institute of World Business Law, Volume 13 (© Kluwer Law International; International Chamber of Commerce (ICC) 2015)

Brooke Guven & Lisa Johnson, *The Policy Implications of Third-Party Funding in Investor-State Dispute Settlement*, Columbia Center on Sustainable Investment, CCSI Working Paper (2019)

Bruce W. Klaw, *State Responsibility for Bribe Solicitation and Extortion: Obligations, Obstacles, and Opportunities*, 33 Berkeley J. Int'l L. 60 (2015)

CAMPBELL MCLACHLAN, LAURENCE SHORE & MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (2 ed. 2017)

Caroline Le Moullec, *The Clean Hands Doctrine: A Tool for Accountability of Investor Conduct and Inadmissibility of Investment Claims,* The International Journal of Arbitration, Mediation and Dispute Management, Volume 84, Issue 1, February 2018

Carolyn B. Lamm, Hansel T. Pham, et al., *'Fraud and Corruption in International Arbitration'*, in Miguel Angel Fernandez-Ballester and David Arias (eds), Liber Amicorum Bernardo Cremades, (© Wolters Kluwer España; La Ley 2010)

Carolyn B. Lamm & Andrea J. Menaker, 'Chapter 31: *Consequences of Corruption in Investor State Arbitration*, in Meg Kinnear, Geraldine R. Fischer, et al. (eds), Building International Investment Law: The First 50 Years of ICSID, (© Kluwer Law International, 2016)

Emmanuel Gaillard, *Chapter 9: Concurrent Proceedings in Investment Arbitration*, in Patricia Shaughnessy and Sherlin Tung (eds), The Powers and Duties of an Arbitrator: Liber Amicorum Pierre A. Karrer, (© Kluwer Law International; Kluwer Law International 2017)

Emmanuel Gaillard*, Abuse of Process in International Arbitration,* ICSID Review, (2017)

Florian Haugeneder, *Corruption in Investor-State Arbitration*, 10 J. World Investment & Trade 323 (2009)

George Kahale III, '*The new Dutch sandwich: The issue of treaty abuse'*, Columbia FDI Perspectives, No: 48, (10 October 2011)

Herve Ascensio, *Abuse of Process in International Investment Arbitration*, 13 Chinese J. Int'l L. 763 (2014)

JORUN BAUMGARTNER, TREATY SHOPPING IN INTERNATIONAL INVESTMENT LAW, (2016)

Julia G. Brown, *International Investment Agreements: Regulatory Chill in the Face of Litigious Heat*, 3 W. J. Legal Stud. [i] (2013)

Mojtaba Dani & Afshin Akhtar-Khavari, *Rethinking the Use of Deference in Investment Arbitration: New Solutions against the Perception of Bias,* 22 UCLA J. Int'l L. Foreign Aff. 37 (2018)

M. Cherif Bassiouni, *A Functional Approach to "General Principles of International Law*, 11 Mich. J. Int'l L. 768 (1990)

NATHAN JENSEN & GLEN BIGLAISER, POLITICS AND FOREIGN DIRECT INVESTMENT (2014).

Patric Dumberry, *State of Confusion: The Doctrine of 'Clean Hands' in*

Investment Arbitration After the Yukos Award, 17 Journal of World Investments and Trade (2016)

Sergio Puig & Gregory Shaffer, *Imperfect Alternatives: Institutional Choice and the Reform of Investment Law*, 112 American Journal of International Law 361–409 (2018)

Thomas Kendra & Anna Bonini*, Dealing with Corruption Allegations in International Investment Arbitration: Reaching a Procedural Consensus,* Journal of International Arbitration vol. 31, no. 4 (August 2014)

Thomas, Obersteiner, *"In Accordance with Domestic Law" Clauses: How International Investment Tribunals Deal with Allegations of Unlawful Conduct of Investors.* Journal of International Arbitration 31, no.2 (2014)

Tsai-Fang Chen, *Deterring Frivolous Challenges in Investor-State Dispute Settlement,* 8 Contemp. Asia Arb. J. 61 (2015)

Vaughan Lowe, *Overlapping Jurisdiction in International Tribunals*, AYBIL, Volume 20, (1999)

William J. Lawrence, *Application of the Clean Hands Doctrine in Damage Actions* (1982) 57 Notre Dame L. Rev. 673

ZIMMERMANN ET AL., THE STATUTE OF THE INTERNATIONAL COURT OF JUSTICE: A COMMENTARY (2006)

CASES

ICJ Case Concerning Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v. United States of America), Judgment of 27 June 1986, Dissenting Opinion of Judge Schwebel.

Gustaf F. W. Hamester GmbH amp; Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24, Award, 18 June 2010

Guyana v. Suriname, PCA, Award of 17 September 2007 (under UNCLOS Ch. VII)

Hesham Talaat M. Al-Warraq v. Indonesia, Arbitration under the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference, Final Award ,15 December 2014.

Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No. ARB/03/26), Award, 2 August 2006

Niko Resources (Bangladesh) Ltd. v. Bangladesh Petroleum Exploration & Production Company Limited ("Bapex") and Bangladesh Oil Gas and Mineral Corporation ("Petrobangla"), ICSID Case No. ARB/10/11 and ARB/10/18, Decision on Jurisdiction, 19 August 2013.

Plama Consortium Limited v. Bulgaria, ICSID Case No. ARB/03/24,

Award, 27 August 2008
Yukos Universal Limited (Isle of Man) v The Russian Federation, UNCITRAL, PCA Case No AA 227, Final Award, 18 July 2014