Investors' Illegality in Investor-State Arbitration

-Panayotis M. Protopsaltis*

1. Introduction

The asymmetry of rights and obligations between investors and States and the problem of introduction of investors' obligations monopolised the discussions on the content of international investment law since the 1960s. The failure of the attempts to impose international duties on multinational corporations through codes of conduct in the 1990s coupled with concerns over the ever-increasing power of arbitral tribunals perceived to favour investors' rights in the 2000s were some of the forces behind the backlash against investment arbitration.[1] Perhaps reacting to accusations of pro-investor bias, some arbitral tribunals tried to address investors' conduct within the existing legal framework, the pre-existing provisions in Bilateral Investment Treaties (BITs) and in International Investment Agreements (IIAs) adopted primarily for the protection of investors' rights. These efforts, according to some authors, led to the re-equilibration of the system in investor - State arbitration through the transition from the focus on States' responsibility to that on investors' responsibility.[2]

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*Research Fellow, Centre for American Legal Studies, Faculty of Business, Law and Social Sciences, Birmingham City University, U.K. The author may be contacted at: <pprotopsalt@gmail.com>.

[1]Waibel, M., Kaushal, A., Chung, K.-H. & Balchin, C., "The Backlash against Investment Arbitration: Perceptions and Reality", *Kluwer Law International* (2010).

[2]*See*, for example, the recently defended doctoral thesis of Inès El Hayek, La prise en compte du comportement de l'investisseurdans le cadre de l'arbitragefondésur les traitésd'investissement (Université de Paris I – Panthéon-Sorbonne 2017).

A prime example of these attempts relates to the interpretation of the so-called 'in accordance with the law' or 'legality requirement' provisions.[3] Originally introduced in the treaties of Friendship, Commerce and Navigation (FCN),[4] these provisions are today, albeit in various forms,[5] included in most modern BITs and in a number of multilateral instruments.[6] For many years, these provisions received limited attention, on the assumption that they referred to host States' procedures of admission of foreign investments.[7] With the exception of Sornarajah who first claimed that they establish an obligation of investors to comply with the laws and regulations of the host country,[8] scholars rarely invoked these provisions in the context of the discussion on investor's duties. Although in the ELSI case, in relation to the legality requirement provision of the US-Italy FCN Treaty, the ICJ referred to the obligation of foreign nationals or companies to conform to local applicable law,[9] UNCTAD seems to

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[3]Dolzer, R. & Schreuer, C., "Principles of International Investment Law", *Oxford University Press*, 89 (2012); Joubin-Bret, A., "Admission and Establishment in the Context of Investment Promotion", *in* Hoffman, A.K., *Protection of Foreign Investment through Modern Treaty Arbitration* (ASA Special Series No. 34/2010), p. 10; Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18, Decision on Jurisdiction of 29 April 2004, ¶ 84.

[4]*See*, for example, US-Italy FCN Treaty (1948), Art. III, *in* Elettronica Sicula S.p.A. (ELSI), (United States of America v. Italy), Judgement of 20 July 1989, *ICJ Rec.* 1989, ¶ 68.

[5]Inceysa Vallisoletana, S.L. v. Republic of El Salvador, ICSID Case no.ARB/03/26, Award of 2 August 2006, ¶ 186.

[6]Protopsaltis, P.M., 'Compliance with the Laws of the Host Country in Bilateral Investment Treaties' in Αίνος μνήμης Καθηγητού Ηλία Κρίσπη: Συμβολές στην επιστήμη του δικαίου και των διεθνών σχέσεων (Sakkoulas 2015), pp. 583-585.

[7]Poulain, B., 'La conformité de l'investissement au droit local dans le contentieux investisseur – État', 2007/4 *Les Cahiers de l'arbitrage, Gaz. Pal.*du 14-15 décembre 2007, p. 44; Aguasdel Tunari, S.A. v. Republic of Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction of 21 October 2005, ¶ 146.

[8]Sornarajah, M., "Protection of Foreign Investment in the Asia-Pacific Economic Co-operation Region", *Journal of World Trade*, 29, 116 (1995).

[9]Elettronica Sicula S.p.A. (ELSI), United States of America v. Italy, [1989] ICJ Rep 15.

have noticed the possible effects of these provisions only in the late 1990s.[10]

The first arbitral award referring to a legality requirement provision included in the definition of investments covered in a BIT was rendered in 2001 in the Salini case. The Tribunal ruled that the relevant provision referred to the validity of the investment and not to its definition, [11] thus allowing for the disqualification from protection investments that are illegal under the law of the host country. Despite criticism against its theoretical acrobacy, [12] this award paved the way for the denial of BITs' protection to illegal investments.[13] Commenting on the Fraport award in 2007, Knahr observed that 'this award could 'open the gate' for states to make alleged violations of their domestic law by investors a regular objection to the jurisdiction of ICSID tribunals'.[14] Carlevaris rightly predicted a year later, that the meaning of the legality requirement provisions is likely to become increasingly relevant in future proceedings not only due to the growing frequency with which the clauses at hand recur in international instruments, but also due to two...decisions', in the Inceysa and the Fraport cases, 'in which two tribunals declined jurisdiction after having found that the investment agreements had been concluded in breach of the local law'.[15]

Both were right. Investment's illegality has become a regular objection of host countries and arbitral awards gradually defined the

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[10] *Scope and Definition*, UNCTAD, 24, available at http://unctad.org/en/Docs/psiteiitd11v2.en.pdf; *cf. World Investment Report 2003*, UNCTAD, 167, available at http://unctad.org/en/docs/wir2003light_en. pdf.

[11] SaliniCostruttoriS.p.A. and ItalstradeS.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/04; *cf.* Schill, S.W., "Illegal Investments in Investment Treaty Arbitration", Law &Prac. Int'l Cts. & Tribunals, 11, 284 (2012); Knahr, Ch., "Investments 'in accordance with the host state law", *TDM*, 4, 3(2007).

[12] Douglas, Z., "The Plea of Illegality in Investment Treaty Arbitration" *ICSID Rev.-FILJ*, 29, 172 (2014).

[13] *Supra* note 3, at 20.

[14] *Supra* note 11, at 18.

[15] Carlevaris, A., "The Conformity of Investments with the Law of the Host State and the Jurisdiction of International Tribunals", *Journal of World Investment and Trade*, 9, 35 (2008).

conditions of application and the effects of the legality requirement provisions. Interestingly enough, some arbitral tribunals went further to consider the existence of a 'general rule that for a foreign investment to enjoy treaty protection it must be lawful under the law of the host State',[16] even in the absence of a relevant provision in the applicable BIT or IIA. Furthermore, some tribunals sought to deprive protection to investors failing to respect the rules of international law.

Despite their differences, the relevant awards nowadays generally agree that the legality requirement provisions establish an obligation of investors to comply with the laws and regulations of the host country. Furthermore, they seem to agree on the conditions of application of the legality requirement provisions relating to the conduct of the investor (wrongfulness) and of the State (circumstances precluding wrongfulness) that may trigger investors' responsibility for illegal investments.[17] In contrast, they have not been consistent with respect to the yardsticks of illegality or with respect to the effects of the illegality for the investor involved. In the first part of this article we will analyse the relevant awards relating to the requirement of compliance with national and with international law. The second part shall concentrate on the denial of protection of illegal investments and the arguments in favour of the restriction of the tribunals' power to deny jurisdiction.

2. THE YARDSTICKS OF ILLEGALITY

Arbitral tribunals relied on explicit or implicit legality requirement provisions in the applicable BITs and IIAs in order to examine the investor's initial or continuous compliance with the law of the host State or with the fundamental principles of the host State's law at the exclusion of investors' minor breaches. However, some tribunals went further to examine investors' conduct in the light of international law.

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[16] Yaung Chi Oo Trading Pte.Ltd. v. Government of the Union of Myanmar, ASEAN I.D. Case No.ARB/01/1.

[17] *Supra* note 6, at 586-595.

2.1. Compliance with National law

Already in the ELSI case the ICJ had ruled that the reference to compliance with applicable laws and regulations in the US-Italy FCN Treaty'surely means no more than that Italian corporations and associations controlled by United States nationals must conform to the local applicable laws and regulations'.[18] In relation to an 'in accordance with the laws and regulations of the ... party' provision, the Tribunal in the Salini case contemplated illegality under national law in order to conclude that 'it has never been shown that the Italian companies infringed the laws and regulations of the Kingdom of Morocco'.[19] In the Tokios Tokelés case, in relation to the legality requirement provision of the applicable BIT, the Tribunal wondered 'whether the alleged violations establish that the assets invested by the Claimant were invested not "in accordance with the laws and regulations of" Ukraine'.[20] In the Mytilineos case, the Tribunal relied on Salini and Tokios Tokelés to rule in relation to a legality requirement provision 'that for the purposes of the BIT the investment has been made in accordance with the laws of Serbia and Montenegro and is thus protected under the BIT'.[21]

A number of subsequent awards followed the same approach. In other words, through the legality requirement provisions, host State's law becomes the yardstick of the legality of the investment and a condition for its protection. BITs' legality requirement provisions therefore introduce an exception to the general rule that a State cannot invoke its internal law to evade international responsibility.[22]

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[18] *Supra* note 9, at ¶ 72.

[19] Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/04.

[20] Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18.

[21] Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia (UNCITRAL), Partial Award on Jurisdiction, 8 September 2006, ¶ 152.

[22] Vienna Convention on the Law of the Treaties (1969), art.27; Draft articles on Responsibility of States for Internationally Wrongful Acts (2001), art. 3.

However, arbitral tribunals did not analyse the process by which the relevant norms of domestic law apply in the international legal order. In the Fraport case, the Tribunal explained that the relevant legality requirement provision of the applicable BIT 'effect a renvoi to national law, a mechanism which is hardly unusual in treaties and, indeed, occurs in the Washington Convention. A failure to comply with the national law to which a treaty refers will have an international legal effect'.[23] According to De Visscher'[o]n est fondé à parler de référence (ou renvoi) quand la mise en application d'une norme relevant d'un ordre juridique donné exige le recours à une notion relevant d'un autre ordre juridique'.For example, when deciding on the right of a State to exercise diplomatic protection in favour of an individual, an international judge will previously verify whether this individual is a national of the State according to its national law.[24] By virtue of this renvoi, the tribunal does not apply national law in the strict sense, as Judge Morelli put it, 'no subordination of international responsibility, as such, to the provisions of municipal law is involved; the point is rather that the very existence of the international obligation depends on a state of affairs created in municipal law, though this is so not by virtue of municipal law but, on the contrary, by virtue of the international rule itself, which to that end refers to the law of the State.[25] Thus, according to Vierucci, 'the international legal order accepts to apply a legal rule created by the national legal order' and '[a]s a consequence, the international judge does not properly apply national law but the international law rule referring to the national one'[26] while, according to Gaja, municipal laws will 'be treated by an

[23]Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25.

[24]De Visscher, Ch., La notion de référence (renvoi) au droit interne dans la protection diplomatique des actionnaires de sociétés anonymes, *Revue Belge de Droit International*, 7, 2 (1971).

[25]*Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain) (Second Phase)*, [1970] ICJ Rep 3.

[26]Vierucci, L., "Special Agreements' between Conflicting Parties in the Case-law of the ICTY', in Bert Swart, B., Zahar, A. & Sluiter, G. (eds.), The Legacy of the International Criminal Tribunal for the Former Yugoslavia (Oxford University Press 2011), p. 420.

international court of tribunal as propositions of law' in the presence of 'some king of reference to them by a rule of international law'.[27] In addition to that, the scope of tribunals' powers introduces another restriction to the application of national law. For, as Judge Casesse points out, 'unless expressly or implicitly authorized to the contrary by an international legal rule, international judges cannot interpret national laws in lieu of national courts or administrative authorities. International judges may easily misapprehend or misconstrue national laws, because normally they lack the necessary legal tools for placing a correct interpretation on them'.[28]

The extent of the renvoi to the host State's law depends on the content of the relevant legality requirement provisions. Schill distinguishes between provisions that tie compliance with domestic law directly to the definition of investment protected and provisions linking compliance with domestic law to the provision on admission of new investments coupled with a limitation of the scope of application of the relevant investment treaty to existing investments made in accordance with host State law.[29] If this was the case, then the legality requirement provisions would cover only illegality at the initiation and not during the performance of the investment. Schill claims indeed that arbitral jurisprudence 'has rather consistently understood 'in accordance with host State law'-clauses to target only initial illegality',[30] in other words, to refer to host State's law at the time of the establishment of the investment.It seems however that arbitral tribunals have contemplated both initial and subsequent illegality. It has been argued that the use of the terms 'admitted', 'invested', 'made', 'implemented, 'permitted' or 'established' imply a

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[27]Gaja, G., 'Dualism – A Review', in Janne, E. Nijman, J.E. & Nollkaemper, A. (eds.), New Perspectives on the Divide Between National and International Law (Oxford University Press 2007), p. 59.

[28]The Prosecutor v. Tihofil also known as Tihomir Blaškić, International Tribunal for the Prosecution of Persons Responsible for Serious Violations of International Humanitarian Law in the Territory of Former Yugoslavia since 1991, Decision on the Motion of the Defence Filed Pursuant to Rule 64 of the Rules of Procedure and Evidence, 3 April 1994, ¶ 6.

[29]*Supra* note 11, at 284-285.

[30]*Id.* at 397.

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[29]*Supra* note 11, at 284-285.

[30]*Id.* at 397.

requirement of initial compliance.[31] In the Fraport case, on the basis of a BIT provision defining investment as 'any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State', the Tribunal confirmed that '[t]he language of both Articles 1 and 2 of the BIT emphasizes the initiation of the investment'.[32] In contrast, the use of terms 'owned' and 'controlled' may be interpreted as a requirement of subsequent compliance.[33] References to compliance with laws 'applicable from time to time' or to compliance 'at all times' may point to an obligation of continuous compliance.

Webb Yackee rightly observes that the 'provisions typically do not mention which laws and regulations must be complied with for an investment to enjoy BIT protections'.[34] Dolzer & Schreuer claim that 'the words 'in accordance with the laws' relate not just to the laws on admission and establishment but also to other rules of the domestic legal order'.[35] However, in the Saba Fakes case, in relation to a BIT covering 'investments ... established in accordance with the laws and regulations', the Tribunal considered 'that the legality requirement contained therein concerns the question of the compliance with the host State's domestic laws governing the admission of investments in the host State'. The Tribunal explained that 'it would run counter to the object and purpose of investment protection treaties to deny substantive protection to those investments that would violate

[31] Obersteiner, Th., "In Accordance with Domestic Law' Clauses: How International Investment Tribunals Deal with Allegations of Unlawful Conduct of Investors", *Journal of International Arbitration*, 31,268-269 (2014); *cf.* Quiborax S.A., Non Metallic Minerals *S.A.* and Allan Fosk Kaplún v. Plurinational State of Bolivia, ICSID Case No.ARB/06/2.; Metal-Tech Ltd. v. Republic of Uzbekistan, ICSID Case No.ARB/10/3.

[32] Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25.; *cf.* Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v. The Argentine Republic, ICSID Case No. ARB/09/1.

[33] *Supra* note 30, at 279; *contra*, Alasdair Ross Anderson *et al.* v. Republic of Costa Rica, ICSID Case No. ARB (AF)/07/3.

[34] Webb Yackee, J., "Investment Treaties & Investor Corruption: An Emerging Defence for Host States", *Virginia J. of Int'l Law*, 52, 740 (2012).

[35] *Supra* note 3, at 95.

domestic laws that are unrelated to the very nature of investment regulation. In the event that an investor breaches a requirement of domestic law, a host State can take appropriate action against such investor within the framework of its domestic legislation...unless specifically stated in the investment treaty under consideration, a host State should not be in a position to rely on its domestic legislation beyond the sphere of investment regime to escape its international undertakings vis-à-vis investments made in its territory'.[36] Consequently, 'a violation of the regulations in the telecommunication sector or of competition law requirements would not trigger the application of the legality requirement'.[37]

Similarly, in the Teinver case, the Tribunal considered 'whether Claimants acquired or made their investment in compliance with Argentine law' but found 'no evidence...that Claimants failed to comply with any Argentine laws or committed any illegalities in entering the SPA', in particular, 'that either Claimants or SEPI were not authorized to sign the agreement, that Claimants committed fraud or made a critical omission in how they represented themselves during the bidding process, or that Claimants engaged in any corruption or failure to comply with bidding or other procurement requirements'.[38] In the Ambiente Ufficio case, the Tribunal referred to 'the rules of public law or administrative law of the host State that forbid certain types of investments or require that these be made respecting certain principles aimed at protecting the interests of the host State', excluding 'from the purview of protected investments when they are not compatible with the ordre public of the host State'.[39] In the Mamidoil case, the Tribunal ruled that 'not every type of non-compliance with national legislation bars the protection of an investment' and 'that there must be an inner link between the illegal act and the investment itself. Illegal conduct of the investor will not

[36]Mr. Saba Fakes v. Republic of Turkey, ICSID Case No.ARB/07/20.

[37]*Id.* at ¶ 120.

[38]Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v. The Argentine Republic, ICSID Case No.ARB/09/1.

[39]Ambiente Ufficio S.p.A. and others v. Argentine Republic, ICSID Case No. ARB/08/9.

affect the investment insofar as it does not relate to its substance or procedural requirements but rather occurs without any material connection to the investment'.[40]

Schill identifies breaches of national law contemplated in arbitral awards in relation to legality requirement provisions, in reality, provisions introducing a requirement of initial compliance, to include illegality per se, prohibition of ownership for foreign investors and legal investments obtained by illegal means.[41] Illegality per se was defined in the Tokios Tokles award as the case where 'the...investment and business activity...are illegal per se'[42] or where 'the assets had been touched in some way by illegality, or...their utilisation had been actively prohibited'.[43] Prohibition of ownership was contemplated in the Fraport case, referring to the prohibition of foreign investors 'under the Philippine Constitution, to hold more than 40% of the shares of locally incorporated companies holding concessions in the public utilities sector'.[44] Finally, legal investments obtained by illegal means contemplated in the Inceysa award include the case of fraudulent and illegal conduct of the investment.[45]

The distinction is by no means theoretical for, as Schill explains in relation to cases of illegality per se, 'no causality requirement needs to be met. In these cases illegality does not result from the investor's conduct to obtain an investment but is inherent in the operation of the investment'. In contrast, 'causality is necessary...in cases where the investor's conduct in acquiring a per se legal investment is illegal, such as fraudulent misrepresentations'.[46] Indeed, in the Hamester case, in relation to 'allegations of fraud in the initiation of the investment, and not with the multiple allegations of fraudulent conduct during the life of the investment', the Tribunal observed

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[40] Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania, ICSID Case No.ARB/11/24.

[41] *Supra* note 11, at 291.

[42] Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18.

[43] *Id.* at ¶ 97.

[44] *Supra* note 11, at 295.

[45] Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No.ARB/03/26.

[46] *Supra* note 11, at 308-309.

that 'the only question here is whether Hamester perpetrated a fraud, and thereby procured the signing of the JVA...If the JVA was obtained on the basis of fraud, it is an illegal investment that does not benefit from the protection'.[47] Similarly, in the Niko Resources, a case not involving a legality requirement provision, the Tribunal concluded the absence of 'link of causation between the established acts of corruption and the conclusion of the agreements', amongst others, because the contracts were concluded long before the acts of corruption and did not procure the contracts on which the claims were based.[48]

Both continuous compliance and compliance with any law and regulation were criticized, the first for introducing a risk of loss of investor's protection for any violation of domestic laws at any time during an investment's operation that would 'constitute an immense systematic setback for the effectiveness of the foreign investment protection regime',[49] the second for providing 'the Achilles Heel of investment arbitration if jurisdiction depends on the Claimant passing a full legal compliance audit'.[50] It is remembered that the requirement of full conformity of the World Bank Guidelines[51] was criticised at the time of their adoption for authorising States to take measures irrespective of the gravity of the illegality and failure to take into account the proportionality principle.[52] However, in principle, legality requirement provisions do not require full compliance. Hence, as Kriebaum concludes on the basis of previous

[47]Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24.

[48]Niko Resources (Bangladesh) Ltd. v. Peoples Republic of Bangladesh, Bangladesh Petroleum Exploration & Production Co. Ltd ('BAPEX') and Bangladesh Oil Gas and Mineral Corporation ('PETROBANGLA',ICSID Cases No. ARB/10/11 and ARB/10/18.

[49]*Supra* note 30, at 280.

[50]Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.

[51]The World Bank Guidelines (1992), Guideline I, Section 2.

[52] Protopsaltis, P., 'Les Principes directeurs de la Banque mondiale pour le traitement de l'investissement étranger', *in* Kahn, P. & Wälde, Th. (eds), *Aspects nouveaux du droit des investissements internationaux*, Académie de droit international de la Haye (Martinus Nijhoff Publishers 2007) p. 225.

arbitral awards, 'not every minor infraction will lead to a denial of investment protection. Only breaches of fundamental norms of a legal order will have such effect'.[53]

Indeed, in the Tokios Tokles case, the Tribunal distinguished between per se illegality and simple breaches of formalities, of bureaucratic finesses,[54]observing that 'to exclude an investment on the basis of such minor errors would be inconsistent with the object and purpose of the Treaty'.[55] Introducing a clear de minimis rule, in the Metalpar case, the Tribunal ruled that it would be disproportionate to punish the omission of timely registration of the company with denying the investor an essential protection.[56]

Since the LESI case, the legality requirement provisions were construed as a reference to the fundamental principles of the host State's law, thus excluding minor violations.In this latter case, the Tribunal observed that'la mention que fait Ie texte à la conformité aux lois et règlements en vigueur ne constitue pas une reconnaissance formelle de la notion d'investissement telle que la comprend Ie droit algérien de manière restrictive, mais, selon une formule classique et parfaitement justifiée, I' exclusion de la protection pour tous les investissements qui auraient été effectués en violation des principes fondamentaux en vigueur'.[57]

In the Desert Line Projects case, the tribunal referred to the exclusion of 'investments made in breach of the fundamental principles of the host State's law, e.g. by fraudulent

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[53]Kriebaum, U., 'Investment Arbitration - Illegal Investments', *in* Klausegger, Ch., Klein, P., *et al.*, *Austrian Arbitration Yearbook 2010* (C.H. Beck, Stämpfli & Manz, 2010),p. 319.

[54]*Supra* note 11, at 292.

[55]Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18.

[56]Metlpar S.A. and Buen Aire S.A. v. Argentine Republic, ICSID Case No. ARB/03/5.; Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia, UNCITRAL, Partial Award on Jurisdiction of 8 September 2006, ¶¶ 150-152; *cf.* Swembalt A.B., Sweden v. Republic of Latvia, UNCITRAL, Decision of 23 October 2000, ¶ 35.

[57]LESI, Sp Aet Astaldi, SpA c. Républiquealgériennedémocratique et populaire, ICSID Case No. ARB/05/03.

misrepresentations or the dissimulation of true ownership'.[58] Subsequent awards followed the same approach.[59]

2.2. Compliance with International Law

Explicitly and, more often than not, implicitly relying on article 31(3)(c) of the Vienna Convention on the Law of the Treaties (VCLT) and the principle of systemic integration, arbitral tribunals have applied the yardstick of international law in a number of cases, albeit never in the context of a legality requirement provision. In the World Duty Free case, for example, the Tribunal ruled that '[i]n light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal'.[60] Examining the applicable laws chosen by the Parties in their Agreement, the Tribunal then found that the 'public policy both under English law and Kenyan law (being materially identical) and on the specific facts of this case' to conclude that 'the Claimant is not legally entitled to maintain any of its pleaded claims in these proceedings on the ground of ex turpicausa non orituractio'[61] 'as a matter of ordre pubic international and public policy under the contract's applicable laws'.[62]

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[58]Desert Line Projects LLC v. The Republic of Yemen, ICSID Case No. ARB/ 05/17.; *cf.* Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri *A.S.* v. Republic of Kazakhstan, ICSID Case No. ARB/05/16.

[59]Inmaris Perestroika Sailing Maritime Services Gmbh and Others v. Ukraine, ICSID Case No. ARB/08/8.; Alpha Projekt holding GmbH v. Ukraine ICSID Case No.ARB/07/16.

[60]World Duty Free Company Limited v. Republic of Kenya, ICSID Case No. ARB/00/7.

[61]*Id.* at ¶ 179.

[62]*Id.* at ¶188; *cf. Supra* note 7, at 42.

It was in the Inceysa case that a tribunal introduced for the first time the yardstick of international law in the context of a legality requirement provision or, as Sasson explains, made its 'task easier by simply importing international law principles into the relevant municipal law'.[63] Relying on a BIT applying to 'investments ... made in accordance with the laws of the other Contracting Party', the Tribunal ruled that because the Constitution of El Salvador determined international law to be part of national law, 'the BIT, as valid law in El Salvador, is the primary and special legislation this Tribunal must analyse to determine whether Inceysa's investment was made in accordance with the legal system of that Nation'.[64]

The Tribunal then rightly observed that 'the Agreement does not contain substantive rules that permit a determination whether Inceysa's investment was made in accordance with the law of EI Salvador'. It therefore decided to test the legality of the investment under international law. On the basis of the provision on applicable law of the BIT referring to both 'the generally recognised rules and principles of international law' and 'the national law of the Contracting Parties', the Tribunal equated international law with the general principles of law of Article 38 of the Statute of the ICJ.[65] The Tribunal thus analysed the investment in the light of 'the general principles of law which the Arbitral Tribunal considers to be applicable in this case', the principle of good faith, the principle nemo auditor propriamturpitudinemallegans, the international public policy and the prohibition of unlawful enrichment.[66]

In this case, as Schill rightly observes, 'instead of dealing primarily with the question of whether the investor's fraudulent misrepresentations breached the law of El Salvador, the Tribunal labored on how the conduct in question was contrary to generally

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[63]Sasson, M., "Substantive Law in Investment Treaty Arbitration: The Unsettled Relationship between International and Municipal Law", *Kluwer Law International*, 48 (2010).

[64]Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No.ARB/03/26.

[65]*Id.* at ¶ 222-24.

[66]*Id.* at ¶ 229-57.

recognized principles of international law',[67] according to Carlevaris, 'on the probable, but unproven, assumption of their conformity with domestic law'.[68]

Subsequently, a number of tribunals have considered the legality of investment as an implicit condition of applicability of every BIT and IIA. Interestingly enough, in this context, some tribunals have examined investor's breaches in the light of both national and international law. In the Plama case, the Tribunal observed that '[u]nlike a number of Bilateral Investment Treaties, the ECT does not contain a provision requiring the conformity of the Investment with a particular law. This does not mean, however, that the protections provided for by the ECT cover all kinds of investments, including those contrary to domestic or international law...the ECT should be interpreted in a manner consistent with the aim of encouraging respect for the rule of law. The Arbitral Tribunal concludes that the substantive protections of the ECT cannot apply to investments that are made contrary to law.' The Tribunal found 'that the investment in this case violates not only Bulgarian law...but also "applicable rules and principles of international law", in conformity with Article 26(6) of the ECT which states that "[a] tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law"'.[69]

The Tribunal relied on the Inceysa and the World Duty Free awards to rule 'that the investment was obtained by deceitful conduct that is in violation of Bulgarian law' and that 'granting the ECT's protections to Claimant's investment would be contrary to the principle nemoauditurpropriamturpitud-inemallegans to add that such protection 'would also be contrary to the basic notion of international public policy - that a contract obtained by wrongful

[67] *Supra* note 11, at 300-301;*cf.* Moloo, R., Khachaturian, A., "The Compliance with the Law Requirement in International Investment Law", *Fordham Int'l L. J.*, 34, 1480(2011). *Supra* note 7, at 42.

[68] *Supra* note 15, at 43.

[69] Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No.ARB/03/24.

means (fraudulent misrepresentation) should not be enforced by a tribunal'.[70] The presence of an implicit legality requirement in BITs was reiterated in subsequent awards, even though those endorsing this approach cautiously avoided references to international public policy.[71]

In the Phoenix case, discussing its jurisdiction rationemateriae, the Tribunal observed that 'international agreements like the ICSID Convention and the BIT have to be analyzed with due regard to the requirements of the general principles of law, such as the principle of non-retroactivity or the principle of good faith, also referred to by the Vienna Convention'. [72] In its analysis of the 'proper interpretation of the notion of investment in the general framework of the ICSID mechanism and the specific framework of the BIT, in light of the general principles of international law', the Tribunal discussed first the requirement of compliance with the law of the host country. Relying on the ICSID Convention and the legality requirement provision of the applicable BIT, it ruled that '[t]he purpose of the international mechanism of protection of investment through ICSID arbitration cannot be to protect investments made in violation of the laws of the host State. The protection of foreign investments not made in accordance with the laws of the host State or investments not made in good faith, obtained, for example, through misrepresentations, concealments or corruption, or amounting to an abuse of the international ICSID arbitration system. In other words, the purpose of international protection is to protect legal and bona fide investments'.[73]

Subsequently, analysing the notion of investment in the light of the general principles of international law, the Tribunal concluded that 'States cannot be deemed to offer access to the ICSID dispute

[70]*Id.* at ¶ 143.

[71]SAUR International S.A. c. République argentine (Aff.CIRDI No. ARB/04/4), Décisionsur la compétenceetsur la responsabilité du 6 Juin 2012, ¶¶308; MamidoilJetoil Greek Petroleum Products Societe S.A. v. Republic of Albania, ICSID Case No. ARB/11/24.

[72]Phoenix Action, Ltd. v. Czech Republic, ICSID Case No.ARB/06/5.

[73]*Id.* at ¶ 100.

settlement mechanism to investments not made in good faith. The protection of international investment arbitration cannot be granted if such protection would run contrary to the general principles of international law, among which the principle of good faith is of most importance'.[74]

After the Phoenix award, a number of tribunals examined investors' compliance with both national and international law. By way of illustration, in the Hamester case, the Tribunal relied in the Phoenix award to rule that '[a]n 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'.[75] It observed in addition that an investment 'will also not be protected if it is made in violation of the host State's law'[76] and relied on the Fraport award to examine investor's compliance with the host State's legislation in accordance with the express requirement of the applicable BIT.[77] In the Malicorp case, in the absence of a legality requirement provision in the applicable BIT, the Tribunal examined investors' conduct in the light of international law. The Tribunal wondered whether it 'would still have jurisdiction in the event the investor were seeking protection in a manner that was contrary to the principle of good faith', on the grounds 'that the safeguarding of good faith is one of the fundamental principles of international law and the law of investments'.[78]

Schill attributes the reference to the principles of international law in the Plama case 'to the combination of the absence of an explicit reference to domestic legality in an 'in accordance with host State law'- clause and the applicable law clause in Article 26(6) ECT'. The

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[74]*Id.* at ¶ 106.

[75]Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24.

[76]*Ibid.*

[77]*Id.* at ¶ 126-129.

[78]Malicorp Limited v. The Arab Republic of Egypt, ICSID Case No.ARB/08/18.

Tribunal, Schill continues, '[p]otentially ... understood this ... clause as precluding a treaty-based tribunal from considering domestic law, therefore using the argumentative hook via principles of international law as a functional equivalent to the renvoi to domestic law effectuated by an 'in accordance with host State law'-clause'.[79] Focussing on good faith, Schill and Bray conclude that '[i]n view of both the Hamster and the Phoenix tribunals, the principle of good faith can therefore seen as serving the function of substituting for the non-existent 'in accordance with host state law' clause. At the same time, the tribunals suggest that the obligation to comply with good faith exists independently of the investor's duty to comply with domestic law'.[80] However, in a number of cases, despite the presence of a legality requirement provision in the applicable BITs, tribunals examined investors' conduct both in the light of national and in the light of international law. Interestingly enough, tribunals avoided to detach the test of compliance with international law from that of compliance with national law. Even in the Plama case, despite the absence of explicit reference to domestic legality, the tribunal felt the need to refer to both the Bulgarian law and the applicable rules and principles of international law. One therefore inevitably has to wonder whether tribunals did in fact introduce an additional yardstick and if so, what the relation of priority between the two may be.

In that respect, one should remember that in the ELSI case, the ICJ observed that the 'Italian corporations and associations controlled by United States nationals must conform to the local applicable laws and regulations...even if they believe a law or regulation to be in breach of the FCN Treaty and, indeed, even if it were in breach of the FCN Treaty.'[81] The priority of national law is confirmed by the OECD Guidelines for Multinational Enterprises, one of the major

[79] *Supra* note 11, at 313.

[80] Schill, S.W. & Bray, H. L., 'Good Faith Limitations on Protected Investments and Corporate Structuring', in Mitchell, A.D., Sornarajah, M. & Voon, T. (eds.), Good Faith and International Economic Law (Oxford University Press 2015), p. 95.

[81] *Supra* note 9, at ¶ 72.

surviving soft law instruments for the regulation of investors' conduct. According to the Guidelines, '[o]beying domestic laws is the first obligation of enterprises. The Guidelines are not a substitute for nor should they be considered to override domestic law and ̧ulation. While the Guidelines extend beyond the law in many cases, they should not and are not intended to place an enterprise in situations where it faces conflicting requirements.'[82]

Aside from the criticism in relation to the application of the general principles of law, the confusion over the distinction between the general principles of law and the general principles of international law and the role of good faith,[83] there are inherent limits to this exercise, stemming from the very nature of international law. For example, international law introduces rights and imposes obligations on States whose violation engages State responsibility.

The PCIJ in its Advisory opinion in the case of the jurisdiction of the Courts of Danzig admitted 'that the very object of an international agreement, according to the intention of the contracting Parties, may be the adoption by the Parties of some definite rules creating individual rights and obligations.'[84]

However, while international law has recognised some rights inuitu personae, amongst others, in favour of foreign investors, the same does not necessarily apply with respect to obligations, for despite attempts to establish liability of business enterprises for violations of international human rights law,[85] as Crawford rightly observes, 'human rights (and other obligations assumed for the benefit of individuals and corporations) arise against the state, which so far has

[82] *OECD Guidelines for Multinational Enterprises 2011 Edition*, OECD, available at https://www.oecd.org/corporate/ mne/48004323.pdf.

[83] *Supra* note 80, at 95-96.

[84] Jurisdiction of the Courts of Danzig, Advisory Opinion No. 15, *PCIJ Coll.*, Series B, No. 15, March 3rd, 1928, p. 17-18.

[85] Paust, J.J., "Human Rights Responsibilities of Private Corporations", *Vanderbilt J.Transnat'l Law*, 35, 803(2002); Dubin, L., "The Direct Application of Human Rights Standards to, and by, Transnational Corporations", *The Review – International Commission of Jurists*, 61, 39 (1999).

a virtual monopoly of responsibility'.[86] In contrast, individuals, including investors, cannot be held liable for their failure to respect these obligations.

3. THE EFFECTS OF ILLEGALITY

Although the legality requirement provisions themselves do not define the consequences of their violation, there is no doubt that their aim is to disqualify illegal investments from the protection of the BIT.[87] In other words, failure to comply with applicable laws and regulations of the host country leads to the loss of protection of the treaty. However, in the ELSI case, the ICJ did not draw this conclusion. It was only in the Salini case where an arbitral tribunal for the first time observed that '[i]n focussing on "the categories of invested assets (...) in accordance with the laws and regulations of the aforementioned party," this provision ... seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal'.[88] With the notable exception of the decision in the Aquas de Tunari case, often attributed to the difference of phrasing of the relevant provisions in the Netherlands-Bolivia BIT,[89] subsequent arbitral awards re-iterated the same conclusion, [90] disqualifying illegal investments from

[86]Crawford, J., "Brownlie's Principles of Public International Law", *Oxford University Press, 121(*2012).; *cf.*Liberti, L., Quelle place pour la responsabilité des entreprises en droit international, *Forum de droit international*, 7, 235 (2005).

[87]McLachlan, C., Shore, L., & Weiniger, M., "International Investment Arbitration Substantive Principles", *Oxford University Press,* 181 (2007); *cf.* Sornarajah, M., "International Law on Foreign Investment", *Cambridge University Press,* 318 (2010).

[88]Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/04.

[89]Aguas del Tunari, S.A. v. Republic of Bolivia, ICSID Case No.ARB/02/3.; *Supra* note 3, at 22-24; *Supra* note 11, at 24-27.

[90]*Supra* note 11, at 3-4; Tokios Tokelés v. Ukraine, ICSID Case No. ARB/02/18.; Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29; L.E.S.I. S.p.A. et ASTALDI S.p.A c. République algérienne démocratique et populaire, CIRDI Aff. No. ARB/05/3.; Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No. ARB/03/26.; Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18; Mr. Saba Fakes v.

protection. In that respect, the effect of the legality requirement provisions is similar to that of the denial of benefits clauses.[91]

As Carlevaris rightly points out, the main effect of the distinction between validity and definition, introduced in the Salini case,[92] is that the specific illegality of the investment will have to be established.[93] Sornarajah claims in error that '[t]he only authorities which could determine' the violation 'would be the local authorities of the host State ... the protection of the treaty lies then at the caprice of each State, for the local authorities may remove the foreign investment from the protection of the treaty simply by holding that it had violated the local rules and regulations governing its operation'.[94] The investor 'could be deprived of...protection by an ex post facto subjective determination that it is not of the type which is subject to protection because it had not satisfied the criteria of operating according to the laws of the host state'. [95] Nevertheless, determinations of national authorities, including national courts, are not binding upon arbitral tribunals,[96] all the more so, since violation of national laws constitutes a regular defence of the host countries, often used as pretext to avoid compensation. Obviously, the absence of violation justifying exclusion from protection will amount to violation of the BIT by the host country.

However, arbitral awards have not been consistent in relation to the denial of protection of illegal investments. In the Teinver case, with respect to the respondent's objections to jurisdiction on the grounds of the claimant's failure to comply with domestic laws and

Republic of Turkey, ICSID Case No. ARB/07/20; Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v.The Argentine Republic, ICSID Case No.ARB/09/1.

[91]*Supra* note 3, at 18-21.

[92]Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/04.

[93]*Supra* note 15, at 44.

[94]*Supra* note 8, at 116.

[95]*Id.* at 117.

[96] Amco Asia Corporation, Pan American Development Limited, PT Amco Indonesia v. Republic of Indo-nesia, ICSID Case No. ARB/81/1.

regulations, the Tribunal noted 'that certain of the allegations raised under this objection may affect the merits of the claim and that it will be open to the Parties to make further submissions in respect of these allegations as appropriate during the merits stage of the Arbitration'.[97] Indeed, some tribunals declined jurisdiction whereas others denied substantive protection at the merits stage,[98] the criterion most often being that of initial or subsequent illegality. However, the classification of illegality as pertaining to jurisdiction, admissibility or merits has a number of important consequences, amongst others, in relation to review and res judicata.[99]

3.1. The Denial of Jurisdiction

Relying on the legality requirement provisions included in BITs, host States have claimed that illegal investments do not fall within the scope of investments covered by them or that they are not covered by the consent to arbitrate, thus contesting the tribunal's jurisdiction.[100] Krebaum explains that this leads to a paradox: host State law becomes both the yardstick to define tribunal's jurisdiction and the object of tribunal's review.[101] Carlevaris observes however that while the notion of investment for the purposes of establishing a tribunal's jurisdiction can only be construed by reference to international law, the law of the host State governs the legal relationship to which the dispute refers and, in the presence of a legality requirement provision, also its legality.[102] The compatibility of restrictions to consent with the Washington Convention was

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[97]Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v. The Argentine Republic, ICSID Case No.ARB/09/1.

[98]Kriebaum (*Supra*, note 53), p. 310; *cf.* Newcombe, A., 'Investor Misconduct: Jurisdiction, Admissibility or Merits?', *in* De Mestral, A. & Lévesque, C. (eds.), *Improving International Investment Agreements* (Routledge 2013), p. 191.

[99]*Weibel, M., "Investment Arbitration: Jurisdiction and Admissibility", University of Cambridge Faculty of Law Research Paper No. 9/2014, pp. 66-70.*

[100]*Supra* note 67, at 1476; *Supra* note 15, at 39; *Supra* note 11, at 321-322; Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia, ICSID Case No.ARB/06/2.

[101]*Supra* note 53, at 308-309.

[102]*Supra* note 15, at 45.

confirmed in the Saba Fakes case. The Tribunal ruled that '[a]s far as the legality of investments is concerned, this question does not relate to the definition of 'investment' provided in Article 25(1) the ICSID Convention and in Article 1(b) of the BIT...while the ICSID Convention remains neutral on this issue, bilateral investment treaties are at liberty to condition their application and the whole protection they afford, including consent to arbitration, to a legality requirement of one form or another'.[103] In contrast, reliance on the so-called 'double-barrelled' test (meeting both the conditions of Article 25 of the Washington Convention and the BIT)[104] would have required a legality requirement to be implicit in the objective definition of investment under Article 25(1) of the Convention, a conclusion that some tribunals have explicitly contested.[105]

In the Fraport case, investment's illegality was treated as a matter of ratione materiae jurisdiction. The Tribunal ruled that Fraport did not havea-priory entitlement to ICSID arbitration because its 'unlawful investment, is not an "investment" which is covered by the BIT. As the BIT is the basis of jurisdiction of this Tribunal, Fraport's claim must be rejected for lack of jurisdiction ratione materiae'.[106] In the Inceysa case, the Tribunal considered that 'the consent granted by Spain and EI Salvador in the BIT is limited to investments made in accordance with the laws of the host State of the investment. Consequently, this Tribunal decides that the disputes that arise from an investment made illegally are outside the consent granted by the parties and, consequently, are not subject to the jurisdiction of the Centre, and that this Tribunal is not competent to resolve them, for failure to meet the requirements of Article 25 of the Convention and those of the BIT'.[107] A number of subsequent awards followed the

[103]Mr. Saba Fakes v. Republic of Turkey, ICSID Case No. ARB/07/20; *cf.* Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25.

[104]Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/4.

[105]Metal-Tech Ltd. v. Republic of Uzbekistan, ICSID Case No.ARB/10/3.

[106]Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.

[107]Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No.ARB/03/26.

same approach in order to decline [108] as well as to admit [109] jurisdiction.

However, some tribunals have introduced different criteria for that matter. By way of illustration, in the Phoenix case, the Tribunal distinguished between manifest and non-manifest violations. According to the Tribunal, '[t]he fact that an investment is in violation of the laws of the host State can be manifest and will therefore allow the tribunal to deny its jurisdiction. Or, the fact that the investment is in violation of the laws of the host State can only appear when dealing with the merits, whether it was not known before that stage or whether the tribunal considered it best to be analyzed as the merits stage'. [110] In the Arif case, the Tribunal distinguished between accepted and non-accepted illegality. It ruled that 'there are temporal limitations on a jurisdictional argument based on the illegality of an investment, where the legality of the investment has been accepted and acted upon in good faith by both parties over a period of time. This is not a case of a concealed illegality, or a class of assets prohibited to foreign investors such as, in some jurisdictions, a concession contract for a strategic resource. The investment was not made fraudulently or on the basis of corruption. In cases like the present one, the passage of time and the actions of the parties on the mutual assumption of legality cannot be ignored in the determination of jurisdiction.

The 'normative power of facticity' requires illegality in a case like the present one to be treated as an issue of liability and not jurisdiction'.[111] In other cases however, tribunals precluded denial of jurisdiction altogether in the presence of acceptance by the host country or, as Kriebaum explains, '[k]nowing acceptance by the host

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[108]Alasdair Ross Anderson *et al.* v. Republic of Costa Rica, ICSID Case No.ARB (AF)/07/3; Metal-Tech Ltd. v. Republic of Uzbekistan, ICSIDCase No.ARB/10/3.

[109]Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania, ICSID Case No.ARB/11/24; Saluka Investments B.V. v. The Czech Republic, UNCITRAL, Partial Award of 17 March 2016.

[110]Phoenix Action, Ltd. v. Czech Republic, ICSID Case No.ARB/06/5.

[111]Mr. Franck Charles Arif v. Republic of Moldova, ICSID Case No.ARB/11/23.

State can cure the breach of the host State law or estop the host State from raising the illegality'.[112]

3.2. The Denial of Substantive Protection

The legality requirement provision has also been used as a defence of the host State for its interference with investment when the illegality occurred during the performance of the investment.[113] In such cases, arbitral tribunals have contemplated the denial of substantive protection.In the Fraport case, the Tribunal observed that 'the effective operation of the BIT regime would appear to require that jurisdictional compliance be limited to the initiation of the investment'. In contrast, '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 defence to claimed substantive violations of the BIT, but could not deprive a tribunal acting under the authority of the BIT of its jurisdiction'.[114]

Drawing upon this award, in the Hamester case, the Tribunal observed 'that a distinction has to be drawn between (1) legality as at the initiation of the investment ("made") and (2) legality during the performance of the investment'. However, it found that 'Article 10 [i.e., a clause providing that the BIT applied to investment made in accordance with host State law prior to the treaty's entry into force] legislates for the scope of application of the BIT, but conditions this only by reference to legality at the initiation of the investment. Hence, only this issue bears upon this Tribunal's jurisdiction. Legality in the subsequent life or performance of the investment is not addressed in Article 10. It follows that this does not bear upon the scope of application of the BIT (and hence this Tribunal's

[112] *Supra* note 53, at 324; *cf. Supra* note 67, at 1497-1498; *Supra* note 11, at 16; Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25; Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18; Desert Line Projects LLC v. Yemen, ICSID Case No.ARB/05/17.

[113] *Supra* note 53, at 316, 319.

[114] Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.

jurisdiction) – albeit that it may well be relevant in the context of the substantive merits of a claim brought under the BIT. Thus, on the wording of this BIT, the legality of the creation of the investment is a jurisdictional issue; the legality of the investor's conduct during the life of the investment is a merits issue'.[115] Nevertheless, as already mentioned, other tribunals used different criteria. In the Phoenix case, the Tribunal reserved the merits stage to non-manifest violations whereas in the Arif case, the Tribunal reserved the merits stage to non-accepted violations.

Both denial of jurisdiction and denial of substantive protection have been heavily criticized. From the legal point of view, amongst others, Douglas claims that even though pursuant to the principle of systemic integration investment treaties may be interpreted in the light of general international law, recourse to the general principles and in particular good faith and the maxim that a claimant should not be able to profit from its own wrongs cannot be used by the tribunal to refashion an express provision of the treaty. Thus, if general principles may inform the interpretation of the substantive investment protection obligations and provide a basis for a plea of inadmissibility they may not be used to modify the express provisions of the arbitration agreement and carve out certain types of disputes from the tribunal's jurisdiction.[116]

Focusing on the mechanics of foreign direct investment Kriebaumargues that an investment is a process involving diverse transactions rather than an instantaneous act and illegality may have occurred at a time when certain steps in the process of establishment were already undertaken while others still follow at a later stage.

In situations where the illegality occurred already to obtain the initial investment, a denial of jurisdiction will be the appropriate reaction. In contrast, addressing illegalities that arise after the establishment of an investment at the merits stage is more

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[115]Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, (ICSID Case No.ARB/07/24.

[116]*Supra* note 12, at 169-172.

appropriate and finds support in the language of many BITs.[117] Douglas criticised '[t]his temporal dividing line between pleas of illegality that go to jurisdiction and to the merits'. Taking the ex^mple of Fraport, he explains that the violation of the Anti-ummy Law occurred 'at the time that Fraport's direct and indirect shareholding interests in PIATCO were acquired and hence fell on the jurisdictional side of the dividing line'. He rightly concludes that 'if those agreements had simply been executed after the shareholding interests were acquired, then this would be a problem for the merits' even though 'the essence of the illegality would be identical'.[118]

For some commentators, denial of jurisdiction is too drastic a sanction against any illegality of the investment. In his dissenting opinion in the Fraport case, Cremades observed that '[i]f the legality of the Claimant's conduct is a jurisdictional issue, and the legality of the Respondent's conduct a merits issue, then the Respondent Host State is placed in a powerful position. In the Biblical phrase, the Tribunal must first examine the speck in the eye of the investor and defer, and maybe never address, a beam in the eye of the Host State. Such an approach does not respect fundamental principles of procedure'.[119] Dealing with illegality at the merits stage allows investor to exercise his rights while his illegal conduct might, to quote Cremades again, 'excuse or limit any liability of the State Party in an arbitration pursuant to the BIT, depending on the circumstances'.[120]

As Webb Yackee observes, 'the tribunal will have the opportunity to balance the investor's misbehavior against the state's'.[121] All the more so since, as Carlevaris rightly suggests, investors' wrongful act might give rise to counterclaims of the State at the merits phase.[122]

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[117] *Supra* note 53, at 330-332.
[118] *Supra* note 12, at 175.
[119] Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.
[120] *Id.* at ¶ 14.
[121] *Supra* note 34, at 741.
[122] *Supra* note 15, at 42.

According to Newcombe, dismissal on jurisdictional grounds may be avoided by treating investment's illegality as an issue of substantive admissibility.[123] This solution would lead essentially to the same result[124] but may indeed be better adapted to the distinction between definition and validity of the investment and may apply to both the case of initial and that of subsequent illegality. Douglas distinguishes between illegality in the acquisition of assets recognized under the host State's laws; illegality in the transaction resulting in the acquisition (investment procured by unlawful means in violation of international public policy or in violation of the host State's law, investment procured for an illicit purpose and investment procured in breach of registration requirements in the treaty); and, finally, illegality in the subsequent use of the assets by the foreign national. Relying on the doctrines of separability and competence-competence, he reserves denial of jurisdiction solely to investment procured in breach of registration requirements. In contrast, he proposes for misconduct in the acquisition of assets to be treated as question of admissibility or merits.

Investment procured in violation of international public policy should be a ground for inadmissibility since 'the concept of international public policy vests a tribunal with a particular responsibility to condemn any violation regardless of the law applicable to the particular issues in dispute and regardless of whether it has specifically raised by one of the parties'. Investment procured in violation of the law of the host State as well as illegalities in the subsequent use of the assets by the foreign national, on the contrary, should be treated at the stage of merits.[125]

These arguments are not that convincing. States have the right to exclude illegal investments from protection and validly limit their consent to arbitration to investments complying with their laws,[126]

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[123] *Supra* note 98, at 198; *cf. Supra* note 7, at 42.
[124] *Supra* note 98, at 198.
[125] *Supra* note 12, at 177-185.For a criticism *see* Roe, Th., 'Illegality and Jurisdiction in Investment Arbitration', 2 *Turkish Commercial Law Review* (2016), p. 17.
[126] *Supra* note 11, at 18.

while tribunals do have the necessary tools in their possession to deal with unfounded host State's objections to jurisdiction and adequately protect investor's rights.

Legality requirement provisions should be interpreted in accordance with article 31.1 of the VCLT, that is, in accordance with the ordinary meaning to be given to them in their context and in the light of their object and purpose, an exercise that arbitral tribunals have yet to undertake.[127]

And the terms of the legality requirement provisions contained in BITs and in IIAs do not seem to support the difference of treatment depending on the gravity or the timing of illegality. In reality, the arguments in favour of denial of substantive protection aim at the introduction of some rule of proportionality in relation to the effects of investors' illegality, translating the uneasiness of theory with establishment of investor's obligations through BITs and IIAs, instruments traditionally reserved to investor's protection.

4. CONCLUSION

Arbitral tribunals' interpretation of the so-called 'in accordance with the law' or 'legality requirement' provisions are amongst the prominent examples of tribunals' attempts to introduce investors' obligations and address the criticism of pro-investor bias. The question of content of the legality requirement provisions seems today more or less settled.

Despite their differences, arbitral tribunals agree that on the interpretation of those provisions as well as on the conditions of their application relating to the conduct of the investor and of the State that may trigger investors' responsibility for illegal investments. In contrast, arbitral awards have not been consistent with respect to the yardstick and the effects of illegality for the investor involved.

[127] *Cf.* Dolzer, R., 'Domestic Conformity Clauses in Investment Agreements: Their Role and Their Limits', *in* Rovine, A. W. (ed.), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (Brill/Nijhoff 2013), p. 27.

With respect to the yardstick of illegality, arbitral tribunals ruled that legality requirement provisions effect a renvoi to host State's law, thus making conformity with national law the yardstick of the legality of the investment and a condition of its protection. However, some tribunals examined investors' compliance not only with national but also with international law. Both requirements raise a number of questions in the light of the dualist theory.With respect to the effects of illegality, arbitral tribunals held that that legality requirement provisions refer to the validity of the investment and not to its definition, thus disqualifying from BIT's protection investments that are illegal under the law of the host country. However, arbitral awards have not been consistent in relation to the denial of protection of illegal investments. Most tribunals declined jurisdiction mainly in the case of initial illegality and denied substantive protection in the case of subsequent illegality.

Numerous issues remain to be settled: continuous compliance and subsequent illegality, content of fundamental principles of the law of the host country and proportionality principle, investor's good and bad faith, State's knowing acceptance, denial of jurisdiction versus denial of substantive protection, to mention just some. Arbitral tribunals have still to clarify a number of issues and surprises should not be ruled out. Nevertheless, investor's responsibility under international law is now acknowledged. Tribunals are moving towards a more balanced approach for investments' protection. Interestingly enough, despite the long struggle for the introduction of international obligations of investors, the change came somewhat effortlessly from where it was least expected, from BITs and investor - State arbitration, traditional instruments of investment's protection, rather than from the codes of conduct on multinational enterprises, traditional instruments of investor's control. BITs and arbitral awards may now perhaps safely replace the obsolete codes of conduct and their cachectic review mechanisms, since both essentially preach alike, investor's obligation to comply with the host country's laws and regulations.