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ARTICLE

The Plea of Illegality in Investment Treaty Arbitration

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Abstract—There is support in the investment treaty cases for the proposition that the lawfulness of the acquisition of the investment is a condition precedent for the conferral of adjudicative power upon the tribunal. This jurisdictional approach to the plea of illegality is justified by reference to three arguments: (i) an express provision of the treaty provides that lawfulness of the acquisition of the investment is a precondition to arbitration; (ii) the notion that investment law should give effect to general principles such as good faith or the maxim that a claimant should not be able to profit from its own wrongs; or (iii) the notion that investment law should respect the integrity of the law of the host State. The thesis defended in this article is that none of these arguments justifies a jurisdictional approach to the plea of illegality, which instead must be considered as a question of admissibility or a question on the merits of the case. A comprehensive road map for dealing with different types of pleas of illegality in investment treaty arbitration is set out at the conclusion to this article.

I. INTRODUCTION

A rule that has emerged from several investment treaty cases is that if the investment has been acquired by the foreign national in violation of the host State's laws and the effect of that violation is to render the investment 'illegal *per se*'[2] or 'illegal as such',[3] then the tribunal is without jurisdiction to entertain the foreign national's claims in arbitration.[4] In accordance with this approach, the

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[2] *Tokios Tokelés v Ukraine,* ICSID Case No ARB/02/18, Decision on Jurisdiction (29 April 2004) para 86, quoted in *Mytilineos v Serbia and Serbia and Montenegro* to dismiss a jurisdictional objection based on the lack of required registration of the relevant investment agreements as such. *Mytilineos Holdings SA v Serbia and Montenegro and Serbia,* UNCITRAL, Partial Award on Jurisdiction (8 September 2006) para 151.

[3] *Alpha Projektholding Gmbh v Ukraine*, ICSID Case No ARB/07/16, Award (8 November 2010) para 294; *Inmaris Perestroika Sailing Maritime Services Gmbh and others v Ukraine*, ICSID Case No ARB/08/8, Decision on Jurisdiction (8 March 2010) para 145.

[4] *Tokios Tokelés* (n 2) para 86; *Inceysa Vallisoletana SL v Republic of El Salvador,* ICSID Case No ARB/03/26, Award (2 August 2006) paras 155, 258–64, 252; *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, ICSID Case No ARB/03/25, Award (16 August 2007) paras 396–401; *Phoenix Action Ltd v Czech Republic*, ICSID Case No ARB/06/5, Award (15 April 2009) paras 101–5; *Railroad Development Corporation v Republic of Guatemala,* ICSID Case No ARB/07/23, Second Decision on Objections to Jurisdiction (18 May 2010) paras 140–7 (although the Respondent was precluded from raising an objection to the Tribunal's *ratione materiae* jurisdiction due to its awareness of the Claimant's alleged illegality); *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award (18 June 2010) para 127; *Alpha Projektholding* (ibid) paras 298–302 (although no breach of Ukranian law was found to

lawfulness of the acquisition of the investment is a condition precedent for the investment treaty's conferral of adjudicative power upon the tribunal. The timing of the unlawful conduct is said to be critical: it is only unlawful conduct pertaining to the acquisition of the investment that is relevant to the tribunal's jurisdiction; unlawful conduct *ex post* the acquisition of the investment is instead a question for the merits. Tribunals adopting this approach have also sought to limit the class of violations to those constituting a 'breach of fundamental principles of the host State's law'[5] to deny pleas of illegality based upon what have been described as 'technical violations' or 'minor errors'[6] of the host State's law.

Three arguments have been made to justify the jurisdictional approach to a plea of illegality. First, the consent of the host State to arbitral jurisdiction does not extend to disputes relating to investments that have been acquired by the claimant's violation of the host State's own law by virtue of an express provision of the investment treaty[7] or by implication.[8] Second, international investment law must give effect to general principles of law such as good faith and the maxim that the claimant should not profit from its own wrongs; this compels that jurisdiction is declined upon a successful plea of illegality.[9] Third, international investment law must respect the integrity of the national law of the host State; this compels that jurisdiction is declined upon a successful plea of illegality.[10]

There is, of course, considerable overlap between these arguments. An implied limitation upon the host State's consent to arbitration is likely to be justified by reference to the idea that a host State could not be taken to have accepted that the treaty would accord the procedural right to arbitrate to a claimant who has violated its law in the acquisition of an investment. Alternatively, the implied limitation might be justified by reference to general principles of law, such as good faith, that must inform the tribunal's interpretation of the host State's consent to arbitration in the treaty.

Each of the three arguments will be addressed in detail in this article, and each will be proven wrong. Instead, the thesis defended here is that a plea by the respondent host State to the effect that the claimant has violated its laws does not

establish the objection to jurisdiction); *SAUR International v Argentine Republic*, ICSID Case No ARB/04/4, Decision on Jurisdiction and Liability (6 June 2012) paras 310–12; *Quiborax SA and Non-Metallic Minerals SA v Plurinational State of Bolivia*, ICSID Case No ARB/06/2, Decision on Jurisdiction (27 September 2012) para 266; *Ambiente Ufficio SpA and others v Argentine Republic*, ICSID Case No ARB/08/9, Decision on Jurisdiction and Admissibility (8 February 2013) para 517.

[5] *LESI, SpA and Astaldi, SpA v People's Democratic Republic of Algeria*, ICSID Case No ARB/05/03, Award (12 November 2008) para 83; *Desert Line Projects LLC v Republic of Yemen*, ICSID Case No ARB/05/17, Award (6 February 2008) para 104; *Rumeli Telekom AS and Telsim Mobil Telekomunikasyon Hizmetleri AS v Republic of Kazakhastan* ICSID Case No ARB/05/16, Award (29 July 2008) para 319.

[6] *Tokios Tokelės* (n 2) para 86; *Mytilineos Holdings* (n 2) paras 151–5 and 120; *Alpha Projektholding* (n 3) para 297; *Quiborax* (n 4) para 281.

[7] *Philippe Gruslin v Malaysia*, ICSID Case No ARB/99/3, Award (28 November 2000) paras 24–26; *Inceysa Vallisoletane* (n 4) paras 190, 191; *Fraport* (n 4) para 334ff; *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award (18 June 2010) paras 125–7; *Alasdair Ross Anderson and others v Republic of Costa Rica*, ICSID Case No ARB(AF)/07/3, Award (19 May 2010) paras 51, 57, 58 and 61; *Quiborax* (n 4) para 255.

[8] *SAUR* (n 4) paras 306–08; *Phoenix Action Limited* (n 4) para 101; *Hamester v Ghana* (n 7) para 123.

[9] *Inceysa Vallisoletane* (n 4) paras 232–7 and 240–4; *Phoenix Action Limited* (n 4) para 106ff, *Rumeli Telekom* (n 5) paras 236–40, 323 and 334–5; *Europe Cement Investment and Trade SA v Republic Turkey*, ICSID Case No ARB(AF)/07/2, Award (13 August 2009) paras 163–75; *Hamester v Ghana* (n 7) para 123.

[10] *Fraport* (n 4) para 402.

provide the basis for an objection to the tribunal's jurisdiction in any circumstances.

Before engaging with these arguments, however, it is important to lay the foundation by revisiting the transnational principles of arbitration that impact a tribunal's consideration of a plea of illegality in all international arbitrations: the doctrines of separability and competence-competence. The article concludes with a comprehensive road map for dealing with different pleas of illegality in investment treaty arbitration.

II. THE PLEA OF ILLEGALITY AND THE DOCTRINES OF SEPARABILITY AND COMPETENCE-COMPETENCE[11]

A. *Commonalities Between Commercial Arbitration and Investment Treaty Arbitration*

Investment treaty arbitration relies, to a significant extent, upon the procedural framework developed for commercial arbitration.[12] The two most common sets of arbitration rules used for investment treaty arbitration—the ICSID Arbitration Rules and the UNCITRAL Arbitration Rules—were originally conceived for commercial arbitration and, at least in respect of the UNCITRAL Rules, the primary field for their application remains commercial arbitration. Outside the realm of the ICSID Convention, investment treaty awards depend upon the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards for their effectiveness if it is necessary to resort to the coercive power of a State for securing compliance with their terms.[13] This means that an arbitration agreement must be cognizable between the claimant investor and the respondent host State within the context of an investment treaty dispute and such an arbitration agreement must satisfy the formal and substantive requirements for recognition under the New York Convention. Indeed, it is now generally accepted that an arbitration agreement comes into existence upon the claimant's filing of a notice of arbitration, which constitutes an acceptance of the host State's unilateral offer to arbitrate in the investment treaty.[14] Investment treaty arbitrations are, moreover, treated in the same way as commercial arbitration proceedings by national laws on arbitration,[15] unless they are governed by the ICSID Convention.

The doctrines of separability and competence-competence, which evolved within the laboratory of commercial arbitration, are thus applicable to investment treaty arbitration by the express terms of the same arbitration rules, laws and

[11] This section has been adapted from: Z Douglas, 'Transposing the Principles Governing the Plea of Illegality in Commercial Arbitration into the Domain of Investment Treaty Arbitration' in C Müller and A Rigozzi (eds), *New Developments in International Commercial Arbitration 2012* (Schulthess 2012) 1–28.

[12] The term 'commercial arbitration' is preferred in this article to 'contractual arbitration' for the purposes of drawing a distinction with 'investment treaty arbitration' because the latter, if properly analysed, is also founded upon an arbitration agreement in the form of a written contract between the investor and the host State. See *Occidental Exploration & Production Company v Republic of Ecuador* [2006] QB 432.

[13] Z Douglas, *The International Law of Investment Claims* (CUP 2009) 31–2.

[14] ibid 35.

[15] ibid 106–10.

conventions that govern the procedure, as well as by the incorporation of transnational principles that sustain international arbitration more generally.

B. *Revisiting the Doctrines of Separability and Competence-Competence in Commercial Arbitration*

When a plea of illegality is raised in commercial arbitration, it must first be asked whether the plea goes to the contract memorializing the commercial transaction or to the arbitration agreement itself. If the plea of illegality goes to the underlying transaction, then, by virtue of the doctrine of separability,[16] the tribunal's adjudicative power is undiminished by the possibility that the transaction may ultimately be adjudged to be void for illegality. The illegality of the underlying transaction does not, in other words, infect the validity of the arbitration agreement, even though it is embedded within the contract purporting to give that transaction the force of law for the parties. As arbitration is a creature of consent, the separability doctrine relies upon the notion of a distinct basis of consent to the authority of the tribunal that is independent of the consent to be bound by the main contract. By this device, the tribunal has authority to render a binding award declaring the main contract to be void, which would otherwise be logically impossible if the legal force of the arbitration agreement depended upon the validity of the main contract in which it is embedded.

The next question is whether the tribunal has the power to decide for itself whether the plea of illegality goes to the main contract or to the arbitration agreement. The doctrine of competence-competence allows, but does not compel, the tribunal to decide this question. If the tribunal finds that the arbitration agreement is void for illegality, then the source of the tribunal's power to make that finding is the doctrine of competence-competence alone and not the doctrine of separability.[17] The doctrine of separability can only serve as a source of adjudicative power for the tribunal if there is valid consent to arbitration; in other words, there must be a valid arbitration agreement.

In what circumstances is a plea of illegality capable of vitiating the arbitration agreement? It is clear that an arbitration agreement embedded in a contract with a manifestly illegal purpose or object will not have any legal effect. The English Court of Appeal in *Soleimany v Soleimany* said that 'it would not recognise an agreement between highwaymen to arbitrate their differences any more than it would recognise the original agreement to split the proceeds'.[18] It did, however,

[16] See Gary B Born, *International Commercial Arbitration* (Kluwer Law International 2009) 311–407; art 23.1 of the LCIA Arbitration Rules (1998) combines the doctrines of separability and competence-competence in a single rule: 'The Arbitral Tribunal shall have the power to rule on its own jurisdiction, including any objection to the initial or continuing existence, validity or effectiveness of the Arbitration Agreement. For that purpose, an arbitration clause which forms or was intended to form part of another agreement shall be treated as an arbitration agreement independent of that other agreement. A decision by the Arbitral Tribunal that such other agreement is non-existent, invalid or ineffective shall not entail ipso jure the non-existence, invalidity or ineffectiveness of the arbitration clause.' See also UNCITRAL Arbitration Rules (2010) art 23(1); ICC Arbitration Rules (2012) arts 6(3) and (9). Article 41 of the ICSID Convention encapsulates the doctrine of competence-competence but there is not specific mention of the doctrine of separability.

[17] Emmanuel Gaillard and John Savage, *Fouchard, Gaillard & Goldman on International Commercial Arbitration* (Kluwer Law International 1999) 214.

[18] *Soleimany v Soleimany* [1999] QB 785, 797.

on the facts of the case, recognize an agreement to arbitrate in a contract concluded for the purpose of smuggling carpets illegally out of Iran.[19]

The House of Lords in *Fiona Trust Holding Corp v Privalov* gave further consideration to the circumstances in which an arbitration agreement will be vitiated by a ground of invalidity asserted in respect of the main contract.[20] Lord Hoffmann acknowledged that 'there may be cases in which the ground upon which the main contract is invalid is identical to the ground upon which the arbitration agreement is invalid', and he gave the example of an allegation that the signature of one of the parties had been forged, thus potentially negating the consent of the party to both the main contract and the arbitration agreement.[21] The particular allegation of bribery in *Fiona Trust*, according to Lord Hoffmann, did not impeach the arbitration agreement:

> [I]t is alleged that the main agreement was in uncommercial terms which, together with other surrounding circumstances, give rise to the inference that an agent acting for the owners was bribed to consent to it. But that does not show that he was bribed to enter into the arbitration agreement.[22]

Arbitration clauses are seldom the object of a specific and independent negotiation between commercial parties, and one may reasonably assume that this is no different when it comes to a negotiation that is alleged to be tainted by illegality such as corruption. It is thus virtually inconceivable that a party would be able to present evidence that the arbitration agreement, as distinct from the main contract in which it is embedded, was itself executed as the result of the payment of a bribe or some other conduct that would have the result of specifically invalidating the arbitration agreement. In *World Duty Free Company Limited v The Republic of Kenya*,[23] for instance, the contract with an ICSID arbitration clause had been procured by the payment of a substantial bribe to the Head of State in Kenya. The Tribunal found that 'the bribe was no separate agreement or otherwise severable' from the contract,[24] but nevertheless 'no evidence was adduced . . . to the effect that the bribe specifically procured [the arbitration agreement]'.[25] The Tribunal thus had jurisdiction to dismiss the Claimant's claims under the contract as founded upon an illegal bargain.

It follows that, in reality, the doctrine of separability can only be defeated by establishing a ground of invalidity for the main contract relating to the non-existence of a party's consent. This is a question of law. If there was no valid consent to the main contract by virtue of a party's mistake about the identity of the other party, a forged signature, a threat of violence and so on, then there will be no valid consent to the arbitration agreement either. However, it is difficult to fathom how a ground of invalidity for the main contract relating to its *illegality* could have the same effect.

[19] ibid 798. Although the Court of Appeal reasoned that it was only during the arbitration that the arbitrator had taken the view that this was the purpose of the contract.
[20] *Fiona Trust Holding Corp v Privalov* [2007] UKHL 40.
[21] ibid para 17.
[22] ibid para 19.
[23] *World Duty Free Company Limited v The Republic of Kenya*, ICSID Case No ARB/00/7, Award (4 October 2006).
[24] ibid para 174.
[25] ibid para 187.

The final potential impediment to a tribunal's adjudication of a plea of illegality in commercial arbitration is the doctrine of arbitrability, which defines whether the subject matter of a dispute is capable of being submitted to international arbitration. In modern times most legal systems have accepted a broad conception of the types of disputes that are suitable for arbitration; the decision of the US Supreme Court in *Mitsubishi Motors* confirming the arbitrability of disputes involving issues of US antitrust law stands out as a watershed in this respect.[26]

The plea of illegality often gives rise to questions of public policy, but that is not sufficient to render the subject matter of the dispute incapable of resolution by arbitration. For example, with respect to issues of corruption, there are two competing values to consider: 'on the one hand the desirability of giving effect to the public policy against enforcement of corrupt transactions and on the other hand the public policy of sustaining international arbitration agreements'.[27] The modern trend is to give preference to the latter consideration on the basis that there is no intrinsic reason to doubt the ability of arbitrators to rule upon allegations of corruption, and the courts at the place of enforcement of any award will be able to exercise some degree of review to ensure that the public policy of that forum in relation to corrupt practices is respected.[28] As a result of this development, there is no general category of disputes involving issues of illegality that are non-arbitrable *per se*, as would be the case in respect of matrimonial disputes, for instance. Non-arbitrability in the context of illegal transactions is likely to be confined to exceptional instances where a particular statute, as part of the law governing the arbitration agreement, expressly invalidates arbitration agreements that would otherwise provide a tribunal with jurisdiction over the issues regulated by that statute.[29]

It follows from this brief outline of the doctrines of separability, competence-competence and arbitrability in the context of commercial arbitration that a tribunal will only be deprived of jurisdiction to adjudicate a plea of illegality in exceptional circumstances.[30] The separability doctrine ensures that the tribunal has an independent source of authority to adjudge a plea relating to the illegality of the main contract and the competence-competence doctrine permits the tribunal to adjudge whether that alleged illegality somehow taints the separate arbitration agreement. The doctrine of arbitrability is only likely to impose a restriction upon the tribunal's jurisdiction over disputes where a plea of illegality is raised if there is an applicable statute that invalidates an arbitration agreement that would otherwise apply to issues covered by the subject matter of that statute.

[26] *Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc* 473 US 614 (1985).
[27] *Westacre Investments Inc v Jugoimport SDPR Holding Co Ltd* [1999] QB 740, 769.
[28] ibid 769, 770.
[29] See eg *Fincantieri-Cantieri Navali Italiani SPA v Ministry of Defence, Armament and Supply Directorate of Iraq* (1996) XXI YB Comm Arb 594 (Genoa Corte di Appello, 1994). However, it is doubtful that the Court of Appeal correctly interpreted the effect of the EU and Italian legislation giving effect to the embargo imposed against Iraq by the UN Security Council.
[30] There are only a handful of reported cases in recent times including: *Alabama Catalog Sales v Harris*, 794 So 2d 312 (Ala 2000); *Nature's 10 Jewelers v Gunderson*, 648 N W 2d 804 (SD 2002); Judgment of 15 June 1987, 1987 NJW 3193 (German Bundesgerischshof); *Fincantieri* (ibid).

C. *The Doctrines of Separability and Competence-Competence in Investment Treaty Arbitration*

For commercial arbitration, the economic aspects of the transaction are negotiated at the same time as the arbitration agreement and both are usually recorded in a single instrument: the commercial contract. The commercial bargain and the undertaking to resort to arbitration are thus intertwined in a temporal and physical sense, and it is precisely the *raison d'être* of the doctrine of separability to untie them juridically in order to preserve the effectiveness of arbitration in circumstances where one party attacks the validity of the commercial bargain. As we have seen, the doctrine of separability has developed to the point where, in cases of illegality, there must be specific evidence tainting the arbitration agreement itself with the illegality to defeat the tribunal's jurisdiction. In reality, this evidential burden is unlikely to be satisfied in all but the most extreme cases.

In contrast with commercial arbitration, investment treaty arbitration is characterized by a temporal and physical disconnect between the economic interests underlying the dispute and the conclusion of an agreement to arbitrate. The foreign national must have already acquired assets in the host State that satisfy the requirements of an investment set out in the investment treaty in order to be in a position to accept the host State's offer to arbitrate, which is also found within the treaty.[31] The arbitration agreement is perfected upon the filing of a notice of arbitration by the foreign national: both the material conditions for consent and the formal requirements for an arbitration agreement are satisfied at that juncture.[32] There is no coincidence in time between the acquisition of the relevant assets and the perfection of an arbitration agreement; indeed, a coincidence in time would tend to have the effect of making the claim inadmissible for forum shopping.[33]

The Tribunal in *Plama Consortium v Republic of Bulgaria*[34] mapped out the logical consequences of the manner in which an arbitration agreement comes into existence for investment treaty arbitration while considering a plea of illegality. The illegality asserted by the Respondent was that the approval of Bulgaria's privatization authorities—which was a condition precedent for the acquisition of the investment (shares in an oil refinery company)—had been obtained by fraudulent misrepresentation. The Tribunal held:

> [T]he Respondent's charges of misrepresentation are not directed specifically at the parties' agreement to arbitrate found in Article 26 [of the Energy Charter Treaty (ECT)]. The alleged misrepresentation relates to the transaction involving the sale of the shares of Nova Plama by EEH to PCL and the approval thereof given by Bulgaria in the Privatization Agreement and elsewhere. It is not in these documents that the agreement to arbitrate is found. Bulgaria's agreement to arbitrate is found in the ECT, a multilateral treaty, a completely separate document. The Respondent has not alleged that the Claimant's purported misrepresentation nullified the ECT or its consent to arbitrate contained in the ECT. Thus not only are the dispute settlement provisions of the ECT, including Article 26, autonomous and separable from Part III of that Treaty but they are

[31] Z Douglas (n 13) ch 5.
[32] ibid 35–8.
[33] ibid ch 12.
[34] *Plama Consortium v Republic of Bulgaria,* ICSID Case No ARB/03/24, Decision on Jurisdiction (8 February 2005).

> independent of the entire Nova Plama transaction; so even if the parties' agreement regarding the purchase of Nova Plama is arguably invalid because of misrepresentation by the Claimant, the agreement to arbitrate remains effective.[35]

The Tribunal thus resolved to hear the allegation of fraudulent misrepresentation on the merits. After a full hearing of all the evidence, the Tribunal was able to conclude that the Respondent's case of fraudulent misrepresentation had been proven. The consequence was not, of course, the retroactive vitiation of the Tribunal's jurisdiction but the dismissal of the Claimant's claims on the basis that its unlawful investment would not be protected by the substantive obligations of the Energy Charter Treaty.[36]

The Tribunal in *Malicorp v Egypt* followed the same approach:

> According to [the doctrine of separability], defects undermining the validity of the substantive legal relationship, which is the subject of the dispute on the merits, do not automatically undermine the validity of the arbitration agreement. Thus, an arbitral tribunal is competent to decide on the merits even if the main contract was entered into as a result of misrepresentation or corruption. Only defects that go to the consent to arbitrate itself can deprive the tribunal of jurisdiction. In the present case, there is nothing to indicate that the consent to arbitrate, as distinct from the consent to the substantive guarantees in the [BIT], was obtained by misrepresentation or corruption or even by mistake. The allegations of the Respondent relate to the granting of the Concession. However, it is not the Contract that provides the basis for the right to arbitrate, but the State's offer to arbitrate contained in the [BIT] and the investor's acceptance of that offer. The offer to arbitrate thereby covers all disputes that might arise in relation to that investment, including its validity.[37]

Given the proximity in time and space of the commercial bargain and the arbitration agreement in commercial arbitration, one might assume that an illegality tainting the commercial bargain would often infect that arbitration agreement given the reality that both are negotiated as a single package. This intuition is not born out in practice. The reason is grounded in the pragmatism that has inspired the modern doctrine of separability. National courts and tribunals have given more weight to the preservation of arbitration as the mechanism chosen to resolve *any* disputes arising out of the commercial bargain than to the principle that no party should be able to benefit from its own wrongdoing. If the latter principle were to be given more prominence, the reality that the commercial bargain and the arbitration agreement are *de facto* inseparable in the pursuit of a single enterprise that may be tainted by illegality would have to militate against their *de jure* separation. For in circumstances where the tribunal upholds its jurisdiction but finds that the commercial bargain is void for illegality, the doctrine of separability has the effect of enforcing one aspect of that enterprise—the arbitration agreement.

The pragmatism behind a preference for a robust doctrine of separability is that arbitration would cease to be a viable alternative to national court litigation if one

[35] ibid para 130.

[36] *Plama Consortium v Republic of Bulgaria*, ICSID Case No ARB/03/24, Award (27 August 2008) para 143. See also *Vannessa Ventures Limited v Venezuela*, although the decision to rule upon the plea of the illegality on the merits was justified for reasons of convenience and not reasons of principle. *Vannessa Ventures Ltd v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/04/6, Decision on Jurisdiction (22 August 2008) paras 71–4.

[37] *Malicorp Ltd v Arab Republic of Egypt,* ICSID Case No ARB/08/18, Award (7 February 2011) para 119.

party could frustrate recourse to it simply by pleading illegality.[38] There is, moreover, no *a priori* reason to doubt a tribunal's capacity to properly adjudicate an alleged illegality in comparison with a national court. The doctrine of separability simply preserves the adjudicative function of the tribunal in respect of this type of plea so that it can be disposed of in a binding decision. In any case, the national courts at the seat of the arbitration in most jurisdictions retain the power to nullify an arbitral award that contravenes public policy by giving effect to an illegal transaction, and such a power is also reserved to national courts at the place of enforcement.[39]

All of these pragmatic considerations that thwart pleas of illegality from depriving the tribunal of jurisdiction in the commercial context apply also to investment treaty arbitration. With these preliminary observations in mind, the three arguments advanced to justify the jurisdictional approach to a plea of illegality in investment treaty arbitration will now be examined.

III. RESPECT FOR THE INTEGRITY OF THE LAW OF THE HOST STATE

The first argument said to justify the jurisdictional approach rests upon the idea that international investment law should work in tandem with the underlying policies of national law when it comes to dealing with illegal conduct.

The objects of inquiry in this section are the policy rationales underlying the approach of national courts to situations where a claimant seeking to vindicate its private interests has violated the law of the host State. Respect for the integrity of the law of the host State is thus taken to mean acting in a way that is consistent with the policy rationales underlying the approach of the national courts in this sense.

The Law Commission of England and Wales has published a comprehensive study on 'The Illegality Defence',[40] which draws upon comparative materials in identifying the following policy rationales for the approach of national courts in dismissing a civil claim that is in some way tainted by illegal conduct on the part of the claimant:

(a) furthering the purpose of the rule which the illegal conduct has infringed;
(b) consistency as between different branches of the law;
(c) the claimant should not profit from its own wrong;
(d) deterrence; and
(e) maintaining the integrity of the legal system.[41]

Is the practice of declining arbitral jurisdiction in the face of illegal conduct on the part of the claimant consistent with one or more of these policy rationales in national law?

[38] Gaillard and Savage (n 17) 210–11.
[39] Gary B Born, *International Arbitration: Law and Practice* (Kluwer Law International 2012) 324–6 and 382–3; arts 34(b)(ii) and 36(b)ii of the UNCITRAL Model Law on International Commercial Arbitration (1986) with amendments, as adopted in 2006. See *World Duty Free v Kenya* (n 23) para 138.
[40] Law Commission, *The Illegality Defence* (Law Com 320, 2010) Presented to Parliament pursuant to s 3(2) of the Law Commission Act 1965.
[41] ibid para 2.35.

A. *Furthering the Purpose of the Rule Which the Claimant's Conduct Has Infringed*

All legal systems adopt the position that, in some circumstances, disallowing a claim will further the purpose of the rule which the claimant has violated. But it is not a rationale that results in a dismissal of the claimant's claim whenever it has violated a rule of law: it depends on the circumstances.

This can be illustrated by two different cases relating to contracts entered into by lawyers.

In the first case, the lawyer entered into a contract for a conditional fee arrangement with a client which was held to be against public policy and thus unenforceable. Rather than bringing a claim for breach of the contract, the lawyer claimed a reasonable sum from the client for the services that had been provided on the basis of unjust enrichment (*quantum meruit*). The claim was dismissed: if the court were to uphold such a claim it would undermine the prohibition on conditional fee arrangements.[42]

In the second case, the lawyer entered into a contract with a translator whereby the translator would introduce clients to the lawyer and perform translation services in return for a percentage of the lawyer's fees. This contract was held to be illegal under a statute regulating the legal profession. The translator claimed a reasonable sum from the lawyer for the services that had been provided on the basis of *quantum meruit*. The claim was upheld: the translator was less culpable than the defendant lawyer since the lawyer was on notice of the rules regulating the profession, whereas the translator was not aware of those rules; moreover, it was the introduction of clients for a fee that violated the statute, whereas the *quantum meruit* claim was directed to the provision of translation services.[43]

The illegality defence thus succeeded in the first case but failed in the second case despite the fact that the contracts in both cases violated the law applicable to the provision of legal services in England.

In some cases the purpose of the rule will actually be furthered if the claim is upheld rather than disallowed. In *Courage Ltd v Crehan*,[44] the European Court of Justice considered the consequences of a violation of European competition law. The contract in question related to an arrangement whereby the tenant of a pub that was let by a brewery was compelled to sell beer supplied by that brewery. The contract was found to be in breach of Article 81 of the European Community Treaty by imposing an unlawful restriction on competition and was thus held to be unenforceable. The tenant claimed damages for losses he had suffered as a result of being a party to that illegal contract. The European Court said that: 'the existence of such a right strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert, which are liable to restrict or distort competition'.[45]

The point is that a statutory rule prohibiting certain types of transactions may or may not be undermined if claims relating to those transactions can be maintained. Statutes rarely spell out the consequences of an infringement upon civil claims and

[42] *Awwad v Geraghty* [2001] QB 570.
[43] *Mohamed v Alaga* [2000] 1 WLR 1815.
[44] Case C–453/99 *Courage and Crehan* [2001] ECR I–6297.
[45] ibid para 27.

this often gives rise to complex questions of statutory interpretation in the national courts. The general approach seems to be that, if a statute does not expressly regulate the issue, the courts will not readily infer that civil claims become unenforceable if the statute is infringed. As an English judge remarked:

> I think that a court ought to be very slow to hold that a statute intends to interfere with the rights and remedies given by the ordinary law of contract. Caution in this respect is, I think, especially necessary in these times when so much of commercial life is governed by regulations of one sort of another, which may easily be broken without wicked intent.[46]

Given these insights relating to the rationale for the illegality defence under discussion, a principle whereby arbitral jurisdiction is declined *in toto* upon establishing that the claimant has violated a norm of the host State's legal order is indefensible. Such a principle attaches international consequences to a violation of national law that are at odds with the policy rationales that inform how the same violation would be treated by the national courts. There is, of course, no mandatory rule requiring symmetry in the manner in which international law and domestic law approach the same violation of domestic law. But an asymmetrical approach must be justified by recourse to an autonomous international legal principle and not on the basis of respect for the integrity of the national legal system.

Consider the situation where the assets constituting an investment have been procured by the foreign national pursuant to an illegal transaction with a State authority and those assets are subsequently expropriated by the host State. The tribunal declines its jurisdiction on the basis that the investment is 'illegal *per se*'.[47] Suppose France is the host State. Under French law, an illegal agreement 'cannot have any effect'.[48] Is there symmetry in the way in which the illegality under domestic law is treated by the international test for jurisdiction and French law on illegal contracts? Not necessarily. French law takes the position that if a contract is a nullity by reason of an illegality, then any effects in fact produced by that contract must be wiped out: the courts must 'undo' the transaction. It follows that the party that has received something under the contract must give it back.[49] Why should an investment treaty tribunal not have jurisdiction over a claim that the host State was obliged to return the investor's consideration paid for the assets in question under domestic law, and that right was effectively abrogated when the assets were taken by the State?

Suppose the host State is the United Kingdom, and English law applies. In contrast to French law, English law generally adopts the position that where both parties are guilty, the position of the defendant is the stronger,[50] so that 'any gains or losses remain where they have accrued or fallen'.[51] Would a tribunal denying jurisdiction in respect of assets acquired under a transaction governed by English law be approaching the illegality in a manner consistent with English law? Not

[46] *St John Shipping Corporation v Joseph Rank Ltd* [1957] 1 QB 267, 288 per Lord Devlin.
[47] The formulation in *Tokios Tokelés* (n 2) para 86.
[48] French Civil Code art 1131.
[49] This is established by a long line of modern cases beginning with: *Soc Majic et Rexor v Julienne* D.1958.II.221, note Malaurie.
[50] *Holman v Johnson* (1775) 1 Cowp 341, 343. This rule is encapsulated in the Latin maxim *in pari delicto potior est conditio defendentis*.
[51] Michael P Furmston, *Cheshire, Fifoot and Furmston's Law of Contract* (OUP 2007) 495.

necessarily. There are exceptions to the English rule of non-recovery if the claimant can plead a cause of action that is not founded upon the illegal contract, is less blameworthy than the other party to the contract, or repents before the contract has been performed.[52]

In conclusion, fidelity to this first policy rationale underling the illegality defence in national law would call for adjudication by an international tribunal to determine, for instance, whether a claim with the object of reversing an unjust enrichment by the host State undermines the rule of national law that has been violated by the claimant.

B. *Consistency As Between Different Branches of the Law*

Consistency as between different branches of the law in some jurisdictions (like Canada, for example) is considered to be the principal justification for the illegality defence.[53] The idea is encapsulated in judicial statements such as '[y]ou cannot recover compensation for loss which you have suffered in consequence of your own criminal act'.[54]

The two cases described above involving contracts entered into by lawyers also suggest that a nuanced approach must be taken to the policy rationale of ensuring that there is consistency between the different branches of the law. In the first of the two cases, it was held that the claim in unjust enrichment must be dismissed because it would have the same effect as a claim for contractual enforcement that the law has prohibited. In the second of those cases, the opposite conclusion was reached because the claim in unjust enrichment did not relate to the very thing that the legal prohibition was directed to. What cannot be postulated is that there is an inflexible principle of domestic law to the effect that consistency requires that no judicial remedy ever be granted to a claimant who has contravened the law.

Even where consistency between different branches of national law requires that a claim be disallowed by a claimant that has violated one branch of that law, it by no means follows that consistency also requires a tribunal to decline arbitral jurisdiction in respect of that same claim.

C. *The Need to Prevent the Claimant from Profiting from Its Own Wrongdoing*

This principle, or its Latin equivalent—*nemo auditor propiam turpitudinem allegans*—is perhaps the most cited justification in the investment treaty cases that have declined jurisdiction on the basis of an illegality committed by the claimant.[55] The mere invocation of a general maxim, however, cannot be a substitute for a rigorous engagement with how that maxim is actually applied in practice. At one end of the spectrum, there is universal acceptance of the idea that 'the Courts will not recognise a benefit accruing to a criminal from his crime'.[56] But the matter becomes more complex in relation to tort claims, where the objective is often compensation rather than the extraction of lost profits, as well as unjust enrichment claims, where

[52] ibid 495–503.

[53] *Hall v Hebert* (1993) 2 SCR 159, 180 per McLachlin J. See also, in Australia, *State Rail Authority of New South Wales v Wiegold* (1991) 25 NSWLR 500, 514 per Samuels JA.

[54] *Gray v Thames Trains* [2009] UKHL 33, para 29.

[55] *Fraport* (n 4) para 402; *Inceysa Vallisoletana* (n 4) paras 240–1; *Plama v Bulgaria* (n 36) paras 140–3; and framed as the content of the principle of public policy in *World Duty Free v Kenya* (n 23) paras 163–79.

[56] *Beresford v Royal Insurance Company Ltd* [1938] AC 586, 599.

the objective is the restitution of a benefit. In France, for example, the courts frequently rely upon the quoted Latin maxim in the absence of a specific provision in the Civil Code, but this has not prevented the emergence of a distinction between a *convention immorale*—in respect of which a claim for unjust enrichment relating to an unenforceable illegal contract cannot be maintained—and a *convention seulement illicite*, in respect of which it can.[57] In England the approach to unjust enrichment claims is informed by another Latin maxim: '*in pari delicto, potior est condition defendentis*' (when the parties are equally blameworthy, the defendant has the stronger position). The claimant is less blameworthy, and thus entitled to make an unjust enrichment claim, if it was induced to enter the contract as a result of the duress of the other party or was ignorant of a fact or law that rendered the contract illegal.[58]

An analysis of how this policy rationale for the illegality defence plays out in national legal systems once again reveals the absence of a rigid or uniform principle to the effect that no judicial remedy may ever be granted to a claimant who has contravened the law. This policy rationale does not suggest that an international tribunal should decline arbitral jurisdiction over the very question of whether the illegality defence should be upheld on the merits.

D. *Deterrence*

Whether or not the policy of deterrence informs the manner in which national courts deal with pleas of illegality in civil cases is controversial. The criminal law is the principal instrument for deterring morally or socially undesirable conduct; it is a more marginal concern of the civil law. The reason that national legal systems eschew inconsistencies between the criminal law and the civil law is perhaps explicable on the basis that to afford a civil remedy to a claimant that has transgressed the criminal law has the effect of undermining the deterrent effect of the criminal law. But there are limits to this insight: the parties to an illegal contract are often ignorant of the norms that they have transgressed.

If an investment is made in contravention of the criminal law of the host State, then is the deterrent effect of that criminal law undermined if a tribunal upholds its jurisdiction over a claim by the investor? This seems doubtful. Presumably if an investor is prepared to incur the significant costs involved in commencing an investment treaty claim, it has calculated that it has plausible grounds for arguing that its conduct did not contravene the criminal law of the host State. The tribunal will thus be presented with a complex dispute requiring an investigation of the host State's criminal law and other matters beyond the usual expertise of international arbitrators.

Those investment treaty tribunals that have declined their jurisdiction when confronted with an objection that the claimant investor has engaged in serious impropriety have generally sought to avoid this dilemma by analyzing that conduct through general principles such as good faith or *nemo auditur propiam*

[57] Konrad Zweigert, Hein Koetz and Tony Weir, *An Introduction to Comparative Law* (3rd edn, OUP 1998) 579.
[58] *Davies v London and Provincial Marine Insurance Co* (1878) 8 Ch D 469.

turpitudinem allegans.[59] Those general principles are said to be part of the host State's legal order[60] and reliance upon them alleviates the difficulty of coming to terms with the host State's criminal laws. It is doubtful that awards following that approach promote a policy of deterrence in relation to the host State's criminal law because it is not the host State's criminal law that provides the basis for the decision.

In contrast, an international tribunal is more likely to engage seriously with the host State's criminal laws if it has jurisdiction. The legality of the investor's conduct can be considered together with the host State's measures adopted to address that conduct. For instance, if the illegality is proven and the host State has confiscated the claimant's assets then the tribunal can render an award vindicating the host State's actions by reference to the police powers doctrine. If the question of illegality is before the host State's domestic courts, then the tribunal might consider whether a stay of its proceedings would be appropriate in order to benefit from a national judge's analysis of the evidence and law. A stay cannot be ordered unless the tribunal has jurisdiction. By engaging with the host State's criminal laws on the merits, the tribunal's award is more likely to promote their deterrent effect.

E. *Maintaining the Integrity of the Legal System*

It is sometimes suggested that one objective of the illegality defence in national legal systems is to ensure that the courts do not become a forum for serious wrongdoers to fight over their spoils and obtain assistance in the form of judicial remedies.[61] This idea also explains the limits of the doctrine of separability in commercial arbitration: an arbitration agreement in a contract for the division of the proceeds of crime, for instance, will be void along with the main contract.[62]

It is only in the most exceptional cases, however, that a court or tribunal would be compelled to refuse to adjudicate a dispute on this basis. The limitations of the principle are illustrated by the Privy Council's decision in *Townsend v Persistence Holdings Ltd*.[63] The Court of Appeal of the Eastern Caribbean stopped a trial and entered judgment for the Defendant after the Claimant accepted that an agreement for the sale of land had been structured so that the Defendant could avoid paying stamp duty to the tax authorities. The Claimant had brought the action to terminate the agreement. On appeal, the Privy Council criticized this approach because the question of illegality required adjudication: if the agreement was dishonestly structured, then the Court had to decide whether this disentitled the Claimant from seeking relief as a matter of law. The case could not simply be summarily dismissed once the Claimant had made its admission.

[59] See cases in n 9.
[60] *Inceysa Vallisoletane* (n 4) paras 233, 243–5, 254; *World Duty Free v Kenya* (n 23) para 166; *Phoenix Action Limited* (n 4) para 107.
[61] *Everet v Williams* (1725) reported at (1893) 9 LQR 197; *Parkinson v College of Ambulance Ltd and Harrison* [1925] 2 KB 1, 13 and *Tappenden v Randall* (1801) 2 Bos & Pul 467, 471.
[62] *Soleimany v Soleimany* (n 18).
[63] *Townsend v Persistence Holdings Ltd* [2008] UKPC 15.

F. *Conclusion*

Respect for the integrity of the law of the host State is surely better assured by seeking to emulate on the international plane the consequences of an illegality in national law. The answer to a jurisdictional objection must be to affirm or to deny, and yet the responses to an illegality in national law are not that straightforward and cannot be forced into a binary scheme. This suggests that respect for the integrity of the law of the host State as an argument for characterizing a plea of illegality as a jurisdictional objection must be rejected.

IV. GENERAL PRINCIPLES OF INTERNATIONAL LAW

The second argument said to justify the jurisdictional approach to a plea of illegality requires the express provisions of the treaty regulating the existence and scope of the international tribunal's jurisdiction to be supplemented by general principles of international law or interpreted against the background of such principles.

The general principles that have been put forward as candidates for this role are good faith and *nemo auditur propiam turpitudinem allegans*.[64] International public policy is also sometimes relied upon, but as will be discussed in Section VI, this is a principle that goes to the admissibility of claims rather than the jurisdiction of the tribunal.

The interpretation of investment treaties against the background of general international law would not, in itself, be incorrect. As Verzijl said:

> Every international convention must be deemed tacitly to refer to general principles of international law for all questions which it does not itself resolve in express terms and in a different way.[65]

However, given that all investment treaties expressly regulate the existence and scope of the international tribunal's jurisdiction, the recourse to general principles must fit within the interpretative space that is captured by the terms of the relevant treaty provisions. Such recourse, in other words, must be consistent with the principles of treaty interpretation in Articles 31 and 32 of the Vienna Convention on the Law of Treaties.

According to Article 31(1) a 'treaty shall be interpreted in *good faith* in accordance with the ordinary meaning to be given to the terms of the treaty in the context and in the light of its object and purpose'. This does not give a tribunal a licence to refashion an express provision of the treaty so that it better serves the principle of good faith in the estimation of the tribunal. As highlighted by Gardiner, 'the term "in good faith" indicates how the task of interpretation is to be undertaken . . . [G]ood faith does not have an entirely independent function'.[66]

It could also be argued that an interpretative approach that seeks to accommodate the interaction of the definition of investment, the plea of illegality

[64] See cases cited in n 9.

[65] *Georges Pinson (France v Mexico)* (1928) 5 RIAA 327. See also ILC Fifty-eight Session, 'Report of the Study Group on Fragmentation of International Law: Difficulties arising from the Diversification and Expansion of International Law' (13 April 2006) A/CN.4/L.688 para 29 ('ILC Report') and Lord McNair, *The Law of Treaties* (OUP 1961) 466.

[66] Richard Gardiner, *Treaty Interpretation* (OUP 2008) 152.

and the principle of good faith is faithful to the rule in Article 31(3)(c) of the Vienna Convention, according to which a treaty should be interpreted taking into account 'any relevant rules of international law applicable between the parties'. This rule reflects what has been described as the principle of systemic integration[67] as it provides a technique for regulating the interaction of international norms and principles.

There is obviously no peremptory norm of international law that could prevent the contracting State parties from consenting to arbitral jurisdiction in circumstances where the putative investor has violated the host State's law. So the question is whether there is a relevant rule of international law that operates to qualify or limit the treaty provisions creating the arbitral jurisdiction in the sense of Article 31(3)(c). In other words, can it be said that the contracting State parties would have negotiated the treaty text against the background of a general principle of international law that would self-evidently impose a qualification or limitation upon the treaty text such that there was no need to make explicit reference to it?

General principles of international law can certainly enlighten a choice between competing interpretations of a treaty provision, but they cannot provide an independent basis for limiting the jurisdiction of an international tribunal through the interpretation of the express treaty provisions that establish that jurisdiction. Principles of international law such as good faith and *nemo auditur propiam turpitudinem allegans* are not principles whose significance in relation to the jurisdiction of an international tribunal is so notorious that they require no express recognition in the treaty text. By contrast, the principles of separability and competence-competence would apply to the jurisdiction of an international tribunal established under the treaty, regardless of whether there is an express reference to them in the treaty text or an indirect incorporation via a reference to a set of arbitral rules.

Next there is the question of the particular source of the general principle of good faith. Given that it is deployed in the context of adjudging the conduct of a putative investor by the tribunals that have followed this approach, it seems clear that good faith as a principle regulating the relations between States is inapposite. The corpus of general principles of law derived from a comparative analysis of national legal systems may be a more fruitful source.[68] Indeed, the tribunals that have invoked general principles of international law to justify a jurisdictional approach to a plea of illegality have acknowledged the overlap between what is said to be dual manifestations of the principles in the different legal orders:

> [The principle of good faith] appears . . . as a kind of 'Janus concept', with one face looking at the national legal order and one at the international legal order. And in most cases, but not in all, a violation of the international principle of good faith and a violation of the national principle of good faith go hand in hand.[69]

But if the principles in question are derived from a comparative analysis of national legal systems, then it has been demonstrated in Section III that the policies underlying how national courts approach the plea of illegality do not

[67] See ILC Report (n 65) para 410ff. See also Campbell McLachlan, 'The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention' (2005) 54 ICLQ 279–320.
[68] Statute of the International Court of Justice, art 38(1)(c).
[69] *Phoenix Action Limited* (n 4) para 109.

translate into a jurisdictional impediment at the international level. In other words, if once again the rationale for the approach is fidelity to the law of the host State (although this time through the medium of general principles of law derived from a comparative analysis of national legal systems), then such fidelity ought to be consistent with how the principle is applied in national legal systems. The principle that no one should profit from his own wrong has been analysed in this context in Section III and it has been shown that it cannot justify a jurisdictional approach to the plea of illegality. The principle of good faith probably animates this principle as well as the others examined in Section III, but once again no inexorable link between the policies directing the national courts in their approach to a plea of illegality, on the one hand, and a requirement that an international tribunal decline its jurisdiction in the face of the same plea, on the other, could be discerned.

If the response to this is that international law, independent of any policies underlying national laws, nonetheless compels an international tribunal to decline its jurisdiction in the face of a successful plea of illegality, then the burden of persuasion lies upon those advocating this position to demonstrate why that is the case and how it is consistent with the principles of interpretation in Articles 31 and 32 of the Vienna Convention. The justification provided in *Phoenix v Czech Republic*, for instance, does not appear to be adequate:

> There is no doubt that the requirement of the conformity with law is important in respect of the access to the substantive provisions on the protection of the investor under the BIT. This access can be denied through a decision on the merits. However, if it is manifest that the investment has been performed in violation of the law, it is in line with judicial economy not to assert jurisdiction.[70]

An appeal to 'judicial economy', important as it is, cannot provide the missing link between general principles of law such as good faith and *nemo auditur propiam turpitudinem allegans* and the jurisdiction of the tribunal. If an allegation of unlawful conduct on the part of the claimant is sufficiently 'manifest' at an early stage of the proceedings, then the tribunal can use its case management powers to determine whether that allegation can be proved and whether it provides a complete defence to the claims as a preliminary issue. That would satisfy the tribunal's obligation to conduct an efficient procedure. However, the characterization of an issue as going to jurisdiction, admissibility or the merits is a question of law. It cannot be decided by reference to procedural considerations like 'judicial economy'. It is not within the discretion of a tribunal to characterize something as jurisdictional in order to dispose of it quickly and efficiently.

These general principles under discussion might be expected to play a role in a tribunal's interpretation of the substantive investment protection obligations. International public policy might also provide a basis for a plea of inadmissibility. However, jurisdiction is concerned with the narrow question of whether the international tribunal is properly vested with adjudicatory power. A jurisdictional objection must, in Paulsson's words, 'take aim at the tribunal'.[71] It is difficult to resist the conclusion that recourse to the principle of good faith and other general

[70] ibid para 104.

[71] Jan Paulsson, 'Jurisdiction and Admissibility' in Gerald Asken and others (eds), *Global Reflections on International Law, Commerce and Dispute Resolution: Liber Amicorum in honour of Robert Briner* (ICC 2005) 601.

principles of international law for the purposes of carving out certain types of disputes from the jurisdiction of the tribunal amounts to modifying the arbitration agreement entered into by the claimant and the respondent host State.[72] That arbitration agreement is based upon the express provisions of the investment treaty and cannot be subsequently amended by the tribunal constituted to adjudicate the dispute.

V. EXPRESS PROVISIONS IN INVESTMENT TREATIES

A provision similar to the following clause in the Italy–Morocco bilateral investment treaty (BIT) can be found in a great number of investment treaties:

> [T]he term 'investment' designates all categories of assets invested, after the coming into force of the present agreement, by a natural or legal person, including the Government of a Contracting Party, on the territory of the other Contracting Party, *in accordance with the laws and regulations of the aforementioned party.*[73]

There is now a series of decisions that have interpreted the italicized text as opening the door to jurisdictional challenges based upon pleas of illegality relating to the underlying investment. The manner in which this has occurred is unfortunately symptomatic of how interpretations become entrenched in many areas of international investment law. The Tribunal in *Salini Costruttori SPA & Italstrade SPA v Kingdom of Morocco* uttered two sentences in respect of this italicized text that were probably unnecessary for its decision:

> [The underlined clause] refers to the validity of the investment and not to its definition. More specifically, it seeks to prevent the Bilateral Treaty from protecting investment that should not be protected, particularly because they would be illegal.[74]

No authority was cited for this interpretation; nor did the Tribunal attempt to justify it by reference to first principles. This interpretation was then adopted, without further analysis, in a series of awards such that it now holds a virtual monopoly over the interpretative space granted to tribunals.[75]

The first thing that is striking about the *Salini* interpretation is that it subsumes the regulation of the highly complex questions surrounding pleas of illegality to the bare mention of the host State's laws in the context of the provision setting out the paradigmatic types of assets that qualify as an investment for the purposes of the treaty. The word 'illegality' is absent from the typical clause under discussion and so is any reference to the conduct of the prospective investor in the host State. It must be extremely doubtful that the contracting States sought to regulate the multifarious issues arising out of a plea of illegality by this simple reference to their own laws in this context. Does any contravention of any law by the foreign

[72] *Saba Fakes v Republic of Turkey,* ICSID Case No ARB/07/20, Award (14 July 2010) para 112 ('[T]he principles of good faith and legality cannot be incorporated into the definition of Art 25(1) of the ICSID Convention without doing violence to the language of the ICSID Convention: an investment might be "legal" or "illegal", made in "good faith" or not, it nonetheless remains an investment. The expressions "legal investment" or "investment made in good faith" are not pleonasms, and the expressions "illegal investment" or "investment made in bad faith" are not oxymorons').

[73] *Salini Costruttori SPA & Italstrade SPA v Kingdom of Morocco*, ICSID Case No ARB/00/4, Decision on Jurisdiction (23 July 2001) para 45 (emphasis added).

[74] ibid para 46.

[75] See eg *Tokios Tokelés* (n 2) para 84.

national have the effect of depriving the tribunal of jurisdiction? (Would the failure to procure approval of the sanitary authorities for an investment in the financial services sector be fatal to the tribunal's jurisdiction?) When must the contravention occur and what is the requisite connection to the assets that have been acquired by the foreign national in the host State? (Would the breach of the road traffic rules in the host State by the general manager of the investment company in the fifth year of its operations have the same effect?) Is the law of the host State controlling in all circumstances of an alleged illegality? (Would a tribunal have no means of censuring an investment using slave labour if this were not prohibited under the host State's law?)

These examples are of course for rhetorical effect and are at the extreme end of the plausibility curve, but the point is that a simple reference to the host State's laws provides no guidance for resolving more nuanced pleas of illegality either.

Next, consider the ramifications of such an interpretation against the background of the doctrines of separability and competence-competence. If a tribunal upholds a plea of illegality relating to its jurisdiction, it has exercised that adjudicative power on the basis of the doctrine of competence-competence. The essence of the plea is that a condition precedent for the valid formation of an arbitration agreement has not been fulfilled: there has been no investment. A determination that there is no arbitration agreement means that there is no independent source of authority for a decision upholding the jurisdictional objection in the sense that the decision will not be *res judicata*. There is no consent to the rendering of a binding decision through arbitration and the separability doctrine is of no avail. There is, therefore, nothing preventing the claimant from commencing fresh proceedings against the host State if jurisdiction has been previously declined. This is hardly consistent with the effective administration of justice.

The principle of competence-competence affords a tribunal the very limited power of determining whether there is a valid source for its adjudicative power in respect of the dispute that has been submitted to it. The plea of illegality raises intricate factual and legal questions that may often require orders for the disclosure of documents by the tribunal, the examination of witnesses and experts and perhaps even the indication of provisional measures. All this activity must be justified, in the event that such a plea is upheld, by reference to the principle of competence-competence alone, which is not consistent with the limited power it confers to preserve the efficacy of consent-based adjudication.

The reference to the host State's laws in a relatively standard provision defining the types of assets that may qualify as investments under the treaty is surely nothing more and nothing less than recognition of the *lex situs* rule for the acquisition of the tangible and intangible property rights listed by the provision.[76] The foreign national must have acquired an asset that is recognized by the host State's laws in a manner that is effective under such laws.[77] If the host State's laws do not vest the owner of land with rights to subsoil minerals, then a foreign national cannot claim that its investment consists of rights to the subsoil minerals despite being the owner of the land. If the host State's laws require that shares in a

[76] Z Douglas (n 13) 52–7.

[77] For examples of where tribunals have declined jurisdiction on this basis, see *Saba Fakes* (n 72); *Europe Cement* (n 9).

local company can only be acquired by the delivery of the share certificates, then the foreign national must take delivery of the share certificates to have an investment in shares. An investment treaty does not create property rights or regulate the means for their acquisition; an investment treaty instead provides an additional layer of protection once property rights defined under the laws of the host State have been acquired in the manner prescribed by those laws. In the words of the tribunal in *EnCana v Ecuador*: 'for there to have been an expropriation of an investment or return . . . the rights affected must exist under the law which creates them, in this case, the law of Ecuador'.[78]

The reference to the host State's laws in the type of provision under discussion is confirmation of the ubiquitous *lex situs* rule in private international law that has been adopted by public international law for the purposes of adjudicating the responsibility of States for interference with the proprietary interests of foreign nationals.[79] The same rule would operate regardless of whether it is confirmed in the treaty text because the requirement of a territorial connection with the host State demands that tangible and intangible property rights must be cognizable under its laws. In other words, it would be applicable by implication given the architecture of an investment treaty.[80]

Accordingly, the reference to the host State's laws in the provision defining the types of assets that may qualify as investments under the treaty should not be considered as an invitation to the tribunal to adjudge whether the entire corpus of the host State's laws was complied with for jurisdictional purposes either during the acquisition of the investment or at some other point in time.[81]

The leading case in which the majority of the Tribunal characterized the plea of illegality as relevant to its jurisdiction on the basis of the express provision under consideration is *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*.[82] The plea of illegality related to Fraport's ability to exercise control over a Philippine company, PIATCO,[83] which had been awarded a concession to build and operate an airport terminal in Manila. In accordance with what is known as the 'Anti-Dummy Law' in the Philippines,[84] it is prohibited for Philippine nationals to act as proxies for foreign nationals in circumstances where the law of the Philippines requires that control over the particular assets in question had to be exercised by Philippine nationals. This is the case in respect of public utilities such as an airport. The majority accepted, however, that the actual direct and indirect equity investment held by Fraport in PIATCO was lawful.[85] The assets (rights to shares) were, therefore, validly acquired but at the time of the acquisition Fraport entered into secret shareholders' agreements with the

[78] *EnCana Corporation v Republic of Ecuador*, UNCITRAL/LCIA Case No UN3481, Award (3 February 2006) para 184.

[79] Christopher Staker, 'Public International Law and the *Lex Situs* Rule in Property Conflicts and Foreign Expropriations' (1987) 58 BYBIL 151, 163–9.

[80] Z Douglas (n 13) 52–7.

[81] *Saba Fakes* (n 72) paras 119–20.

[82] *Fraport* (n 4). The award was subsequently annulled by an *ad hoc* Committee on the basis that Fraport was not given an adequate opportunity to make submissions on documents filed after the hearing upon which the Tribunal subsequently relied in upholding the objection to its jurisdiction founded upon a plea of illegality *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, ICSID Case No ARB/03/25, Annulment Decision (23 December 2010).

[83] Earlier known as the Philippine International Air Terminals Co Inc.

[84] Philippine Constitution and Commonwealth Act No 108 (1936) 'An Act to Punish Acts of Evasion of the Laws on the Nationalization of Certain Rights, Franchises or Privileges'.

[85] *Fraport* (n 4) para 350.

Philippine shareholders in PIATCO, which had the effect of giving Fraport ultimate control over the airport project. The majority held that Fraport had 'consciously, intentionally and covertly structur[ed] its investment in a way which it knew to be a violation of the [Anti-Dummy Law]'.[86] The majority found that this violation infringed the provision in the Germany–Philippines BIT requiring the assets be 'accepted in accordance with the respective laws and regulations of the [host State]' and on this basis declared that it had no jurisdiction *ratione materiae*.[87]

An examination of the attendant difficulties with such an interpretation of the provision in question with reference to the facts of the *Fraport* case will help elucidate the reasons for preferring the interpretation offered by the present writer.

The first difficulty is the question of timing. The majority was adamant that it was only at the 'moment of the investment' that the plea of illegality as a jurisdictional objection could bite.[88] It expressly rejected the Respondent's contention that the provision in question required compliance with the host State's laws throughout the lifespan of the investment as a condition precedent to the Tribunal's jurisdiction.[89] Any violation of the host State's laws occurring after the 'initiation' of an investment, according to the majority, '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'.[90]

This temporal dividing line between pleas of illegality that go to jurisdiction and to the merits has no sound basis in principle. The illegality discerned by the majority related to the execution of secret shareholders' agreements to ensure that Fraport could exercise managerial control over PIATCO in violation of the Anti-Dummy Law. These agreements were executed 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. It would seem to follow that if those agreements had simply been executed after the shareholding interests were acquired, then this would be a problem for the merits. And yet the essence of the illegality would be identical.

What if relevant acts giving rise to a violation of the law of the host State commenced before the acquisition but the violation was only consummated afterwards? The dissenter asserted that there was no evidence that control was actually exercised by Fraport over PIATCO pursuant to the shareholders' agreements during the performance of the concession, and this was necessary for a violation of the Anti-Dummy Law.[91] If the dissenter's interpretation of the Anti-Dummy Law is correct, then following the majority's approach, there would cease to be a viable jurisdictional objection because the violation was consummated after the acquisition of the investment, despite the fact that critical steps were taken before the acquisition by executing the secret shareholders' agreements. The temporal dividing line between the issues of jurisdiction and the merits endorsed by the majority leads to artificial results.

[86] ibid para 323. See also para 355.
[87] ibid para 401.
[88] ibid para 395.
[89] ibid para 345.
[90] ibid. See also *Hamester v Ghana* (n 7) para 127.
[91] *Fraport* (n 4) Dissenting Opinion, para 25.

The second difficulty is the requisite connection between the illegality and the acquisition of the investment. In the circumstances of the *Fraport* case there was evidence that linked the unlawful quest for managerial control with the acquisition of the assets themselves. The evidential record was perhaps exceptional in this respect. But what if the violation of the host State's law during the course of the acquisition is more incidental? The majority anticipated this question by reasoning that if the illegality were 'not central to the profitability of the investment, such that the investor might have made the investment in ways that accorded with local law without any loss of protected profitability'[92] then this would be indicative of the investor's good faith such that no jurisdictional impediment could be discerned. However, this is a rather invidious touchstone for taking account of the host State's laws. It would appear to suggest that if compliance affects the investment's profitability then compliance will be essential to establishing the tribunal's jurisdiction, but not otherwise. The majority sought to buttress its approach with the laudable statement that '[r]espect for the integrity of the law of the host State is also a critical part of development and a concern of international investment law'.[93] It is doubtful, however, that such respect is fostered by a jurisdictional test that attributes significance to the host State's laws on the basis of their economic impact upon the investment.

The same must be said of the Tribunal's other caveat that 'the law in question of the host State may not be entirely clear and mistakes may be made in good faith'.[94] Once again, this is a problematic basis for deciding whether or not to give effect to the host State's law for jurisdictional purposes. When is ignorance of the law or a mistaken interpretation of the law, even in good faith, an excuse for non-compliance? Other tribunals have purported to carve out 'technical' or '*de minimis*' violations and the like, which is no more coherent. It would appear that the category of violations that do not provoke a jurisdictional infirmity is expanding in the jurisprudence to avoid the draconian effects of the approach to the plea of illegality under consideration. In *Gustav F W Hamester GmbH & Co KG v Republic of Ghana,*[95] for instance, the Tribunal reasoned that Hamester's submission of false invoices 'might not be in line with what could be called "l'éthique des affaires", but, in the tribunal's view, they did not amount, in the circumstances of the case, to a fraud that would affect the tribunal's jurisdiction'.[96] So it transpires that only a serious fraud might deprive a tribunal of its jurisdiction, whereas a lesser fraud can be swept under the carpet, at least for jurisdictional purposes.[97]

The irony is that this purported fidelity to the text of the express provision under consideration, reflected in the characterization of illegality in the acquisition of the investment as a jurisdictional problem, has resulted in a series of judicially created exceptions that may serve to undermine the fundamental principle that the prospective investor is bound to observe the entire spectrum of the host State's laws.

[92] ibid para 396.
[93] ibid para 402.
[94] ibid para 396.
[95] *Hamester v Ghana* (n 7).
[96] ibid para 138.
[97] It was stated by Lord Goff in *Tinsley v Milligan* [1994] 1 AC 340, 362, that the common law rules on illegality do not distinguish 'between degrees of iniquity'.

The third and related problem, which has already been analysed above, is the extent to which the consequences of the illegality in national law are to be taken into account at the international level. The difficulty with selecting certain types of illegality under the host State's laws as relevant or irrelevant to the tribunal's jurisdiction is that it has the effect of obfuscating the relationship between the consequences of the illegality under national law and the impugned measures of the host State.

In *Fraport*, it was alleged that the Government of the Philippines had expropriated Fraport's interest in PIATCO. Suppose, *arguendo*, that a violation of the Anti-Dummy Law obliged Fraport to divest itself of its interest in PIATCO for whatever consideration it could obtain in the market. Suppose further that PIATCO was deprived of its legal right to obtain a fair price for its interest due to the expropriation. Would it be right, in such circumstances, to decline jurisdiction over Fraport's treaty claim to recover damages for its interest in PIATCO by virtue of its breach of the Anti-Dummy Law? Surely not.

This type of scenario is, moreover, far from uncommon. A violation of competition law does not, for instance, result in the forfeiture of the assets acquired in the transaction leading to that violation. The transaction must instead be unwound with each party entitled to restitution.[98] Suppose the transaction led to the acquisition of an investment by the purchaser but the host State's competition authorities subsequently declared the transaction to be void as anti-competitive. At that point, the host State expropriates the assets that were the object of the transaction. Must an investment treaty tribunal decline jurisdiction over the resultant claim by virtue of the original violation of competition law? This would seem inimical to the effective operation of the investment treaty.

In conclusion, the express provisions of investment treaties referring to the laws of the host State in the context of defining the characteristics of assets that will be protected as investments under the treaties do not compel tribunals to dispose of pleas of illegality as objections to their jurisdiction. It follows from this analysis of the express treaty provisions, as well as the two more general arguments made in support of the jurisdictional approach to a plea of illegality, that a limitation upon the host State's consent to arbitration should not be implied in respect of investments that have been acquired in contravention of the laws of the host State either.

VI. A ROADMAP FOR PLEAS OF ILLEGALITY IN INVESTMENT TREATY ARBITRATION

It is necessary to distinguish three objects of inquiry into compliance with the laws of the host State in relation to: (i) the assets acquired by the foreign national; (ii) the transaction resulting in the acquisition; and (iii) the subsequent use of the assets by the foreign national. The question that is now addressed is whether a plea of illegality in relation to each of those objects is a plea that goes to the tribunal's jurisdiction, the admissibility of the claims or the merits of the dispute.

[98] For an example under European law, see *Courage and Crehan* (n 44).

A. *The Assets Acquired by the Foreign National*

An investment is an asset or group of assets acquired by a foreign national on the basis of a commitment of resources to the economy of the host State entailing the assumption of risk in expectation of a commercial return.[99] The host State's consent to international arbitration is contingent upon the foreign national's acquisition of an investment: this is the *quid pro quo* at the heart of the investment treaty. The assets comprising the investment must be cognizable as property rights under the law of the host State. This link to the law of the host State is mandated by the architecture of the investment treaty, which is designed to provide international protection in respect of the host State's exercise of sovereign powers within its territory.

The host State's consent to international arbitration is obviously a prerequisite for the tribunal's jurisdiction. But for jurisdictional purposes it is sufficient that the claimant has acquired an asset that is cognizable by the law of the host State and the circumstances surrounding the acquisition satisfies the aforementioned economic characteristics of an investment. If the asset is not recognized under the host State's laws then there is no investment. If the foreign national has purported to acquire property rights in a manner that is not effective to pass title or another legal interest under the host State's laws then there is no investment. This is the extent of the inquiry into compliance with the host State's laws that is relevant to establish the tribunal's jurisdiction. This, as has already been explained, is the meaning of the common provision that the assets constituting an investment must be acquired in accordance with the laws of the host State, but the same principle would apply in the absence of such a provision.

In *Saba Fakes v Republic of Turkey*,[100] the Claimant argued that it had an investment by virtue of its possession of temporary share certificates in a Turkish company.[101] The Tribunal asked itself 'whether any property and rights corresponding thereto were actually transferred to the Claimant' as a result of that transaction.[102] It concluded that the Claimant had not acquired legal title to the shares (the Claimant did not assert that it otherwise had a beneficial interest in the shares).[103] As the Claimant had not acquired the shares in a manner cognizable under the law of the host State, there was no investment.

Similarly, in *Europe Cement Investment & Trade SA v Republic of Turkey*,[104] the Claimant company asserted that it had share certificates evidencing its ownership of shares in two Turkish companies.[105] The Tribunal found that the Claimant did not own the shares in question and hence declined jurisdiction for lack of an investment.[106]

It will be immediately apparent that this conception of the jurisdictional inquiry does not address any form of misconduct on the part of the putative investor that may or may not constitute a violation of the host State's laws. The thesis defended

[99] Z Douglas (n 13) ch 5.
[100] *Saba Fakes* (n 72).
[101] ibid para 123.
[102] ibid para 132.
[103] ibid para 147.
[104] *Europe Cement* (n 9).
[105] ibid para 89.
[106] ibid paras 167, 170. See also the analysis of the *Quiborax* Tribunal on the legality of the share transfer to the Claimant, *Quiborax* (n 4) paras 268–85.

here is that such misconduct is never an issue relevant to the tribunal's jurisdiction: it is rather a question of admissibility or one for the merits.

This solution is consistent with comparative private law on the acquisition of property rights. Where a legal interest in property is transferred under a contract that is tainted by illegality, that legal interest is deemed to have passed and can be enforced by the courts. It matters not that the illegality could be raised to defeat any attempt to enforce the contract if it had not been executed.[107] In other words, once the contract is executed, the illegality is in the past and can be ignored in respect of the property rights that have been transferred in accordance with its terms.[108] In some jurisdictions this is rationalized on the basis that the party asserting the rights over property does not need to rely upon the illegality that infected the contract.[109]

The circumstances in which the putative investment is unlawful for jurisdictional purposes in the sense defended here are likely to be relatively rare. This means that, in the vast majority of cases, the tribunal will have jurisdiction or adjudicative power to render a binding decision on a plea of illegality with *res judicata* effect for the parties instead of relying upon the power of competence-competence, which may not result in a binding decision at all. It is surely preferable if the tribunal is obliged to undertake a searching investigation of the factual and legal arguments deployed to make out a plea of illegality for its decision to have *res judicata* effect to eliminate the possibility that the losing party may seek to have a second bite of the cherry before a different tribunal.

Just like for commercial arbitration, there is no *a priori* reason to question a tribunal's ability to rule upon pleas of illegality whatever their nature in investment treaty arbitration and thus no overriding principle of non-arbitrability that would serve to deprive the tribunal of jurisdiction to do so. Additionally, any decision rendered by the tribunal is still subject to review by national courts on the basis of public policy at the seat of the arbitration or the place of enforcement (or by an *ad hoc* committee if the arbitration is governed by the ICSID Convention).

B. *The Transaction Resulting in the Acquisition*

The conduct of the putative investor in acquiring the assets constituting the investment may be tainted by illegality in three ways. First, the investment may have been procured by unlawful means such as by fraudulent misrepresentation or the corruption of a public official. Second, the investment may have been procured for an unlawful purpose such as to carry out a trade in counterfeited goods. Third, the investment may have been procured in breach of a provision of the treaty requiring approval by the authorities of the host State. The proper approach to a plea of each of these three types of illegality will now be assessed.

(i) *Investment procured by unlawful means*

This is the most common plea of illegality in the jurisprudence. In *Plama v Bulgaria*, for instance, the illegality was the investor's fraudulent misrepresentation in obtaining the approval of Bulgaria's privatization authorities for an acquisition

[107] *Singh v Ali* [1960] AC 167.
[108] *Bowmakers Ltd v Barnet Instruments Ltd* [1945] KB 65.
[109] *Tinsley v Milligan* (n 97).

of shares in an oil refinery company, which was a condition precedent for this kind of investment under Bulgarian law. In *World Duty Free v Kenya*, the investment had been procured by the payment of a bribe to the Head of State of Kenya. In neither case was the illegality treated as an impediment to the tribunal's jurisdiction.

A plea of illegality to the effect that the investment has been procured by unlawful means raises two possible scenarios that must be distinguished. The first scenario is that the plea gives rise to one of the limited grounds of international public policy. The second is that the plea does not give rise to a ground of international public policy but instead rests upon a violation of the host State's laws.

Investment procured in violation of international public policy. In respect of the first scenario, if a plea of illegality to the effect that the investor has violated a ground of international public policy is successful, then it should result in the rejection of the claims as inadmissible. If such a plea is raised by the respondent State and the tribunal, on the basis of the documents considers that it has a *prima facie* basis, the tribunal should use its case management powers to ensure that it is determined in a preliminary phase of the arbitration.

The justification for treating a violation of international public policy as a ground of inadmissibility is as follows. 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 is specifically raised by one of the parties. That condemnation must entail that a party that has engaged in a violation of international public policy is not assisted in any way by the arbitral process in the vindication of any rights that are asserted by that party under any law. If the host State's law provides a restitutionary remedy to allow a bribe to be recovered from a State official, for example, the international arbitral process cannot be invoked in aid of the party who has paid the bribe.

It also follows from the concept of international public policy that the other party's conduct is irrelevant to the tribunal's adjudication of a violation of international public policy. If the host State violates international law in its response to the discovery of the investor's payment of a bribe (such as by expropriating the investment), then the tribunal cannot adjudicate upon this violation. This would be tantamount to coming to the assistance of a party that has violated international public policy. That is not to say that the violation of international law by the host State is somehow excused. The investor is simply unable to assert a claim in investment treaty arbitration by reason of its own misconduct.[110]

The position would be different if the investor's human rights were violated by the measures adopted by the host State in response to the discovery of the bribe. Human rights obligations are different from investment protection standards in this sense: misconduct on the part of a human being cannot have the effect of denying certain fundamental human rights to that person. No international court of human rights could deny the investor the possibility of asserting claims on this basis. But this not the case in respect of the economic interests protected by

[110] From the Tribunal's reasoning in *World Duty Free v Kenya*, it transpires that although no restitutionary claim was pleaded, a claim for recovery, if pleaded, would have been inadmissible due to the Claimant's impossibility of establishing its title without relying on its own illegality. See *World Duty Free v Kenya* (n 23) paras 162 and 179.

investment protection standards that are enforced by a consensual arbitral procedure.

It might be said that international public policy is a rather blunt instrument and so it is. The complexities of the host State's particular regulation of the conduct in question need not be investigated by the tribunal. Nor must the tribunal concern itself with the equities emerging from an analysis of both parties' conduct under the applicable laws. This is why the grounds of international public policy are limited to conduct that is universally condemned and abhorred by the international community.[111] That is also why it is appropriate for the tribunal to dismiss the investor's claims without consideration of their merits and with prejudice if it has concluded that the investor has violated international public policy. In other words, a finding of a breach of international public policy must result in a declaration of inadmissibility.

Tribunals must exercise care in their recognition of grounds of international public policy given the draconian consequences that follow the application of this doctrine. Such consequences can only be justified if the ground of illegality in question is exceptional in the sense that it attracts the opprobrium of the international community. The grounds of international public policy are not immutable, but nevertheless there appears to be sufficient consensus that no legal effect can be given to a transaction involving the transgression of a peremptory norm of international law.[112] Thus a transaction that contemplated or facilitated slavery or torture, for instance, would be void for international public policy. Certain other international norms that do not have the status of *jus cogens* but that nonetheless have widespread endorsement in multilateral instruments such as those addressing terrorism, the corruption of public officials, the trafficking of illicit drugs and so on would also qualify as grounds of international public policy. So too would the most fundamental principles of morality and justice.[113]

Some tribunals have pushed the concept of international public policy too far. In *Inceysa Vallisoletana SL v El Salvador*,[114] the Tribunal defined international public policy as 'a series of fundamental principles that constitute the very essence of the State, whose function "is to preserve the values of the international legal system against actions contrary to it"'.[115] This statement of principle might have suggested a narrow and accurate conception of the doctrine of international public policy. However, the Tribunal went on to postulate that 'respect of the law' is a principle of international public policy such that 'it is not possible to recognize the existence of rights arising from illegal acts'.[116] This would entail that any breach of the host State's law is a failure to respect that law and hence a violation of international public policy. Exceeding the speed limit on the way to the signing

[111] See International Law Association, *Interim Report on Public Policy as a Bar of Enforcement of International Awards* (2000) and London Conference and International Law Association Committee on International Commercial Arbitration, *Final Report on Public Policy as a Bar of Enforcement of International Awards* (2002). See also *World Duty Free v Kenya* (n 23) para 139.

[112] See eg Pierre Lalive, 'Transnational (or Truly International) Public Policy and International Arbitration' ICCA Congress (Series No 3257) (1986).

[113] To paraphrase *Parsons & Whittemore v Société Générale de l'Industrie du Papier*, 508 F 2d 969 (1974).

[114] *Inceysa Vallisoletana* (n 4). See also *Rumeli Telekom* (n 5) paras 318–23 where a violation of public policy was invoked by the Respondent as the investment was allegedly made as part of a worldwide fraudulent scheme. The Tribunal did not find sufficient evidence to uphold such an objection.

[115] *Inceysa Vallisoletana* (n 4) para 245.

[116] ibid para 249.

ceremony for the concession agreement would thus be a violation of international public policy.

In *Plama v Bulgaria*,[117] the Bulgarian Privatization Agency gave consent for the sale and transfer of all shares of a refinery—Nova Plama—to the Claimant, subject to the satisfaction of certain conditions which included providing evidence of sufficient resources to assume the operation of the refinery.[118] Such evidence was later provided by the Claimant and, as a result, the shares were transferred.[119] It transpired during the course of the arbitration that the Claimant's representative had concealed the fact that two large commercial entities had withdrawn their interest in the Claimant by the time of the proposed transfer of the shares.[120] The Tribunal concluded:

> The investment in Nova Plama was, therefore, the result of a deliberate concealment amounting to fraud, calculated to induce the Bulgarian authorities to authorize the transfer of shares to an entity that did not have the financial and managerial capacities required to resume operation of the Refinery.[121]

The Tribunal was also satisfied that:

> Bulgaria would not have given its consent to the transfer of Nova Plama's shares to [the claimant] had it known it was simply a corporate cover for a private individual with limited financial resources.[122]

Despite the fact that the fraudulent misrepresentation occurred in the period leading up to the acquisition of the investment, the Tribunal, correctly, did not consider that it created an impediment to its own jurisdiction.[123] But was the Tribunal right to characterize this fraud as a violation of international public policy, which was stated to include a 'basic notion' to the effect that 'a contract obtained by wrongful means (fraudulent misrepresentation) should not be enforced by a tribunal'?[124]

A contract induced by fraudulent misrepresentation is voidable under Bulgarian law.[125] The Tribunal referred to this principle to conclude that '[t]he misrepresentation made by the Claimant renders the Agreement unlawful' under Bulgarian law.[126]

If a contract procured by fraudulent misrepresentation is voidable under Bulgarian law, then it must follow that it is capable of being affirmed by the innocent party. This makes perfect sense: if the Bulgarian Government with full knowledge of the fraud had nonetheless decided that it was in the best interests of the Government to give full effect to the transaction, then it would have the right to insist that the Claimant perform its obligations under the agreement. If the Claimant failed to do so following such affirmation, then the Government would

[117] *Plama v Bulgaria* (n 36).
[118] ibid paras 60, 61.
[119] ibid paras 62, 64.
[120] ibid para 100.
[121] ibid para 135.
[122] ibid para 133.
[123] ibid para 112.
[124] ibid para 143.
[125] Bulgaria Obligations and Contracts Acts (2008) art 29: 'Fraud shall constitute grounds for invalidating a contract provided that one of the parties has been misled by the other party into concluding the contract through intentional misrepresentation.' See *Plama v Bulgaria* (n 36) para 136.
[126] *Plama v Bulgaria* (ibid) para 137.

be able to sue for breach of contract but it would no longer be entitled to have the agreement 'invalidated' on the basis of the fraudulent misrepresentation. While the doctrine of affirmation, or its precise equivalent in Bulgarian law, was not argued on the facts by the Claimant, it suffices to point out that the existence of this possibility demolishes the premise that a contract procured by fraudulent misrepresentation cannot be enforced without violating international public policy.

The Tribunal in *Plama* referred to the Award in *World Duty Free v Kenya* in support of its conception of international public policy, but the two situations must be distinguished. In *World Duty Free*, the contract was procured by the payment of a substantial bribe to the Head of State of Kenya. That is a true violation of international public policy: transactions involving the corruption of public officials cannot be validated by an international tribunal in any circumstances and such transactions cannot be affirmed by the innocent party because there is no innocent party. The international community has a direct interest in combating the corruption of public officials; it has no such interest in preventing contracts obtained by the fraud of a private party from ever being enforced.

In the circumstances of *Plama*, it may well have been necessary and just for the Tribunal to consider the equities emerging from an analysis of both parties' conduct under Bulgarian law. Suppose the Claimant had relied on the fact that the Government had affirmed the agreement? Or suppose the Claimant had transferred property to the Government under the agreement and the Government then refused to return it despite having elected to 'invalidate' the agreement? As previously stated, a true ground of international public policy does not require an international tribunal to address such questions.

Perhaps in recognition of the weak foundation of its reliance on international public policy, the Tribunal in *Plama* proceeded to adjudicate the merits of the Claimant's treaty claims and decided that they would have failed in any case.[127]

Investment procured in violation of law of the host State. The second scenario concerning the procurement of an investment by unlawful means is that the plea of illegality does not give rise to a ground of international public policy but instead rests upon a violation of the host State's laws.[128] For reasons that can perhaps be anticipated from the foregoing discussion of international public policy, such a violation may be relevant to a defence to the investor's claims on the merits but it does not furnish a basis for a declaration of inadmissibility. A plea that the claimant has violated the law of the host State in the procurement of an investment invariably necessitates an analysis of the conduct of both the claimant and the respondent host State. This is not a situation where the domestic norm in question is entitled to automatic international effect.

(ii) *Investment procured for an illicit purpose*

It is unlikely that there will be many cases in which it can be proven that the investment, which was acquired by lawful means, was nonetheless acquired for an unlawful purpose. An evidential record establishing the claimant's subjective motivation for acquiring the assets in the host State will be a rarity.

[127] ibid para 147.

[128] *SAUR* (n 4) paras 310–12; *Inmaris Perestroika Sailing* (n 3) para 66ff; *Alpha Projektholding* (n 3) paras 298–303. See also *Anderson* (n 7) paras 55–8.

If an unlawful purpose is disclosed in evidence, then it is capable of rendering the claims inadmissible if that purpose offends international public policy. If, for example, the evidence demonstrates that a pharmaceutical plant was acquired for the purpose of producing illicit drugs, then a tribunal would be entitled to reject the claims as inadmissible for violating international public policy.

If the investment is procured for a purpose that is illicit under the law of the host State but not under international public policy then this would provide a defence to the merits of the claims. In this situation the conduct of the host State—including the *bona fides* of any exercise of enforcement powers against the investor by reference to the domestic norms in question—could not be excluded as irrelevant to the tribunal's consideration of the merits of the claims *ipso facto* by reference to the illicit purpose. Hence this plea would have to be adjudicated together with the merits of the claims.

(iii) *Investment procured in breach of registration requirements in the treaty*

A number of States have included registration requirements in their investment treaties to ensure that the beneficiaries of the treaties can be identified in advance of the submission of a particular dispute to investment treaty arbitration.[129] The Tribunal in *Desert Line Projects LLC v Yemen*[130] summarized the different approaches as follows:

> Some States sign BITs without any regard to the *ex ante* identification of investors who may be covered by the treaty in question. This option ensures broader coverage, and may be thought to maximize the stimulation of investment flows between the two countries. Others require that investors wishing to be protected must identify themselves, on the footing that only specifically approved investments will give rise to benefits under the relevant treaty. This is a different approach, but it too has a legitimate policy rationale, in the sense that the Governments of such States evidently wish to exercise a qualitative control on the types of investments which are indeed to be promoted and protected.[131]

These registration provisions form part of the arbitration agreement and must be treated as conditions precedent for arbitral jurisdiction.

An example of such a registration provision[132] can be found in Article 1 of the Malaysia–Belgo-Luxemburg Economic Union BIT, which stipulates that assets can only be considered an investment under the BIT in Malaysia if they are 'invested in a project classified as an "approved project" by the appropriate Ministry in Malaysia, in accordance with the legislation and the administrative practice, based thereupon'.[133] The same requirement was not replicated for investments in the

[129] UK–Singapore BIT (signed 22 July 1975, entered into force 13 January 1978) art 12; UK–Thailand BIT (signed 28 November 1978, entered into force 11 August 1979) art 3; Belgium–Indonesia BIT (signed 15 January 1970, entered into force 17 June 1972) art 9; Indonesia–Denmark BIT (signed 30 January 1968, entered into force 2 July 1968) art 2.

[130] *Desert Line Projects* (n 5).

[131] ibid para 108.

[132] Other examples can be found in the ASEAN Agreement (1987) art II(1) as well as in several BITs signed by Indonesia.

[133] *Gruslin v Malaysia* (n 7) para 9.2.

Belgo-Luxemburg Economic Union. This provision was the subject of litigation in *Philippe Gruslin v Malaysia.*[134] The alleged investment was in the form of a stake in a mutual fund in Luxemburg which in turn had purchased shares on the Kuala Lumpur Stock Exchange. Such an acquisition would have been entirely unknown to the Malaysian authorities and no approval had ever been given by those authorities to the acquisition. The Tribunal correctly declined its jurisdiction.[135]

The Tribunal in *Desert Line Projects* had a more difficult interpretative task in relation to Article 1(1) of the Oman–Yemen BIT, which requires that the investment be 'accepted' by the host State and such acceptance is to be evidence by the issuance of an 'investment certificate'. The plain meaning of a reference to the issuance of a certificate would normally suggest a formal requirement but in that case, it would have been indispensable to identify the nature of the document and the issuing department, and this information was omitted from the treaty text.[136] This led the Tribunal to interpret the reference to the issuance of a certificate as a substantive requirement that could be met with appropriate evidence relating to the acceptance of the investment by the authorities in Yemen.[137]

C. *The Subsequent Use of the Assets by the Foreign National*

Here there is a total consensus in the jurisprudence[138] and it is a consensus that can be endorsed: any plea of illegality relating to the use of the assets comprising the investment by the foreign national must be considered as a defence to the merits of the claims. A plea of this nature may require an analysis of the evolution of the law of the host State and the manner of its application to the investment in question, as well as an assessment of the conduct of both the investor and the host State.

VII. CONCLUSIONS

A plea of illegality relating to the conduct of the putative investor never goes to the tribunal's jurisdiction in investment treaty arbitration. A road map for dealing with the plea of illegality and related objections was provided in Section

[134] ibid.
[135] ibid para 25.7.
[136] ibid para 109.
[137] ibid para 111.
[138] *Fraport* (n 4) paras 344–5; *Phoenix Action Limited* (n 4) para 102; *Hamester v Ghana* (n 7) para 127; *Quiborax* (n 4) para 266.

VI of this article and the conclusions can be represented in tabular form as follows:

Nature of the plea of illegality	Jurisdiction	Admissibility	Merits
Assets acquired by the foreign national	Must obtain a legal interest in assets under law of host State		
Transaction resulting in the acquisition:			
(a) investment procured by illicit means		If means contravene IPP[139]	If means contravene law of host State
(b) investment procured for illicit purpose		If purpose contravenes IPP	If purpose contravenes law of host State
(c) failure to comply with registration requirement	If requirement explicit in treaty		If requirement not explicit in treaty
Subsequent use of the assets by the foreign national			If use contravenes IPP or law of host State

[139] International Public Policy.