Investor State Arbitration And China

Principles And Practice

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relevant professional body,[378] threaten to award costs occasioned by the disruptive behaviour or criticise their conduct in writing in the award.

(2) Using tools for enforcement: The arbitrators should not hesitate to use procedural orders to manage misconduct. This includes excluding late-offered documents or witnesses and assessing costs for disruptions caused by non-compliance with tribunal orders. Tribunals may issue peremptory orders against parties that fail to comply with directives.

(3) Indicative Sanctions: Another proposed tool is the use of 'indicative sanctions,' where the arbitrator keeps a running tally of anticipated cost assessments against one or both sides for misconduct. This approach aims to deter ongoing abusive tactics without imposing immediate penalties.

[3-337] In summary, while aggressive tactics in arbitration may not always warrant immediate cessation, arbitrators must remain vigilant and responsive to ensure that proceedings are conducted fairly and respectfully. The approach should be tailored to the specific circumstances, with a focus on maintaining decorum and protecting the integrity of the arbitration process. The use of procedural tools and clear communication of expectations can help manage counsel behaviour effectively.[379]

5.4.3 Sanctioning guerrilla tactics

[3-338] Sanctions are a last resort, and ultimately a poor resort because sanctions cannot retroactively correct the harm done to the proceedings. Arbitrators use formal sanctions when other measures fail to deter guerrilla tactics. Firstly, an arbitrator should decide whether he or she has authority to sanction. Many arbitration rules allow tribunals to consider the parties' conduct in expediting and managing costs when deciding on cost allocation.[380] Secondly, an arbitrator should issue warnings before sanctions to ensure transparency and avoid perceptions of arbitrariness. However, warnings may not be necessary for criminal or grossly unethical conduct. Thirdly, sanctioning counsel directly. There is ongoing debate about whether tribunals should sanction offending counsel directly, such as disqualifying them or reporting them to their licensing authority. This raises complex issues of authority and discretion, especially given parties' rights to choose their representatives. Fourthly, criticism in final award. Explicit criticism of counsel conduct in the final award can serve as an effective sanction. Counsel are sensitive and cautious about the public perception of their conduct in international arbitration as any negative comments may jeopardise their professional career.[381]

378 *Ahuja* at 179–182.
379 *Horvath* at 99.
380 ICSID Arbitration Rules 2022, art 52(1)(b); ICC Arbitration Rules 2021, art 38(5); HKIAC Administered Arbitration Rules 2024, r 34.4(c). See also, *Ahuja* at 183–188.
381 *Horvath* at 100–101.

CHAPTER 4

STATE RESPONSIBILITY AND STANDARDS OF PROTECTION

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1. Acts Attributable to State

[4-1] A foreign investor who asserts any claim needs to verify that the acts concerned are attributable to the respondent State. In many cases this will not be difficult, given that takings are typically achieved through legislative acts or administrative decrees, revocations of licences and authorisations by State organs. The International Law Commission has drafted a widely accepted document on States responsibility—Responsibility of States for Internationally Wrongful Acts 2001[1]—known as the 'ILC Articles on State Responsibility'.[2] The ARSIWA are accepted as reflecting the customary international law on matters of State responsibility. Therefore, tribunals generally treat them as binding.[3]

1 Until recently, the theory of the law of state responsibility was not well developed. The position has now changed, with the adoption of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts ('Draft Articles') by the International Law Commission (ILC) in August 2001. The Draft Articles are a combination of codification and progressive development. They have already been cited by the International Court of Justice and 'are considered by courts and commentators to be in whole or in large part an accurate codification of the customary international law of state responsibility'. See, Oona A Hathaway, Maggie M Mills and Thomas M Poston, 'War Reparations: The Case for Countermeasures' (2024) 76(5) *Stanford Law Review* 971 at 1024. See also, *Dolzer* at 313.

2 Also abbreviated as 'ARSIWA' for Articles on Responsibility of States for Internationally Wrongful Acts.

3 *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award, 18 June 2010 at para 171 (the Tribunal must decide the issue of attribution under international law as guided by the ARSIWA as a code); *Tulip Real Estate and Development Netherlands BV v Republic of Turkey*, ICSID Case No ARB/11/28, Award, 10 March 2014 at para 281 (The Tribunal accepted that the ARSIWA constituted a codification of customary international law with respect to the issue of attribution of conduct to the State); *Almas v The Republic of Poland*, PCA Case No 2015-13, Award, 27 June 2016 at para 206 (Tribunal noted the Parties' agreement that the ARSIWA being widely regarded by investment tribunals 'as a

[4-2] The conduct of a State is considered an act of that State under international law under various articles in Chapter II, Attribution of Conduct to a State. Three articles are more prominently relied on by foreign investors in claims, articles 4, 5 and 8. These three articles contains attribution on the basis of structure, function and control:[4]

(1) Structural attribution: article 4(1), *Conduct of organs of a State*: The conduct of any State organ[5] shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions,[6] whatever position it holds in the organisation of the State,[7] and whatever its character as an organ of the central Government or of a territorial unit of the State;

codification of customary international law' which provided the legally relevant yardstick to determine whether specific acts can be attributed to a host State for purposes of establishing the latter's responsibility for a breach of international law); *Gavrilovic v Republic of Croatia*, ICSID Case No ARB/12/39, Award, 26 July 2018 at para 779 (the Tribunal held that ARSIWA were the relevant rules on attribution that were widely considered to reflect international law).

4 International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (United Nations). See now, *Dolzer* at 315.

5 The reference to a 'State organ' covers all the individual or collective entities which make up the organisation of the State and act on its behalf. It includes an organ of any territorial governmental entity within the State on the same basis as the central governmental organs of that State: this is made clear by the final phrase. Certain acts of individuals or entities which do not have the status of organs of the State may be attributed to the State in international law, and these cases are dealt with in later articles of this chapter. But the rule is nonetheless a point of departure. It defines the core cases of attribution, and it is a starting point for other cases. For example, under art 8 conduct which is authorised by the State, so as to be attributable to it, must have been authorised by an organ of the State, either directly or indirectly. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 40.

6 This language allows for the fact that the principle of the separation of powers is not followed in any uniform way, and that many organs exercise some combination of public powers of a legislative, executive or judicial character. Moreover, the term is one of extension, not limitation, as is made clear by the words 'or any other functions'. It is irrelevant for the purposes of attribution that the conduct of a State organ may be classified as 'commercial' nature. Of course, the breach by a State of a contract does not as such entail a breach of international law. Something further is required before international law becomes relevant, such as a denial of justice by the courts of the State in proceedings brought by the other contracting party. But the entry into or breach of a contract by a State organ is nonetheless an act of the State for the purposes of art 4, and it might in certain circumstances amount to an internationally wrongful act. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 41.

7 No distinction is drawn between the acts of 'superior' and 'subordinate' officials, provided they are acting in their official capacity. This is expressed in the phrase 'whatever position it holds in the organization of the State' in art 4. No doubt lower-

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(2) Functional attribution: article 5(1), *Conduct of persons or entities exercising elements of governmental authority*:[8] The conduct of a person or entity[9] which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State

level officials may have a more restricted scope of activity, and they may not be able to make final decisions. But conduct carried out by them in their official capacity is nonetheless attributable to the State for the purposes of art 4. Likewise, the principle in art 4 applies equally to organs of the central government and to those of regional or local units. It does not matter for this purpose whether the territorial unit in question is a component unit of a federal State or a specific autonomous area, and it is equally irrelevant whether the internal law of the State in question gives the federal parliament power to compel the component unit to abide by the State's international obligations. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 41.

8 The article is intended to take account of the increasingly common phenomenon of parastatal entities, which exercise elements of governmental authority in place of State organs, as well as situations where former State corporations have been privatised but retain certain public or regulatory functions. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 42.

9 The generic term 'entity' reflects the wide variety of bodies which, though not organs, may be empowered by the law of a State to exercise elements of governmental authority. They may include public corporations, semi-public entities, public agencies of various kinds and even, in special cases, private companies, provided that in each case the entity is empowered by the law of the State to exercise functions of a public character normally exercised by State organs, and the conduct of the entity relates to the exercise of the governmental authority concerned. For example, in some countries private security firms may be contracted to act as prison guards and in that capacity may exercise public powers such as powers of detention and discipline pursuant to a judicial sentence or to prison regulations. Private or State-owned airlines may have delegated to them certain powers in relation to immigration control or quarantine. If it is to be regarded as an act of the State for purposes of international responsibility, the conduct of an entity must, accordingly, concern governmental activity and no other private or commercial activity in which the entity may engage. Thus, for example, the conduct of a railway company to which certain police powers have been granted will be regarded as an act of the State under international law if it concerns the exercise of those powers, but not if it concerns other activities (eg, the sale of tickets or the purchase of rolling stock). Article 5 does not extend to cover, for example, situations where internal law authorises or justifies certain conduct by way of self-help or self-defence, ie, where it confers powers upon or authorises conduct by citizens or residents generally. The internal law in question must specifically authorise the conduct as involving the exercise of public authority; it is not enough that it permits activity as part of the general regulation of the affairs of the community. It is, accordingly, a narrow category. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 43.

under international law, provided the person or entity is acting in that capacity in the particular instance;

(3) Control-based attribution: article 8, *Conduct directed or controlled by a State*[10]: The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of,[11] that State in carrying out the conduct.[12]

[4-3] Article 4(1) reflects the well settled rule that the conduct of any State organ is considered an act of that State and that an organ includes any person or entity which has that status in accordance with the internal law of that State.[13] Tribunals have held

10 As a general principle, the conduct of private persons or entities is not attributable to the State under international law. Circumstances may arise, however, where such conduct is nevertheless attributable to the State because there exists a specific factual relationship between the person or entity engaging in the conduct and the State. Article 8 deals with two such circumstances. The first involves private persons acting on the instructions of the State in carrying out the wrongful conduct. The second deals with a more general situation where private persons act under the State's direction or control. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 47.

11 More complex issues arise in determining whether conduct was carried out 'under the direction or control' of a State. Such conduct will be attributable to the State only if it directed or controlled the specific operation and the conduct complained of was an integral part of that operation. The principle does not extend to conduct which was only incidentally or peripherally associated with an operation and which escaped from the State's direction or control. The degree of control which must be exercised by the State in order for the conduct to be attributable to it was a key issue in *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v United States of America)* ICJ (27 June 1986). The question was whether the conduct of the contras was attributable to the United States so as to hold the latter generally responsible for breaches of international humanitarian law committed by the contras. This was analysed by ICJ in terms of the notion of 'control'. On the one hand, it held that the United States was responsible for the 'planning, direction and support' given by the United States to Nicaraguan operatives. But it rejected the broader claim of Nicaragua that all the conduct of the contras was attributable to the United States by reason of its control over them. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 47.

12 Most commonly, cases of this kind will arise where State organs supplement their own action by recruiting or instigating private persons or groups who act as 'auxiliaries' while remaining outside the official structure of the State. These include, for example, individuals or groups of private individuals who, though not specifically commissioned by the State and not forming part of its police or armed forces, are employed as auxiliaries or are sent as 'volunteers' to neighbouring countries, or who are instructed to carry out particular missions abroad. See, International Law Commission, *Responsibility of States for Internationally Wrongful Acts 2001* (with commentaries) (Report of the International Law Commission on the work of its fifty-third session, United Nations 2008) at 47.

13 *Eureko BV v Republic of Poland*, Partial Award, 19 August 2005 at para 127.

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that actions by a variety of State organs were attributable to the State.[14] These included action by a government minister,[15] by the armed forces and police,[16] by the State treasury,[17] by the Central Bank,[18] by the legislature,[19] and by the courts.[20] On the other

14 *Rusoro Mining Ltd v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/12/5, Award, 22 August 2016 at para 523 (the Tribunal held that the treaty's FET standards binding on all branches of government: (1) by administrative acts, adopted by the government or its agencies, targeting the investor or its investment directly, (2) by judicial decisions, approved by the State's judicial system, which were directed directly against the investor or the investment personally and which amount to a denial of justice, (3) by legislation, approved by the legislative power, or regulation, adopted by government, affecting citizens in general, and the protected investor and investment in particular).

15 *Díaz v Republic of Costa Rica*, ICSID Case No ARB/19/13, Award, 29 June 2022 (Spanish) at para 541(5) (the Tribunal held that the Costa Rican Minister of Health's press statements constituted a violation of the State's obligation to provide fair treatment and equitable in accordance with the BIT).

16 *Busta v The Czech Republic*, SCC Case No 2015/014, Final Award, 10 March 2017 at paras 400, 420 (a State's police authorities are organs of that State and the Czech police's conduct, standing by and allowing the Czech Building Authority to remove investor's goods, was attributable to the State); *Stabil LLC v Russian Federation*, UNCITRAL, PCA Case No 2015-35, Award, 24 April 2019 at para 204 (the Tribunal held that the acts of the paramilitary forces/People's Militia were attributable to the Russian Federation under ARSIWA, arts 5 and 11).

17 *Eureko BV v Republic of Poland*, ad hoc arbitration, Partial Award, 19 August 2005 at para 134 (the Tribunal held that Poland was responsible to the investor for the actions of the State Treasury and the Treasury's actions were clearly attributable to Poland).

18 *United Agencies Ltd SA v People's Democratic Republic of Algeria* (I), ICSID Case No ARB/20/1, Award, 25 July 2022 (French) (the Tribunal held that the tribunal held that though the Central Bank did not qualify as a state organ de jure (since Algerian law provided for its independence and financial autonomy), it nevertheless amounted to a state organ de facto. The Algerian Central Bank performed numerous 'essential governmental functions', its 100% state ownership, and its governance mainly made up of state appointees qualified itself as a state organ de facto under ARSIWA, art 4). For a case summary, see, Damien Charlotin, 'ICSID tribunal dismisses illegality objection, declines jurisdiction over counterclaim, and finds that Algeria breached free transfer obligation' (*IA Reporter*, 15 August 2022).

19 *Nykomb Synergetics Technology Holding AB v The Republic of Latvia*, SCC, Award, 16 December 2003, s 4.2 (the Tribunal held that the State Joint-Stock Company's actions concerning were attributable to Latvia); *Paushok v The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011 at paras 298–299 (the Tribunal held that actions by legislative assemblies were not beyond the reach of BITs as a State was not immune from claims by foreign investors in connection with legislation passed by its legislative body, unless a specific exemption is included in the relevant treaty).

20 At the international level, the judgment given by a judicial authority emanates from an organ of the State is treated in just the same way as a law promulgated by the legislature or a decision taken by the executive. See, *Azinian v The United Mexican States*, ICSID Case No ARB (AF)/97/2, Award, 1 November 1999 at paras 97–103 (domestic judgement may be disavowed at international level if it clearly incompatible with a rule of international law, or that judgment the result of denial

hand, tribunals have refused to find that actions by private persons were attributable to the State.[21]

[4-4] State-owned enterprises may tend to operate under the direction and control of a government ministry and therefore their acts are attributable to the State.

[4-5] In *EDF v Romania*.[22] In that case, a Jersey airport operator invested in Romania in the 90s by injecting capital into a Romanian joint venture company, together with two State enterprises as its joint venture partners, A and C. The Jersey foreign investor contributed USD 510,000 and the joint venture partners

of natural justice); *Loewen Group, Inc v United States of America*, ICSID Case No ARB(AF)/98/3, Decision on Jurisdiction, 5 January 2001 at paras 69 (the Tribunal held that the responsibility of the State for a breach of international law constituted by an alleged judicial action arises only when there is final action by the State's judicial system considered as a whole because the judiciary was an organ of the State and that judicial action which violated a rule of international law would be attributable to the State. The judiciary, though independent of the executive government, was not independent of the State); *Saipem SpA v The People's Republic of Bangladesh*, ICSID Case No ARB/05/07, Award, 30 June 2009 at paras 189, 190 (the Tribunal held that the Bangladeshi judiciary was part of the State and that the acts committed by it are directly attributable to the State under the ARSIWA, art 4); *RosInvestCo UK Ltd v The Russian Federation*, SCC Case No V079/2005, Final Award, 12 September 2010 at paras 602–603 (the Tribunal held that Russian courts were also organs of the Russian state and their acts may be attributable to the State); *Gavrilovic v Republic of Croatia*, ICSID Case No ARB/12/39, Award, 26 July 2018 at para 803 (the Tribunal held that under the ARSIWA, art 4, the actions of the Bankruptcy Judge and the Bankruptcy Council were attributable to the State); *Karkey Karadeniz Elektrik Uretim AS v Islamic Republic of Pakistan*, ICSID Case No ARB/13/1, Award, 22 August 2017 at para 645 (the Tribunal held that the Pakistan Supreme Court's judgment which declared the concession contract to be void ab initio was arbitrary, and for the Tribunal, it was nothing more than a fact, attributable to Pakistan).

21 *Tradex Hellas SA v Republic of Albania*, ICSID Case No ARB/94/2, Award, 29 April 1999 at paras 136, 147, 165, 169, 175, 198 (the Tribunal found no evidence that the invasion by the Mali Kolaj villagers in the investor's land had been provoked by a state act and there was also no evidence that the behaviour of the Albanian authorities actually encouraged villagers to invade the land); *Tatneft v Ukraine*, PCA Case No 2008-8, Award on the Merit, 29 July 2014 at paras 514–516 (where the acts of raiders who took over the investment resulting in loss to the investor could not be attributable to Ukraine as they were actions of private parties which Ukraine did not encouraged); *United Utilities (Tallinn) BV v Republic of Estonia*, ICSID Case No ARB/14/24, Award, 21 June 2019 at paras 315, 335, 916–918 (investor was granted a water sewage concession with a lucrative tariff incentives. Key figures of the Estonia Central Government, including certain Estonian Parliamentarians and the Estonia Homeowners' Association, engaged in a publicity campaign against it and eventually the tariff was greatly reduced. The investor attributed these actions to the State, but the Tribunal held that the conduct of private entities and individuals, such as the Estonia Homeowners' Association and its members (even if those members are also members of parliament), was not attributable to the Estonian State).

22 *EDF (Services) Ltd v Romania*, ICSID Case No ARB/05/13.

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made contributions in kind in the form of commercial spaces and furniture and fittings of the existing airports. These joint venture companies were licensed to operate duty free services in Romanian airports for 15 years. A few years later, the joint venture partner A withdrew from the joint venture and when the joint venture company sought to renew the right to operate, joint venture partner A challenged such extension. The challenge was upheld by a Romanian court and the joint venture company need to leave its premises at the airport upon expiry of the lease. In 2002, the Romanian government passed a law regulating duty-free business within airports and as a result the joint venture company's licence was revoked and then closure of its duty-free operations in the Romanian airports. The Romanian government imposed a fine on the joint venture company and its asset sequestrated and was subsequently declared bankrupt. Relying on the Romania - United Kingdom BIT (1995),[23] the Jersey investor commenced an ICSID arbitration against Romania for treaty breach. Romania argued that the state enterprise C's purpose was for profit to benefit its shareholders and the Ministry of Transportation only exercise control in connection with public services provided by C; and that for commercial dealings, the Ministry acted only as a shareholder; and, therefore, C was not an organ of the State. The tribunal held that enactment of the 'duty free' law was attributable to Romania; that after close examination of the evidence, the conduct of C in the performance of the joint venture contract was under the direction and control of the State; that, C's action was within the meaning of article 8 of the ARSIWA; and that, accordingly, C's action was attributable to Romania.[24]

[4-6] Some State enterprises are given liberty and power to decide on their own matters that should properly within their purview and government ministries only request that they be informed of the outcome. Then, acts of such State enterprises are not attributable to the State.

[4-7] In *Hamester v Ghana*,[25] a German investor entered into a joint venture with the Ghana Cocoa Board (GCB), which was established as a statutory body to purchase cocoa beans from Ghana farmers and to market and export them. In 1992, the German investor and GCB started a joint venture to modernise a cocoa factory. Under their joint-venture agreement, GCB undertook to ensure that the cocoa factory was supplied at all times with cocoa beans so that it could operate at full capacity and the German investor provided a loan to GCB as well as engineering consultancy services. The pricing terms of the joint-venture agreement provided that the JV would agree upon prices with GCB, and that prices would be 'based on' a local benchmark price. This ambiguous pricing clause triggered disagreements between the two joint-venturers. In 2000, a change of government resulted in a change in GCB's management. Parties were unable to agree on the pricing of the beans and GCB allegedly imposed a pricing agreement in 2001 on the joint venture by duress,

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23 This BIT was extended to nationals of the Isle of Man and the Bailiwicks of Guernsey and Jersey by an Exchange of Notes dated 25 February and 22 March 1999, which agreement entered into force on 22 March 1999.

24 *EDF (Services) Ltd v Romania*, ICSID Case No ARB/05/13, Award, 8 October 2009 at paras 164, 166, 209, 213.

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

and by threat of interrupting supplies contrary to their duty under the joint venture agreement. Ultimately Hamester's management rights over the joint-venture was terminated. The German investor commenced ICSID arbitration against Ghana for indirect expropriation. Ghana maintained that the German investor repudiated the agreement and abandoned the venture. One of the jurisdictional objections that Ghana led was attribution—that GCB's act was not attributable to Ghana. The German investor argued that GCB had completely assimilated to the government of Ghana. Ghana averred that under article 5 of the ARSIWA that GCB was a public entity, it was not under direct control of the government. The Tribunal held that the government could only give directions of a general character but not specific instructions to GCB; so that under article 4 of the ARSIWA, GCB was not a state organ; that as it exercised elements of governmental authority, GCB was a public entity under article 5 of the ARSIWA; that there were several communications with the Minister of Finance in November/December 2001, the government did not interfere with the negotiation of the 2001 pricing agreement, but only requested to be informed of its outcome; that, accordingly, the acts of GCB in the negotiation and finalising of the 2001 pricing agreement were not attributable to Ghana.[26]

[4-8] If an entity has legal personality it will not normally be regarded as an organ of the State. An entity's capacity to own property, to sue and be sued and to perform transactions on its own behalf is difficult to reconcile with the status of a State organ. Such an entity would be an actor in its own right rather than an instrument for the action of the State.[27] Conversely, a government ministry seeking to convince the tribunal that it has two legal personality one as a regulator and another acts commercially, does not carry much weight.

[4-9] In *Eureko v Poland*,[28] a Dutch investor purchased company shares of a Polish insurance company from the Minister of State Treasury, during the privatisation process of State-Owned companies in Poland in 1999. The Share Purchase Agreement expressly provided for the future IPO of the insurer, no later than 2001, and the buyer and the seller both undertook to take all actions which might be required to accomplish the goal of IPO. It was later discovered by the Dutch investor that the insurer was at the epicentre of political disputes and despite various promises by different ministers to achieve an IPO, it did not happen at all. Being unable to exit, the Dutch investor relied on the Netherlands - Poland BIT (1992) to commence an ad hoc arbitration in 2003 against Poland for treaty breaches. Poland argued, inter alia, that the Minister's conduct could

26 *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award, 18 June 2010 at paras 22, 23, 28, 35, 40, 41, 58,140, 148, 159, 168, 187, 188, 192, 249, 250.

27 In *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan* (I), ICSID Case No ARB/03/29, Award, 27 August 2009 at para 119 (the Tribunal had to decide whether the National Highway Authority (NHA), a public corporation responsible for the planning, development, operation, and maintenance of Pakistan's highways, was a State organ for purposes of attribution. The Tribunal accepted Pakistan's argument that NHA's distinct legal personality ruled out the possibility that it was a State organ). See, *Dolzer* at 318.

28 *Eureko BV v Republic of Poland*, Partial Award, 19 August 2005.

Settlement of Disputes between an Investor and a Host State

(1) Disputes between an investor of one Contracting Party and the other Contracting Party concerning an obligation of the latter under Articles 2(3), 4, 5 and 6 of this Agreement in relation to an investment of the former which have not been amicably settled shall … be submitted to arbitration …

[4-292] If the BIT's dispute settlement clause excludes FET or FPS claims, the Tribunal has no jurisdiction to deal with FET and FPS breaches. The Tribunal's jurisdiction over FET and FPS claims cannot be 'read back in' via the umbrella clause, as such interpretation will render the explicit limitations of the dispute settlement clause meaningless.

[4-293] In *Anglia Auto v Czech Republic*,[519] a UK company obtained an arbitral award in December 1997 in the sum of CZK 4.8 million against its business partner in the Czech Republic. Although the UK company was granted several of the enforcement orders it sought, it alleged that the Czech courts unduly delayed in issuing these and that during this time the business partner became bankrupt. Accordingly, the UK company considered that it had been deprived of the value of the arbitral award by the courts. Article 2(2) of the Czech Republic - United Kingdom BIT (1990) included FET and FPS standards as protection, but the dispute resolution clause in article 8 expressly excluded claims under article 2(2).

[4-294] Relying on the Czech Republic - United Kingdom BIT (1990), the UK company commenced SCC arbitration against the Czech Republic alleging that the courts' conduct amounts to, inter alia, breach of the FET and FPS standards in article 2(2) of the BIT. The Czech Republic objected to the jurisdiction, denied any breach of the BIT and sought a dismissal of the claims on the merits. Knowing that article 2(2) of the FET and FPS claims were not covered by the dispute resolution clause in article 8, the UK company in reply alleged that the umbrella clause in article 2(3)[520] seeking to provide jurisdictional basis for its FET and FPS claims. The tribunal held that to the extent article 8 had expressly excluded article 2(2) from its scope, the tribunal could not, through the umbrella clause, reintroduce into the scope of investor-State arbitration the provisions of article 2(2); that the umbrella clause could not provide an alternative basis for jurisdiction under article 2(2) where none otherwise exists.[521]

519 *Anglia Auto Accessories Ltd v Czech Republic*, SCC Case No V 2014/181.
520 Czech Republic - United Kingdom BIT (1990), art 2(3) provides '[e]ach Contracting Party shall, with regard to investments of investors of the other Contracting Party, observe the provisions of these specific agreements, as well as the provisions of this Agreement'.
521 *Anglia Auto Accessories Ltd v Czech Republic*, SCC Case No V 2014/181, Final Award, 10 March 2017 at paras 159, 201.

CHAPTER 5

STATE'S DEFENCE AND COUNTERCLAIM

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[5-1] The purpose of the international mechanism of protection of investment arbitration cannot be to protect investments made in violation of the laws of the host State. Foreign investments made in contrary to the laws of the host State or not made in good faith,[1] or otherwise obtained through misrepresentations, concealments or corruption, or amounting to an abuse of the international investment arbitration system should not be protected. In other words, the purpose of international protection is to protect legal and bona fide investments.[2]

1. Defence: Conduct of Investor

1.1 Abandonment of the investment

[5-2] Tribunals recognise that an investment has become worthless obviously does not automatically means expropriation must have occurred. Investment always entails risk. Nor is it sufficient for the disappointed foreign investor to point to some governmental initiative, or inaction, which might have contributed to his ill fortune. Yet again, it is not enough for an investor to seize upon an act of maladministration, no matter how low the level of the relevant governmental authority; to abandon his investment without any effort at overturning the administrative fault; and thus to claim an international delict on the theory that there had been an uncompensated expropriation. In such instances, an international tribunal may deem that the failure to seek redress from national authorities disqualifies the international claim, not because there is a requirement of exhaustion of local remedies but because the very reality of conduct tantamount to expropriation is doubtful in the absence of a reasonable—not necessarily exhaustive—effort by the investor to obtain correction.[3]

[5-3] Foreign investors are expected to attempt to have the dispute resolved by local judicial bodies if it really has a genuine claim. The foreign investor is not required to exhaust local remedies before commencing international investor state arbitration but at least tried bona fide to resolve the dispute within the local

1 See, *Derains* at 184–187.

2 *Phoenix Action, Ltd v The Czech Republic*, ICSID Case No ARB/06/5, Award, 15 April 2009 at para 100.

3 *Generation Ukraine, Inc v Ukraine*, ICSID Case No ARB/00/9, Award, 16 September 2003 at para 20.30.

judicial system first.[4] Otherwise, may give rise to a suspicion that the investor has already abandoned the investment.

[5-4] In *Generation Ukraine, Inc v Ukraine*,[5] a US investor established a local company in Ukraine to invest in the country allegedly so encouraged by the Ukrainian government in 1992. The local company duly identified a specific project and obtained approval. The US investor alleged that, over the course of the ensuing six years, the Kyiv City State Administration delayed and ultimately denied construction permits, rendering the project non-viable. Allegedly, Kyiv local authorities obstructed and interfered with the realisation of that project in a manner which was tantamount to expropriation. Relying on the Ukraine - USA BIT (1994), the US investor commenced ICSID arbitration against Ukraine. At hearing, the US investor could not produce evidence of expenditure on the project and the excuse was all accounting record was destroyed inadvertently by workmen who misunderstood their instructions when the US investor abandoned its Kyiv office in 2000. The tribunal held that central to the dispute was the highly technical issues about interpretations of local planning law; that if the US investor had been denied justice before local courts when trying to remedy the situation the matter could be transformed into a violation of an international treaty; that the tribunal's task was not to exercise the function of an administrative review body to ensure that municipal agencies perform their tasks diligently, conscientiously or efficiently as this remained in the domain of the local courts; that the failure of the US investor to challenge the actions of the Kiev local authorities thus proved fatal to its BIT claim; that, accordingly, the US investor's expropriation claim failed.[6]

[5-5] In *Discovery Global v Slovakia*,[7] in 2006, Slovakia granted three oil exploration licences to British oil and gas company to explore three different areas (S, KO and RP) in the north-eastern Slovakia. The British oil and gas company had incorporated a local Slovakia subsidiary to carry out the exploration under these licences and in 2014, a US investor acquired the British oil and gas company and its right to oil exploration under these licences. Upon acquisition, the US investor commenced exploration, but the exploration came to a halt due to local protest on site S. Activists suspicious of negative environmental impact might brought about by exploration and blocked the access road. Local police regarded the access road leading to site S was a public road and therefore refused to remove activists or their vehicles that were blocking that road. To pacify them, the subsidiary carried out a

4 *Feldman v United Mexican States*, ICSID Case No ARB(AF)/99/1, Award, 16 December 2002 at para 114 (where the tribunal rejected the investor-claimant's expropriation claim that the investor-claimant could have availed himself early on of the procedures available under Mexican law to obtain a formal, binding ruling on the dispute but apparently chose not to do so); *Generation Ukraine, Inc v Ukraine*, ICSID Case No ARB/00/9, Award, 16 September 2003 at para 20.33.

5 *Generation Ukraine, Inc v Ukraine*, ICSID Case No ARB/00/9.

6 *Generation Ukraine, Inc v Ukraine*, ICSID Case No ARB/00/9, Award, 16 September 2003 at paras 24.4, 20.33, 20.38, 21.4.

7 *Discovery Global LLC v Slovak Republic*, ICSID Case No ARB/21/51, Award, 17 January 2025.

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preliminary EIA that alleviated their concern. After the subsidiary voluntarily submitted a preliminary EIA, the local governments required a full EIA to be carried out. The subsidiary refused to carry out a full EIA for all sites. The US investor successfully appealed against the full EIA decision of Site RP but failed to appeal against the full EIA decisions in relation to Site S and Site KO. Eventually the US investor left the project and relying on the Slovakia - USA BIT (1991), it commenced ICSID arbitration against Slovakia. The US investor alleged that its local subsidiary had a legitimate expectation to conduct its drilling operations in Site S and Site KO and Slovakia had prevented it from happening thus frustrated its legitimate expectation. The tribunal held that Slovakia had not frustrated the US investor's alleged legitimate expectations in respect to the EIA obligations; that it chose to relinquish its licenses and ultimately abandoned its investment.[8]

1.2 Clean hands

[5-6] 'Clean hands' is originally a maxim in equity that 'He who seeks equity must come with clean hands'. The party seeking relief must not have acted improperly in the transaction that is the subject matter of the action currently before the court. Impropriety is in the legal and not the moral sense.[9] Whether this private law doctrine forms part of or being accepted in public international has been controversial. Tribunals have either accepted[10] or rejected it.[11]

8 *Discovery Global LLC v Slovak Republic*, ICSID Case No ARB/21/51, Award, 17 January 2025 at paras 273, 371, 378, 379, 605, 616, 674.

9 See, L Ma, *Equity and Trusts Law in Hong Kong* (6th edn, LexisNexis 2024) at 11–17.

10 *Rusoro Mining Ltd v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/12/5, Award, 22 August 2016 at para 492 (the Tribunal held that it was undisputed that investors with 'dirty hands' had no standing in investment arbitration); *Fraport AG v Republic of the Philippines* (II), ICSID Case No ARB/11/12, Award, 10 December 2014 at para 328 (the Tribunal held that investment treaty cases confirmed that such treaties do not afford protection to illegal investments either based on clauses of the treaties or, absent an express provision in the treaty, based on rules of international law, such as the 'clean hands' doctrine); *Littop Enterprises Ltd v Ukraine*, SCC Case No V 2015/092, Final Award, 4 February 2021 at para 485 (the Tribunal recognised that in international investment transactions an investor with 'unclean hands' should not benefit from the protections afforded under any treaty; and the substantive protections could not apply to investments that were made contrary to law or which violated international public policy as no State would ever give its consent to international arbitration for the resolution of disputes relating to investments that were tainted by, obtained and/or managed through illegal and corrupt behaviour and which violate internationally recognised standards of international public policy).

11 *Yukos Universal Ltd v Russian Federation*, PCA Case No AA 227, Final Award, 18 July 2014 at 1357–1363 (the Tribunal observed that general principles of law required a certain level of recognition and consensus but there was a significant amount of controversy as to the existence of an 'unclean hands' principle in international law; and concluded that 'unclean hands' did not exist as a general principle of international law which would bar a claim by an investor). See, *McLachlan* at para 6.112.

[5-7] In *South American Silver v Bolivia*,[12] the tribunal held that Bolivia had failed to prove that the 'clean hands doctrine is a general principle of international law or that it forms part of international public policy' and while the state cited some individual opinions of judges at the ICJ, that these 'do not seem even to reflect the majority position' of the court. As such, the tribunal concluded that there was no established clean hands doctrine in international law and thus no reason to hold the investor's claims inadmissible.[13]

[5-8] Some international tribunal find that 'unclean hands' is a principle of international law allowing arbitrators to dismiss a claim for public policy reasons if the investment was acquired, effected or otherwise tainted by bribery or corruption. In *Littop v Ukraine*,[14] the tribunal said:

> Respondent contends that the Tribunal has a 'duty as a matter of international public policy' and 'other principles of international law' to take evidence of illegality, bribery and corruption into account and rule accordingly. Respondent further specifies that the Tribunal should decline jurisdiction 'by reference to illegality and/or unclean hands and/or international public policy considerations against such background.' … It is correct, as Claimants contend, that the Yukos tribunals stated that Russia 'has been unable to cite a single majority decision where an international court or arbitral tribunal has applied the principle of "unclean hands" in an inter-State or investor-State dispute' and concluded that 'unclean hands' does not exist as a general principle of international law … In several cases tribunals have made clear that a party cannot come to investment arbitration with unclean hands. This has now been recognised in cases where there has been some illegality underlying the contract or the rights which a party is seeking to enforce. *The doctrine has been recognised as a principle of general international law by arbitral tribunals and a number of academic authorities.* … Further, and in any event, the Tribunal has the authority and duty to uphold international public policy. This would allow and may in fact mandate that a tribunal decline jurisdiction or dismiss the claims of an investor if its investment was acquired, effected or somehow tainted/permeated by bribery and/or corruption, illegality or other internationally unacceptable behaviour. … Finally, *it is recognised that in international investment transactions an investor with 'unclean hands' should not benefit from the protections afforded under any treaty, and especially not under the ECT.*[15] [emphasis added]

[5-9] In *Littop v Ukraine*,[16] Ukrnafta was one of the largest oil and gas producers in Ukraine, with the state owning 50%. In 1999, two oligarchs, began acquiring

12 *South American Silver Ltd v Bolivia*, PCA Case No 2013-15.

13 *South American Silver Ltd v Bolivia*, PCA Case No 2013-15, Award, 22 November 2018 at paras 447, 453, 471.

14 *Littop Enterprises Ltd v Ukraine*, SCC Case No V 2015/092.

15 *Littop Enterprises Ltd v Ukraine*, SCC Case No V 2015/092 at 433, 438, 439, 442, 485.

16 *Littop Enterprises Ltd v Ukraine*, SCC Case No V 2015/092, Final Award, 4 February 2021. See, Lisa Bohmer, 'Uncovered: Littop v. Ukraine ECT tribunal recognizes "unclean hands" principle and declines jurisdiction over 6 billion USD case after finding that the investment was tainted by corruption; denial of benefits objection is also upheld' (*IA Reporter*, 30 May 2021).

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shares in Ukrnafta. The minority shareholding in Ukrnafta ultimately owned by the two oligarchs was sufficient to allow them to have influence over the quorum at the shareholders meetings of Ukrnafta but was not sufficient to enable them to control the management board to have an impact on the running of the company. The two oligarchs had their shareholdings transferred to their Cyprus subsidiary as part of corporate restructuring in 2017. By March 2007, the subsidiary had acquired a total of 40.05% of shares in Ukrnafta. In 2011, it acquired a further 0.78% of shares. Later on, the Ukraine government introduced a number of measures including tax increase in relation to extraction of oil and gas as well as legislative amendments reducing the quorum of company meetings from 60% to 50% so that companies could skipped notifying the opposing minority shareholders. Relying on the ECT, the subsidiary commenced and SCC arbitration against Ukraine alleging treaty breach. In defence, Ukraine alleged that, Ukrnafta's oil production was sold chiefly to refineries controlled by the two oligarchs at a discount; Ukrnafta converted its gas into ammonia at a facility leased from one of the oligarchs had no alternative but to sell the ammonia on terms to him at whatever price he fixed; Ukrnafta sold oil and petrol products at a significant loss to Ukrnafta but benefitted the two oligarchs instead. The critical evidence produced by Ukraine was the payments exceeding USD100m to the President of Ukraine through a middleman. The tribunal held that had it not been for the payments made by the two oligarchs in 2003–2004, the subsidiary may not have obtained control over Ukrnafta's management, and may not have maintained that control for years resulting in the alleged defrauding of Ukrnafta; the payments exceeding USD 100 million to a middleman were made with the sole objective to have President of Ukraine exercise his authority to enable the two oligarchs to obtain management control of Ukrnafta; that the Ukrnafta shares ownership had their origin in bribery and corruption; and that, accordingly, the tribunal declined jurisdiction.[17]

[5-10] If the investor's misconduct is not a material operating cause contributable to the formation of the investment contract, the improper behaviour may not be sufficient to deprive the investor's right to compensation.[18]

[5-11] In *Biedermann v Kazakhstan*,[19] in June 1991, the then Kazakh Soviet Socialist Republic opened up for foreign investment in its oil exploration sector. Following high-level discussions with Kazakh authorities during 1990 and 1991,

17 *Littop Enterprises Ltd v Ukraine*, SCC Case No V 2015/092, Final Award, 4 February 2021 at paras 78, 87, 92, 94, 97, 174, 176, 183–186, 505, 528, 538, 640, 641.

18 *Biedermann International, Inc v Republic of Kazakhstan*, SCC Case No 97/1996, Award of 2 August 1999 (not public). See, Jarrod Hepburn, 'Looking Back: In first treaty claim under SCC rules, arbitrators in the long-opaque Biedermann case held Kazakhstan liable for breaching US-Kazak BIT, and rejected counterclaim on merits' (*IA Reporter*, 1 November 2017).

19 *Biedermann International, Inc v Republic of Kazakhstan*, SCC Case No 97/1996, Award of 2 August 1999 (not public). See, Jarrod Hepburn, 'Looking Back: In first treaty claim under SCC rules, arbitrators in the long-opaque Biedermann case held Kazakhstan liable for breaching US-Kazak BIT, and rejected counterclaim on merits' (*IA Reporter*, 1 November 2017).

a US firm Biedermann International Inc took a 37% share in the joint venture, with Soviet state entity Intercaspian taking 63% as counterparty to the contract. The contract envisaged a validity of 25 years and an area of 40 square kilometres on the Kenbai oil field for the development project. Already by March 1992, however, the parties were experiencing difficulties, with Biedermann alleging that authorities (of the newly-independent Kazakhstan) had failed to deliver an amount of oil intended for sale to finance the project. In early June 1992, after being told that Intercaspian was bankrupt, Biedermann agreed to terminate the joint venture contract and replace it with a production sharing agreement (PSA), which eventually entered into force in July 1993. The PSA provided for a process to complete the termination and winding-up of the joint venture. Meanwhile, a decree from mid-June 1992 revoked a land use permit issued to Biedermann allowing it to operate on the oil field area. In January 1994, Kazakh authorities alleged that Biedermann was not fulfilling its new PSA obligations, and, in July 1994, the PSA itself was terminated. Biedermann filed its request for arbitration in December 1996, based on the contract and the Kazakhstan - USA BIT (1992). Kazak relied on Biedermann's fraudulent conduct to justify Kazak's revocation of the PSA and evidence included certain false statements, a forged cheque, a fictitious signature on a letter, and a false statement from the investor that a fire at its premises had delayed certain negotiations. Indeed, the investor admitted some of this conduct but denied knowledge about the forged cheque alleging these was a set-up by Kazakh authorities. The tribunal held that general principles of international law suggested that investments obtained by fraud may mean that 'compensation is reduced or even eliminated'; that, however, while acknowledging the investor's admitted misconduct, such misconduct had not induced Intercaspian to sign the contract; that the evidence did not show sufficient improper behaviour to deprive Biedermann of its rights to compensation.

1.3 Estoppel

[5-12] Investor-claimant is estopped from raising alleged treaty breach if the investor-claimant has conceded or condoned it.

[5-13] In *Adriano Gardella v Côte d'Ivoire*,[20] an Italian investor incorporated in 1967, a joint venture with the Ivorian government to which it would contribute know-how, expertise, and credit obtained from Italian banks for an investment in a hemp farm and textile factory. The Italian investor was also the main supplier of materials to the joint-venture. After trials and studies showed that the venture could be successful, the investor and the government signed further agreements in 1970 and 1971 setting out the various steps to develop the plant. The joint-venture agreement also provided for ICSID arbitration in case of dispute. Yet, by the end of 1973, the joint-venture hit a wall: while the investor insisted on profound changes to the original plan (due to deteriorating export markets), the Ivorian government refused to pay the bills relating to the material already supplied by the Italian company. The investor commenced ICSID proceedings in February 1974,

20 *Adriano Gardella SpA v Côte d'Ivoire*, ICSID Case No ARB/74/1, (1993) 1 ICSID Reports 283.

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seeking payment for materials and services supplied, as well as for loss of profits of the unrealised venture. Côte d'Ivoire, in addition to contesting the jurisdiction of the tribunal, brought counterclaims based on the investor's alleged termination of the joint-venture agreement. On the merits, the tribunal found that up until September-October 1973, there was no evidence that the parties had failed to comply with their obligations under the agreements. Despite the Italian investor had regularly complained of the government's delays and general dilatoriness but, the investor never acted upon such delays to request termination of the joint venture agreement. Rather, the Italian investor had continued to express a desire to carry on the joint venture project. He was therefore estopped from claim damages for non-performance by the Ivorian government.

[5-14] Investors' claims are not estopped due to letter to government that was a 'cry for help' to salvage the project.

[5-15] In *EcoDevelopment v Tanzania*,[21] in 2006, a predecessor to the Swedish investors signed a Memorandum of Understanding with the government of Tanzania, with a view to developing a large-scale agricultural venture to grow sugarcane and produce biofuel for export. The venture was meant to be established on government lands, near the coastal town of Bagamoyo. Subsequently, the Swedish investors acquired a stake in two local subsidiaries, which later entered into a Performance Agreement with Tanzanian authorities. It appeared that the land, though technically owned by the government, was in fact settled by several communities, and the cost of resettling them was put on the Swedish investors—slowing the project down. In particular, the investors failed to achieve financial closing, blaming this on contradictory conduct from the state. In March 2015, the local subsidiaries had sent a 'cry for help' letter to the President of Tanzania saying that they would irrevocably cease all work on and would effectively abandon the project with effect from 30 April 2015. Ultimately, the state's Commissioner of Lands proceeded to a 'rectification' of the land register, which cancelled the two local subsidiaries' title to the land. Loss of the land meant a total loss of the project since the project could not proceed without the land. In 2016, relying on the Sweden - Tanzania BIT (1999), the Swedish investors commenced ICSID arbitration against Tanzania for expropriation. Tanzania argued that, by the 'cry for help' letter, the Swedish investors were already abandoning the project and should therefore be estopped from claiming expropriation. The Tribunal held that the letter was not stating an irrevocable decision but inviting further discussion in the hope of avoiding closure; that the following actions by Tanzania were explicable only on the basis that the Government considered that the letter did not close the door and that the project could continue; that Tanzania's conduct for many months after receipt of that letter showed that it had not relied upon the

21 *EcoDevelopment in Europe AB v United Republic of Tanzania*, ICSID Case No ARB/17/33. For a case summary, see, Damien Charlotin, 'Analysis: ICSID tribunal found that Tanzania breached its investment treaty with Sweden when the state expropriated agricultural venture' (*IA Reporter*, 4 April 2024).

representation of withdrawal or abandonment; and that, accordingly, the defence of estoppel was rejected.[22]

1.4 Fraud and illegality

1.4.1 Jurisdiction or merit?

[5-16] In some cases, investment tribunals denied protection because the investment or the investor-claimant's conduct in making it was illegal either under domestic law or under international legal rules or principles.[23] It became part of an apparent growing trend in which bribery is playing a critical role in international investment arbitration when foreign investors lost their rights under an investment treaty against a host State because it had secured its investment through corruption. These awards highlight the growing relevance of corruption both in the context of national anti-bribery legislation and international investment frameworks—to the extent that, where bribery exists, relief may no longer be available under the investment treaty.[24]

[5-17] A host State may challenge an investment induced by fraud is no 'investment' under the treaty and therefore the tribunal has no jurisdiction in the outset. But whether the wrong gives rise to a jurisdictional challenge or a defence on the merit, one must read the investment treaty in detail. Usually for BITs, a distinction has to be drawn between:

(1) legality as at the initiation of the investment when the investment was made; and
(2) legality during the performance of the investment.

[5-18] If the investment treaty provides for compliance with the internal legislation of the host State prior to the making of the investment, then this issue will bear upon this Tribunal's jurisdiction. Legality in the subsequent life or performance of the investment usually does not bear upon the scope of application of the investment treaty and hence the Tribunal's jurisdiction—albeit that it may well be relevant in the context of the substantive merits of a claim brought under the investment treaty. Therefore, legality of the creation of the investment is a

22 *EcoDevelopment in Europe AB v United Republic of Tanzania*, ICSID Case No ARB/17/33, Award (Excerpt), 13 April 2022 at paras 270, 284, 330, 337.

23 *Dolzer* at 106.

24 See, *World Duty Free Company v Republic of Kenya*, ICSID Case No Arb/00/7, Award, 4 October 2006 (where international public policy was found to have been violated as a result of the investor's illicit payments to the then Kenyan head of state—though the findings were rooted in contract rather than the law of bilateral investment treaties); *Siemens AG v The Argentine Republic*, ICSID Case No ARB/02/8, Award, 17 January 2007 (the out-of-court settlement between Siemens and Argentina following the latter's request to ICSID to 'revise' a 2007 ICSID award as a result of the contemporaneous Siemens corruption scandal, which led to a costly settlement for the German multinational) See, Ruth Cowley, 'Investor corruption' (*Norton Rose Fullbright*, May 2014). See, Gary Born, *International Arbitration: Law and Practice* (3rd edn, Wolters Kluwer 2021) at 517.

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jurisdictional issue; and the legality of the investor's conduct during the life of the investment is a merits issue.[25]

[5-19] In *Metal-Tech v Uzbekistan*,[26] an Israeli investor sought to invest by building and operating a modern molybdenum[27] plant with two Uzbek state-owned companies. The joint venture was approved by the Uzbek Cabinet of Ministers issuing government resolutions. The joint venture vehicle, Uzmetal was incorporated to run the project, which made profit in 2005. In 2006, the public prosecutor initiated criminal proceedings against officials of Uzmetal who were responsible for negotiation and execution of export contract for Uzmetal. Later, the Uzbek Cabinet of Ministers issued government resolutions to abrogate Uzmetal's exclusive right to export Uzmetal's molybdenum oxide. The Israeli investor commenced ICSID arbitration for expropriation. During the merit hearing, evidence of corrupt payments by the Israeli investor's chairman and CEO was exposed. Prior to the Israeli investor securing the investment contract from the Uzbek authorities, it paid approximately USD 4 million to 'consultants' connected to key public officials. The payments were made for 'lobbyist activity' rather than what was originally understood by the tribunal as operational and logistical product support. The consultants, who included the brother of the then prime minister as well as a formal public official, were said to have provided 'immense assistance' and were a 'substantial part of putting the deal together'. The tribunal held that corruption was a breach of the requirement for legal investments under the Israel - Uzbekistan BIT; and that, accordingly, the Tribunal lack jurisdiction over the investor's claim.[28]

[5-20] Payment of secret profit in the course of the investment is a form of illegality but if such payment does not cause or contributed to the formation of the investment or otherwise procured it, then the defence is not made out. In other

25 *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award, 18 June 2010 at para 127 (the Tribunal held that the legality of the creation of the investment was a jurisdictional issue and the legality of the investor's conduct during the life of the investment was a merits issue); *Fraport AG Frankfurt Airport Services Worldwide v The Republic of the Philippines*, ICSID Case No ARB/03/25, Award, 16 August 2007 at para 345 (the Tribunal held that if, at the time of the initiation of the investment, there had been compliance with the law of the host State, allegations by the host State of violations of its law in the course of the investment, as a justification for state action with respect to the investment, might be a defence to claimed substantive violations of the BIT, but could not deprive a tribunal acting under the authority of the BIT of its jurisdiction).

26 *Metal-Tech Ltd v Republic of Uzbekistan*, ICSID Case No ARB/10/3.

27 Molybdenum is a chemical element, a silvery-white metal that is essential for life as a trace mineral and also widely used in industrial applications. It is a transition metal with the symbol Mo and atomic number 42. Molybdenum is crucial for the function of several enzymes in the body and is also a key component in various alloys and industrial materials.

28 *Metal-Tech Ltd v Republic of Uzbekistan*, ICSID Case No ARB/10/3, Award, 4 October 2013 at paras 7, 13, 19, 30, 37, 38, 372, 374.

words, the illegality 'must go to the essence of the investment' otherwise the defence fails.[29]

[5-21] In *Hamester v Ghana*,[30] a German investor entered into a joint venture with the Ghana Cocoa Board (Cocobod), which was established as a statutory body to purchase cocoa beans from Ghana farmers and to market and export them. German investor and Cocobod started a project to modernise a cocoa factory and to do so, the German investor provided a loan to Cocobod as well as engineering consultancy services. Years later the German investor sued Ghana for treaty breaches and Ghana challenged the jurisdiction of the ICSID tribunal, alleging that the investment was vitiated by fraud. Ghana alleged that the German investor was seeking to exploit Cocobod by taking the factory's entire output at low prices and resold for profits for itself and charged the factory fees and commissions for selling the factory's produces to itself—all for the purpose of extracting profits from the factory. Ghana also alleged that the German investor earned a secret commission (by not disclosing the discount received) from a machinery supplier during the formation of the joint venture since installation of new machinery was for the modernisation of the factory.[31] The tribunal held that despite the discount was not disclosed to the Cocobod, the total amount that the German investor injected was significantly higher than that of the undisclosed commission; that there was no conclusive evidence proving that Cocobod would not have entered into the joint-venture had it known of the secret commission being made; that there was not a single witness from Ghana attesting to the alleged fraudulent action having induced the joint venture; that the initial investment was not induced by fraud; and that, accordingly, the jurisdiction challenge failed.

[5-22] Where evidence of corruption during the investment was proved, the Tribunal nullified the entire transaction as a consequence of illegality and corruption.

[5-23] In *Exem v Sonangol* (I),[32] in 2005, a Portugal entrepreneur sought to acquire share in Galp, the largest oil and gas company in Portugal, but he did not want to put up cash for payment. He contacted his business acquaintance the Angola President's daughter to enquire whether she had interest. She then contracted Sonangol, Angola's largest and State-owned oil and gas company, which agreed to take part in the investment. The Portugal entrepreneur formed a corporate holding structure which was later used to acquire the Galp shares. Sonangol paid EUR 189m for 45% shares in that corporate holding structure and these funds was used by the Portugal entrepreneur to pay for Galp shares in Galp's IPO in 2006. After a successful IPO, Sonangol and Exem (a company incorporated in the Netherlands controlled by the son-in-law of the Angola President) concluded

29 *South American Silver Ltd v Bolivia*, PCA Case No 2013-15, Award, 22 November 2018 at para 470.

30 *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award, 18 June 2010.

31 *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award, 18 June 2010 at paras 99, 105, 134, 135, 137–139.

32 *Exem Energy BV v Sonangol* (I), NAI Case No 4687, Final Award, 23 July 2021.

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a Share Purchase Agreement (SPA) with Sonangol which Sonangol would sell its 45% shares to Exem for EUR 75m. Sonangol duly transferred the 45% shares to Exem but when came to payment, Exem wrote to Sonangol requesting payment to be made in Angola currency instead of Euro. The then chairman of the board of director was the President's daughter, appointed in 2015 by her father, accepted the proposal in 2017 and thereby discharging Exem's obligation under the SPA. Shortly after, a new President came to power and a new board of Sonangol was appointed. In 2018, Sonangol repatriated the Angola currency payment received from Exem, and insisted the payment should be in Euro. The SPA was expressed to be governed by Dutch law and provided for dispute to be arbitrated in the Netherlands Arbitration Institute. In October 2018, Exem commenced an NAI arbitration seeking declaration that its payment obligation was discharged and Sonangol counterclaim seeking to set aside the SPA on ground of illegality and corruption. The tribunal held that Sonangol succeeded in proving that the SPA was tainted by illegality, enabling the then President's daughter and her husband, while using her position as daughter of the Angolan President who had a direct control over the State owned oil and gas company Sonangol, to reap an extraordinary financial gain to the detriment of Sonangol and, consequently, of the State of Angola; that the SPA was null and void; that Exem's claims dismissed and that Sonangol's counterclaim upheld.[33]

[5-24] Similarly, in *Grand Express v Belarus*[34] GE sought to build a modern railcar plant in Belarus. In 2007, GE and the state-owned Belarus Railways established OVZ, in which GE held 74% of shares. In 2008, GE and Belarus signed an investment contract with construction deadlines, an obligation for GE to invest around USD 131m, and various tax incentives. The project was financed by several loans. GE itself made loans to OVZ, for around USD 46m, while Belarus Railways made loans of USD 11m. In addition, in April 2011, the Eurasian Development Bank extended a credit facility of USD 64m to OVZ, guaranteed by GE and Belarus. The construction of the plant was delayed at almost every stage. In 2011, GE replaced two of the original project developers with two new entities. Belarus found out that these two new entities were GE's affiliates and suspected nepotism within. GE maintained that the previous contractors needed to be replaced because their work had not been satisfactory. In 2012, Belarus' Committee of State Control found that the amounts invoiced to OVZ by one of these new entities were excessive and an audit was conducted in 2016 which revealed that the two new entities did in fact overcharged OVZ. Later on, it was discovered that the GE was involved in at least 22 fraudulent transactions, using the same *modus operandi* to replace original suppliers and contractors with its affiliates then over-invoiced the project. By late 2015, OVZ was unable to repay its loans and in 2016, Belarus

33 *Exem Energy BV v Sonangol* (I), NAI Case No 4687, Final Award, 23 July 2021 at paras 5.1–5.16, 6.2–6.10, 7.1, 7.2, 8.3, 10.2.

34 *Grand Express v Republic of Belarus*, ICSID Case No ARB(AF)/18/1 (not public). For a case summary, see, Lisa Bohmer, 'Uncovered: Tribunal in Grand Express v. Belarus declares claims inadmissible after finding that claimant defrauded its Belarusian partner and sent falsified documents to Eurasian Development Bank' (*IA Reporter*, 15 February 2024).

decided to terminate the investment contract. In May 2016, OVZ defaulted, and the Eurasian Development Bank called for accelerated payment of the outstanding USD 35m which the Belarus State, being a guarantor, repaid the amount in full. GE filed for arbitration in 2017 under the EEU Treaty seeking damages of USD 234m. The tribunal found that a conjunction of direct and circumstantial evidence, confirmed by adverse inferences, indicated that GE had defrauded OVZ by causing it to pay twice as much for a technological complex than what had been charged by a German company that had fabricated these goods; that this fraud had been orchestrated with the assistance of several entities and individuals, in particular a UK-based entity, which had served as an intermediary and was linked to GE; that GE had misled and sent falsified documents to the Eurasian Development Bank to cover up this fraud; that the fraudulently appropriated funds had then travelled through a series of offshore companies, in operations that 'bear the hallmarks' of a money laundering scheme; that GE's claims were inadmissible and GE was ordered to pay over USD 10m in costs.

[5-25] Practically, the result of successfully proving fraud and corruption will be dismissal of the investor-claimant's claim regardless whether it is at the earlier stage where jurisdiction is determined or at the final stage where merit is determined.

[5-26] In *Spentex v Uzbekistan*,[35] the tribunal started its analysis by enquiring whether a finding of corruption would be dispositive of the entire claim and was of the opinion that this would indeed be the case. however, the tribunal was split on the precise legal consequences that would befall a claim tainted by corruption. While one member of the tribunal was of the opinion that a finding of corruption would result in the tribunal being deprived of jurisdiction, the (undisclosed) majority preferred to treat the issue as a matter of admissibility of claims. In the end, the tribunal noted that it did not need to resolve the issue, as both findings resulted in the dismissal of the claims.

[5-27] The fraudulent conduct has to be attributable to the investor-claimant otherwise the investment is not tainted by fraud. In *Grand Express v Belarus*,[36] the tribunal observed that the fraud allegations in this case concerned a 'complex and dense set of evidence' and featured a 'myriad of individuals and corporate entities' linked to the investor-claimant. Based on the conduct and functions of

35 *Spentex Netherlands, BV v Republic of Uzbekistan*, ICSID Case No ARB/13/26, Award, 27 December 2016 (not public). For a case summary, see, Luke Eric Peterson, 'Indian company invokes Dutch BIT – rather than Indian treaty – in new arbitration over withdrawn subsidies in Uzbekistan' (*IA Reporter*, 30 September 2013); Vladislav Djanic, 'In newly unearthed Uzbekistan ruling, exorbitant fees promised to consultants on eve of tender process are viewed by tribunal as evidence of corruption, leading to dismissal of all claims under Dutch BIT' (*IA Reporter*, 22 June 2017).

36 *Grand Express v Republic of Belarus*, ICSID Case No ARB(AF)/18/1 (not open to public), see, Lisa Bohmer, 'Uncovered: Tribunal in Grand Express v. Belarus declares claims inadmissible after finding that claimant defrauded its Belarusian partner and sent falsified documents to Eurasian Development Bank' (*IA Reporter*, 15 February 2024).

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