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From the Arab World to the Globalization of
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Reflections on Recent ICSID Arbitral Awards in Which the “Illegality of the Investment” Defense Was Raised by the Host State

Muhammad EL GAWHARY*

INTRODUCTION

Ignorance of the law excuses no man: Not that all men know the law, but because 'tis an excuse every man will plead, and no man can tell how to refute him.¹

As the old principle states, *ignorantia juris non excusat* (“ignorance of the law excuses no one”). Several investor-state arbitral tribunals have recently reaffirmed that doctrine. This article discusses these recent cases arbitrated at the International Centre for Settlement of Investment Disputes (“ICSID”) in which the host state raised the illegality of the foreign investment as a defense to the investment dispute, and looks at how different ICSID arbitral tribunals have analyzed and responded to that defense in different ways.

Specifically, this article analyzes the following nine cases (listed in chronological order):

- (1) *Alasdair Ross Anderson et al. v. Republic of Costa Rica* (“*Anderson v. Costa Rica*”);²
- (2) *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana* (“*Hamester v. Ghana*”);³
- (3) *Mr. Saba Fakes v. Republic of Turkey* (“*Fakes v. Turkey*”);⁴

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¹ John Selden, English jurist (1584 - 1654).

² *Alasdair Ross Anderson et al. v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award (May 19, 2010).

³ *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award (June 18, 2010).

⁴ *Mr. Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award (July 14, 2010).

- (4) *SAUR International S.A. v. Republic of Argentina* (“SAUR v. Argentina”);⁵
- (5) *Quiborax S.A., Non-Metallic Minerals S.A. and Allan Fosc Kaplún v. Plurinational State of Bolivia* (“Quiborax v. Bolivia”);⁶
- (6) *Vannessa Ventures Ltd. v. Bolivarian Republic of Venezuela* (“Vannessa v. Venezuela”);⁷
- (7) *Mr. Franck Charles Arif v. Republic of Moldova* (“Arif v. Moldova”);⁸
- (8) *Niko Resources (Bangladesh) Limited v. People’s Republic of Bangladesh, Bangladesh Petroleum Exploration and Production Company Limited (“Bapex”) and Bangladesh Oil Gas and Mineral Corporation (“Petrobangla”)* (“Niko v. Bangladesh”);⁹ and
- (9) *Metal-Tech Ltd. v. Republic of Uzbekistan* (“Metal-Tech v. Uzbekistan”).¹⁰

The “illegality of the investment” defense is a term used to describe a host state’s defense in an investment dispute with a foreign investor, whereby the investor is accused of having an illegal investment, which is therefore not protected under the bilateral investment treaty (“BIT”) between the host state and that of the investor.

This defense is often based on the text of the “legality requirement” found in many BITs. The legality requirement generally provides that to be valid and to be protected under the BIT, the investment must have been “*made in accordance with the laws of the host State.*” The effect of this language is to remove the tribunal’s ability to hear the investor’s claim in a dispute where the investor has failed to comply with the laws of the host state when making its investment.¹¹ When a state can point to an illegality of the kind envisaged by the legality requirement, it can short-circuit the investor’s legal claims, placing them outside the scope of the BIT’s protection and therefore outside the tribunal’s jurisdiction.¹²

⁵ *SAUR International S.A. v. Republic of Argentina*, ICSID Case No. ARB/04/4, Decision on Jurisdiction and Liability (June 6, 2012).

⁶ *Quiborax S.A., Non-Metallic Minerals S.A. & Allan Fosc Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction (Sept. 27, 2012).

⁷ *Vannessa Ventures Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)04/6, Award (Jan. 16, 2013).

⁸ *Mr. Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award (Apr. 8, 2013).

⁹ *Niko Resources (Bangladesh) Limited v. People’s Republic of Bangladesh, Bangladesh Petroleum Exploration and Production Company Limited (“Bapex”) & Bangladesh Oil Gas and Mineral Corporation (“Petrobangla”)*, ICSID Case No. ARB/10/11 & ARB/10/18, Decision on Jurisdiction (Aug. 19, 2013).

¹⁰ *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award (Oct. 4, 2013).

¹¹ Jarrod Hepburn, *In Accordance With Which Host State Laws? Restoring the ‘Defence’ of Investor Illegality in Investment Arbitration*, at 1 (Apr. 24, 2014), available at <http://ssrn.com/abstract=2428859> [hereinafter Hepburn II].

¹² *Id.*

The recent ICSID cases that interpret this legality requirement provide an in-depth analysis of its exact scope; whether it applies to any and all “trivial” and “non-trivial” laws and regulations of the host state or whether it is restricted in its subject-matter scope to certain investment-related laws; whether it applies solely to the initiation of the investment or also to its subsequent life and performance; and whether a claimant can use the Most-Favored Nation (“MFN”) clause found in many BITs to sidestep this legality requirement.

Section I of this article looks at the different arguments made by claimants to try to bypass the BIT’s legality requirement. Section II discusses cases arbitrated under BITs that had an express legality requirement. Section A discusses the cases of *Anderson v. Costa Rica* and *Metal-Tech v. Uzbekistan*, in which the host state’s “illegality of the investment” defense was successful. In contrast, section B discusses the cases of *Hamester v. Ghana*, *Quiborax v. Bolivia*, *Vannessa v. Venezuela*, and *Arif v. Moldova*, in which the host state’s “illegality of the investment” defense was not successful. Section III examines the case of *SAUR v. Argentina*, in which the BIT had no express legality requirement. Yet, the tribunal found that the legality requirement was inherent in all investment treaties. Section IV analyzes the recent case of *Fakes v. Turkey*—a nineteen-billion dollar case dismissed in a fifty-page decision in which the tribunal defined the scope of the legality requirement. Section V focuses on the recent case of *Niko v. Bangladesh* in which the investor was accused of procuring the investment through bribery and corruption. Finally, section VI looks at certain criticisms levelled against the tribunals’ conclusions and reasoning in some of these cases.

I. CLAIMANTS’ ARGUMENTS REGARDING THE LEGALITY REQUIREMENT

In sum, host States should not be able to invoke the legality requirement as an excuse to avoid their international responsibility.¹³

The claimants in the cases described below were all accused of having an investment that did not comply with the laws of the host state. The “investment” was therefore alleged to be illegal and not protected under the BIT.

In response, some claimants attempted to use the BIT’s MFN provision to circumvent the legality requirement, arguing that other BITs between the host state and third countries did not have a legality requirement and were therefore

¹³ *Quiborax v. Bolivia*, *supra* note 6, ¶ 247.

allegedly more favorable, and that they should be entitled to use them. These arguments were rejected by the tribunals in *Vannessa v. Venezuela* and *Metal-Tech v. Uzbekistan*, which reasoned that an investor must first fall within the scope of the BIT's legality requirement before being able to invoke its other provisions. As the tribunal stated in *Vannessa v. Venezuela*, the "MFN clause cannot be used to expand the category of investments to which the BIT applies."¹⁴ That principle was affirmed in *Metal-Tech v. Uzbekistan*, in which the tribunal confirmed that "an MFN clause cannot be used to import a more favorable definition of investment contained in another BIT," and that an investor "must be *under* the treaty to claim *through* the treaty."¹⁵

Some claimants also tried to restrict the scope of the legality requirement to certain laws so that it would not apply to their alleged breach. For example, the claimant in *Vannessa v. Venezuela* argued that

the "legality requirement" is limited in its application to breaches of fundamental principles of law and of laws concerning foreign investments, and that it does not apply so as to bar the existence of jurisdiction in circumstances where that would be a disproportionate response to a breach of the law.¹⁶

Similarly, the claimants in *Quiborax v. Bolivia* argued that "the legality requirement has a limited scope" which "applies only to violations of the host State's fundamental principles or investment regime, and only at the time the investment is established."¹⁷ This argument was echoed by the claimant in *Fakes v. Turkey*, who argued that a "certain level of violation" was required to breach the legality requirement.¹⁸

These arguments were to some extent accepted by the tribunals, which generally agreed that the legality requirement should be limited in its subject-matter scope to "non-trivial" violations of the host state's laws.¹⁹ The tribunal in *Quiborax v. Bolivia*, for example, found that the legality requirement applied only to "non-trivial" violations of the host state's law,²⁰ and it concluded that "even if the [c]laimants had breached" a law regarding a shareholder registry, "any such breach would have been trivial and thus beyond the subject matter scope of the legality requirement."²¹ Likewise, the tribunal in *Metal-Tech v. Uzbekistan* stated that "on the basis of existing case law," the legality requirement covers only "non-trivial" violations of domestic law.²² The

¹⁴ *Vannessa v. Venezuela*, *supra* note 7, ¶ 133.

¹⁵ *Metal-Tech Ltd. v. Uzbekistan*, *supra* note 10, ¶ 145 (emphasis in original).

¹⁶ *Vannessa v. Venezuela*, *supra* note 7, ¶ 132.

¹⁷ *Quiborax v. Bolivia*, *supra* note 6, ¶ 246.

¹⁸ *Fakes v. Turkey*, *supra* note 4, ¶ 118.

¹⁹ As explained in section VI, some tribunals have been criticized for this non-textual limitation of the legality requirement, which does not appear in the text of the BIT itself.

²⁰ *Quiborax v. Bolivia*, *supra* note 6, ¶ 266.

²¹ *Id.* ¶ 281.

²² *Metal-Tech v. Uzbekistan*, *supra* note 10, ¶ 165.

tribunal in *Vannessa v. Venezuela* did not respond to the claimant's argument that the legality requirement covered only "breaches of fundamental principles of law," but held that the legality requirement did "not extend to purely contractual obligations" with the host state,²³ and that a breach of contract with the host state did not rise to the level of a breach of law for purposes of the legality requirement.

In contrast to the subject-matter scope of the legality requirement, which concerns the nature or type of the laws breached, its temporal scope concerns the timing of the breach, and whether the alleged breach occurred at the initiation of the investment or during its subsequent life and performance.

The tribunals in *Metal-Tech v. Uzbekistan*, *Hamester v. Ghana*, *Quiborax v. Bolivia*, and *Fakes v. Turkey* restricted the temporal scope of the legality requirement, finding that where the BIT defines an "investment" as one that was "made," "implemented," or "established" in "accordance with the laws and regulations" of the host state; the legality requirement is restricted in its temporal scope and applies only to the legality of the investment at the time of its "creation,"²⁴ "admission,"²⁵ and "establishment,"²⁶ and that it does "not extend" to its "subsequent performance."²⁷

Also noteworthy, the claimants in *Anderson v. Costa Rica* argued that, despite the illegality of the investment, they had intended to follow the law. The tribunal rejected that argument, finding that the BIT's legality requirement was stated in "objective and categorical terms." Therefore, the tribunal stated:

Each Claimant must meet this requirement, regardless of his or her knowledge of the law or his or her intention to follow the law. Thus, the Claimants' statements that they intended to follow the law or that they did not know the law are irrelevant to a determination of whether they actually owned or controlled their investments *in accordance with the laws of Costa Rica*.²⁸

Finally, another argument made by the claimants in *Quiborax v. Bolivia* was that the host state was *estopped* from disputing the legality of the investment since the parties were engaged in negotiations for almost three years, and at no point did Bolivia call into question the legality of the investment.²⁹ The tribunal rejected that argument, finding that settlement negotiations do not mean that the host state has accepted the legality of the investment,³⁰ and that a "different

²³ *Vannessa v. Venezuela*, *supra* note 7, ¶ 134.

²⁴ *Hamester v. Ghana*, *supra* note 3, ¶ 127.

²⁵ *Fakes v. Turkey*, *supra* note 4, ¶ 119.

²⁶ *Metal-Tech v. Uzbekistan*, *supra* note 10, ¶ 185.

²⁷ *Hamester v. Ghana*, *supra* note 3, ¶ 127; *Quiborax v. Bolivia*, *supra* note 6, ¶ 266.

²⁸ *Anderson v. Costa Rica*, *supra* note 2, ¶ 52.

²⁹ *Quiborax v. Bolivia*, *supra* note 6, ¶ 253.

³⁰ *Id.* ¶ 257.

conclusion could have a chilling effect on” a state’s “willingness to entertain settlement negotiations.”³¹

The claimants’ arguments and the tribunals’ responses are explored in more detail below.

II. CASES WHERE THE BIT EXPRESSLY REQUIRED THAT THE INVESTMENT BE “MADE IN ACCORDANCE WITH THE LAWS OF THE HOST STATE”

*Not all BITs contain a requirement that investments subject to treaty protection be “made” or “owned” in accordance with the law of the host country. The fact that the Contracting Parties...specifically included such a provision is a clear indication of the importance that they attached to the legality of investments...and their intention that their laws with respect to investments be strictly followed.*³²

This category of cases, in which the BIT expressly required that the investment be “made in accordance with the laws of the host State,” generally establishes that this requirement is a jurisdictional prerequisite, and that the failure of the claimant to comply with it will result in the case being dismissed on jurisdictional grounds. The recent ICSID cases under this category are *Anderson v. Costa Rica* and *Metal-Tech v. Uzbekistan*, both of which were dismissed on jurisdictional grounds based on the illegality of the investment.

In contrast, despite involving BITs with similarly worded legality requirements, the cases discussed in section B rejected the host state’s “illegality of the investment” defense. The cases under that category are *Hamester v. Ghana*, *Quiborax v. Bolivia*, *Vannessa v. Venezuela*, and *Arif v. Moldova*.

A. CASES WHERE THE “ILLEGALITY OF THE INVESTMENT” DEFENSE WAS SUCCESSFUL

Each Claimant must meet this [legality] requirement, regardless of his or her knowledge of the law or his or her intention to follow the law³³

Anderson v. Costa Rica is a classic example of a case in which the tribunal denied jurisdiction on the ground that the investment was made in breach of the host state’s national law where the BIT expressly required such compliance for the investment to be valid. In doing so, the tribunal underscored that

³¹ *Id.*

³² *Anderson v. Costa Rica*, *supra* note 2, ¶ 53.

³³ *Id.*

investments must comply with the legality requirement of a BIT before the tribunal can adjudicate the investor's claims.

The claimants in *Anderson* were 137 Canadian nationals who invested in Costa Rica's financial system through an investment fund that was run by the shady Villalobos brothers, one of whom disappeared in 2007 as the ICSID case was being registered, while the other was convicted of aggravated fraud and illegal financial intermediation and sentenced to eighteen years imprisonment by the Costa Rican courts:

[T]he judges of the Trial Court concluded that the Villalobos brothers had put in place and operated a Ponzi scheme in which they had used funds received from depositors to pay other depositors and themselves The judges noted that the brothers' scheme was cloaked in secrecy and was designed to avoid notice by the public or detection by the governmental authorities.³⁴

The tribunal explained that:

By actively seeking and accepting deposits from the Claimants and several thousand other persons, the Villalobos brothers were engaged in financial intermediation without authorization by the Central Bank or any other government body as required by law. The courts of Costa Rica after a lengthy and extensive legal process determined that [one of the brothers], because of his involvement in the scheme, committed aggravated fraud and illegal financial intermediation. In securing investments from the Claimants, the Villalobos brothers were thus clearly not acting in accordance with the laws of Costa Rica. The entire transaction between the Villalobos brothers and each Claimant was illegal because it violated the Organic Law of the Central Bank. If the transaction by which the Villalobos acquired the deposit was illegal, it follows that the acquisition by each Claimant of the asset resulting from that transaction was also not in accordance with the law of Costa Rica.³⁵

The claimants in *Anderson* brought their case under the Canada-Costa Rica BIT, which contained an express legality requirement. Article I(g) stated that "'investment' means any kind of asset owned or controlled either directly, or indirectly through an enterprise or natural person of a third State, by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the latter's laws"³⁶

Even though the 137 claimants "who had provided funds to the brothers were considered victims of fraud,"³⁷ strictly interpreting the text of the BIT's legality requirement, the tribunal explained that the "requirement" is stated "in objective and categorical terms," and each claimant "must meet this

³⁴ *Id.* ¶ 26.

³⁵ *Id.* ¶ 55.

³⁶ *Id.* ¶ 46.

³⁷ *Id.* ¶ 27.

requirement, regardless of his or her knowledge of the law or his or her intention to follow” it.³⁸

The tribunal’s statement regarding the irrelevance of “knowledge of the law” or “intention to follow” reaffirms the principle that ignorance of the law is no defense. In that respect, the tribunal underscored that investors have a duty of “due diligence” to ensure their “investments comply with the law,” adding that:

Costa Rica, indeed any country, has a fundamental interest in securing respect for its law. It clearly sought to secure that interest by requiring investments under the BIT to be owned and controlled according to law. At the same time, prudent investment practice requires that any investor exercise due diligence before committing funds to any particular investment proposal. An important element of such due diligence is for investors to assure themselves that their investments comply with the law. Such due diligence obligation is neither overly onerous nor unreasonable. Based on the evidence presented to the Tribunal, it is clear that the Claimants did not exercise the kind of due diligence that reasonable investors would have undertaken to assure themselves that their deposits with the Villalobos scheme were in accordance with the laws of Costa Rica.³⁹

The tribunal’s statement above underscores that the investor’s duty of due diligence to comply with domestic law is not a light one. The Villalobos brothers were not only given deposits by the 137 claimants, but also by “several thousand other persons.”⁴⁰ Moreover, the tribunal described the 137 claimants as “victims of fraud.”⁴¹ The local court decisions discussed in *Anderson* also stated that the investment “scheme was cloaked in secrecy” and “designed to avoid notice by the public or detection by the governmental authorities.”⁴² The tribunal’s holding, therefore, that the 137 claimants, and by extension thousands of other investors, had failed to “exercise the kind of due diligence that reasonable investors would have undertaken to assure themselves that their” investments comply with domestic law,⁴³ highlights that the investor’s obligation of due diligence is not to be overlooked and that being a victim of fraud along with thousands of other investors does not excuse an investor’s failure to comply with domestic law. The tribunal stated that such “due diligence obligation is neither overly onerous nor unreasonable” and that this interpretation of the legality requirement “reflects both sound public policy and sound investment practice.”⁴⁴

³⁸ *Id.* ¶ 52.

³⁹ *Id.* ¶ 58.

⁴⁰ *Id.* ¶ 55.

⁴¹ *Id.* ¶ 27.

⁴² *Id.* ¶ 26.

⁴³ *Id.* ¶ 58.

⁴⁴ *Id.*

The tribunal justified this conclusion by explaining that not all BITs contain an express legality requirement and that the inclusion of such a provision “is a clear indication” that the host state’s “laws with respect to investments” must “be strictly followed.”⁴⁵

More recently, in 2013, faced with similar language in the applicable BIT, the tribunal in *Metal-Tech v. Uzbekistan* reached the same conclusion and dismissed the case on jurisdictional grounds on the basis of the illegality of the investment. The *Metal-Tech* case is said to be “the first” case in which “an ICSID tribunal has dismissed an investment treaty claim because of corruption.”⁴⁶ There, the tribunal

refused jurisdiction over claims by Israeli company Metal-Tech under the Israeli-Uzbekistan bilateral investment treaty. The tribunal found that the claimant’s payouts to “consultants”, including the brother of Uzbekistan’s then prime minister, breached a treaty requirement that investments be made in accordance with Uzbek law.⁴⁷

Like the BIT in *Anderson*, the BIT in *Metal-Tech* also had an express compliance with the law requirement:

Article 1(1) of the BIT define[d] investments as “any kind of *assets, implemented* in accordance with the laws and regulations of the Contracting Party in whose territory the investment is made.” In other words, it contain[ed] a legality requirement, the scope of which [was] circumscribed in terms of subject-matter (laws and regulations) and time (the time of implementation).⁴⁸

Interpreting that language, the tribunal gave particular weight to the BIT’s use of the word “*implemented*” in its legality requirement. That, the tribunal observed, meant that “the investment must be legal when it is initially established. Article 1 simply does not address whether or not the investment must be operated lawfully after it is in place.”⁴⁹ With that interpretation, the tribunal rejected the respondent’s argument that “*implemented*” means “made and operated,”⁵⁰ and that the legality requirement extends past the initiation phase of the investment. But that did not matter as the tribunal ultimately found the investment not to have been “*implemented*” in accordance with domestic law.

The tribunal ruled that the claimant had breached the legality requirement by engaging in corruption and violating Uzbekistan’s laws on bribery. It found that by paying suspiciously large amounts of money to individuals with government connections, including the brother of the prime

⁴⁵ *Id.* ¶ 53.

⁴⁶ Sebastian Perry, *Uzbek Claim Dismissed Because of Corruption*, GAR (Nov. 26, 2013).

⁴⁷ *Id.* See also *Metal-Tech Ltd. v. Uzbekistan*, *supra* note 10, ¶¶ 327, 337-52, 372-74.

⁴⁸ *Metal-Tech Ltd. v. Uzbekistan*, *supra* note 10, ¶ 164 (emphasis in original).

⁴⁹ *Id.* ¶ 193.

⁵⁰ *Id.* ¶ 185.

minister, to “exercise” their “influence in support of the Claimant’s investment, the Claimant breached” the “Uzbek Criminal Code and, thereby the legality requirement contained” in the BIT.⁵¹ Accordingly, the “investment” was found not to have been “implemented in accordance with the laws and regulations” of the host state.⁵²

The tribunal also rejected the claimant’s attempt to circumvent the legality requirement by invoking the MFN clause.⁵³ The tribunal explained that

[a]s a general matter . . . an MFN clause cannot be used to import a more favorable definition of investment contained in another BIT. The reason is that the defined terms “investments” and “investors” are used in the MFN clause itself, so that the treatment assured to investments and investors by [the MFN clause] necessarily refers to investments and investors as defined in Article 1 of the BIT. In other words, one must fall within the scope of the treaty . . . to be entitled to invoke the treaty protections, of which MFN treatment forms part. Or, in fewer words, one must be under the treaty to claim through the treaty.⁵⁴

Finally, the tribunal made the following observation regarding corruption cases:

[F]indings on corruption often come down heavily on claimants, while possibly exonerating defendants that may have themselves been involved in the corrupt acts. It is true that the outcome in cases of corruption often appears unsatisfactory because, at first sight at least, it seems to give an unfair advantage to the defendant party. The idea, however, is not to punish one party at the cost of the other, but rather to ensure the promotion of the rule of law, which entails that a court or tribunal cannot grant assistance to a party that has engaged in a corrupt act.⁵⁵

Together, the *Anderson* and *Metal-Tech* cases show that a tribunal cannot assist a claimant who has engaged in a corrupt or illegal act. The cases illustrate that where the BIT has an express compliance with the law requirement, any substantial breach of domestic laws by the foreign investor can result in the investor’s claims being dismissed on jurisdictional grounds.

The *Anderson* case is especially telling as there 137 claimants, who arguably had no actual knowledge of the illegality perpetrated by the Villalobos brothers, were denied their claim because they failed to comply with the host state’s laws. In dismissing the claim, the tribunal underscored that ignorance of the law is no defense and that investors have a duty of due diligence “to assure themselves that their investments comply with the law.”⁵⁶

⁵¹ *Id.*, ¶¶ 199, 200, 327, 337–52.

⁵² *Id.*, ¶ 372.

⁵³ *Id.*, ¶ 135.

⁵⁴ *Id.*, ¶ 145.

⁵⁵ *Id.*

⁵⁶ *Anderson v. Costa Rica*, *supra* note 2, ¶ 58.

Whereas *Anderson* shut the door to any attempt to plead ignorance of the law, the *Metal-Tech* case confirmed that any attempt to use the MFN clause to detour around the legality requirement will also be rejected. As the next section demonstrates, however, the illegality of the investment defense is not always successful. And not all cases in which the investor is accused of illegality under a BIT with an express legality requirement are dismissed.

B. CASES WHERE THE “ILLEGALITY OF THE INVESTMENT” DEFENSE WAS UNSUCCESSFUL

This is not a case of a concealed illegalityThe investment was not made fraudulently or on the basis of corruption. In cases like the present one, the passage of time and the actions of the parties on the mutual assumption of legality cannot be ignored⁵⁷

Unlike *Anderson v. Costa Rica* and *Metal-Tech v. Uzbekistan*, the host state’s “illegality of the investment” defense was rejected in *Hamester v. Ghana*, *Quiborax v. Bolivia*, *Vannessa v. Venezuela*, and *Arif v. Moldova*. Even though the BITs in all six cases had a similarly worded legality requirement, the outcome in these cases was not identical, showing that the wording of a BIT’s legality requirement is not the only decisive factor in determining the success of the illegality defense.

The Germany-Ghana BIT applicable in *Hamester v. Ghana* had an express legality provision requiring compliance with the laws of the host state:

Article 10 of the BIT contain[ed] an express requirement for compliance with the host State’s legislation. It state[d] that: “[t]his Treaty shall also apply to investments made prior to [the Treaty’s] entry into force by nationals or companies of either Contracting Party in the territory of the other Contracting Party consistent with the latter’s legislation.”⁵⁸

Based on that requirement, Ghana objected to the tribunal’s jurisdiction, arguing that “the investment was tainted with substantial fraud,” including the falsification of an invoice,⁵⁹ and that it was therefore not “in accordance with Ghanaian law.”⁶⁰

The *Hamester* tribunal drew a distinction between “legality at the *initiation* of the investment” and “legality *during the performance* of the investment.”⁶¹ Like the tribunal in *Metal-Tech*, which had interpreted the word “*implemented*” (in

⁵⁷ *Charles Arif v. Moldova*, *supra* note 8, ¶ 376.

⁵⁸ *Hamester v. Ghana*, *supra* note 3, ¶ 126 (emphasis in original).

⁵⁹ *Id.* ¶ 105.

⁶⁰ *Id.* ¶ 96.

⁶¹ *Id.* ¶ 127 (emphasis in original).

“implemented in accordance with the laws”) to refer to the legality of the investment at the time it was made,⁶² the tribunal in *Hamester* interpreted the word “made” in the same way—i.e., as a verb used in the past tense, applying solely “to legality at the initiation of the investment,” and found that “[l]egality in the subsequent life or performance of the investment [was] not addressed in Article 10.”⁶³

The *Hamester* tribunal also observed that:

An investment will not be protected if it has been created in violation of national or international principles of good faith; by way of corruption, fraud, or deceitful conduct It will also not be protected if it is made in violation of the host State’s law. These are general principles that exist independently of specific language to this effect in the Treaty.⁶⁴

The tribunal, however, went on to find that Ghana had “not fully discharged its burden of proof” in establishing the claimant’s fraud and rejected its “illegality of the investment” defense.⁶⁵ It also stated that “even if [claimant’s] alleged scheme to inflate invoices was fully proven . . . [,] the Tribunal would still not be prepared to analyse [claimant’s] practices as amounting to a fraud such as to deprive the Tribunal of its jurisdiction.”⁶⁶ On that issue, the tribunal found that “the over-statement of invoices” in this case was not determinative of “the existence” of “the contract or the investment” and that it was a more appropriate consideration for the merits of the dispute.⁶⁷ The case was, however, ultimately dismissed after the tribunal found that some of the conduct complained of was not attributable to Ghana, while other conduct was not a breach of the BIT.

Similarly, the tribunal in *Quiborax v. Bolivia* also rejected the host state’s illegality defense. The dispute in *Quiborax* arose after the government revoked eleven mining concessions that were awarded to the claimants. The case was brought under the Bolivia–Chile BIT, Article II of which

limit[ed] its scope of application to investments made “in accordance with the legal provisions” of the host State. Similarly, Article I(2) of the Treaty define[d] “investment” as one that was made “in accordance with the laws and regulations” of the host State.⁶⁸

⁶² See *Metal-Tech Ltd. v. Uzbekistan*, *supra* note 10, ¶¶ 185–93.

⁶³ *Hamester v. Ghana*, *supra* note 3, ¶ 127.

⁶⁴ *Id.* ¶¶ 123–24.

⁶⁵ *Id.* ¶¶ 132, 139.

⁶⁶ *Id.* ¶ 137.

⁶⁷ *Id.* ¶ 138.

⁶⁸ *Quiborax v. Bolivia*, *supra* note 6, ¶ 255.

Bolivia objected to the tribunal's jurisdiction, accusing the claimants of violating no less than eleven Bolivian laws, ranging from tax, criminal, and commercial laws,⁶⁹ as well as engaging in fraud and misrepresentation.⁷⁰

The claimants pressed for a narrow interpretation of the legality requirement, arguing that it had a "limited scope" that "applies only to violations of the host State's fundamental principles or investment regime, and only at the time the investment is established."⁷¹ In response, Bolivia argued that "the legality requirement covers any breach of Bolivian law regardless of when the breach occurred, i.e. regardless of whether the breach is committed at the time of the establishment of the investment or thereafter."⁷² Bolivia emphasized that the "very use of the terms 'laws and regulations' shows that the legality requirement covers the entire Bolivian legal order, without regard to the significance of the rule breached."⁷³

The tribunal dismissed all eleven accusations of illegality and concluded that it had jurisdiction over the dispute.⁷⁴ In doing so, it explained that it "favours a balanced interpretation" of the legality requirement "that takes account of the need to protect foreign investments" and "of the State's other responsibilities."⁷⁵ Interpreting the text of the legality requirement, the tribunal observed that:

[T]he BIT's legality requirement has both subject-matter and temporal limitations. The subject-matter scope of the legality requirement is limited to (i) non-trivial violations of the host State's legal order, (ii) violations of the host State's foreign investment regime, and (iii) fraud – for instance, to secure the investment or profits. Additionally, under this BIT, the temporal scope of the legality requirement is limited to the establishment of the investment; it does not extend to the subsequent performance. Indeed, the Treaty refers to the legality requirement in the past tense by using the words investments "made" in accordance with the laws and regulations of the host State⁷⁶

The tribunal's analysis therefore showed that trivial violations of the host state's legal order do not amount to a breach of the legality requirement, implicitly rejecting Bolivia's argument that the legality requirement covers any breach of Bolivian law regardless of its seriousness.

Also noteworthy, in a manner similar to how the tribunal in *Metal-Tech* interpreted the word "implemented" and the tribunal in *Hamester* interpreted the word "made," the tribunal in *Quiborax v. Bolivia* also engaged in a linguistic

⁶⁹ *Id.* ¶ 242.

⁷⁰ *Id.* ¶¶ 172, 243.

⁷¹ *Id.* ¶ 246.

⁷² *Id.* ¶¶ 239-41.

⁷³ *Id.* ¶ 240.

⁷⁴ *Id.* ¶¶ 268-82.

⁷⁵ *Id.* ¶ 264.

⁷⁶ *Id.* ¶ 266 (internal citations omitted).

analysis, finding that the word “*made*” implied past tense, and therefore limited the temporal scope of the legality requirement to “the establishment of the investment” and did not apply to its “subsequent performance.”⁷⁷

In contrast, the tribunal in *Vannessa v. Venezuela* addressed a different question: whether the legality requirement extends to contractual obligations with the host state. It found that it does not. That case was brought by a Canadian mining company, originally known as Vannessa Ventures, based on the termination of its mining rights in Las Cristinas, considered one of the world’s greatest undeveloped sources of gold.⁷⁸

Vannessa alleged to have purchased a majority shareholding in the MINCA mining company from the Canadian mining company Placer Dome. MINCA was jointly owned by Placer Dome and CVG,⁷⁹ a Venezuelan state instrumentality. Venezuela alleged that the sale was a breach of Placer Dome’s contractual obligations with CVG.⁸⁰ The sale of Placer Dome’s interest in MINCA to Vannessa was therefore opposed by CVG,⁸¹ which moved to cancel the authorizations and concessions granted to MINCA and ultimately took possession of the Las Cristinas site.⁸² The claimant subsequently filed for ICSID arbitration, seeking more than U.S. \$1 billion in monetary damages.⁸³

Venezuela objected the tribunal’s jurisdiction, arguing that the sale of Placer Dome’s interest to Vannessa was contrary to its legal obligations and was therefore in breach of the BIT’s legality requirement.⁸⁴ Venezuela also accused the claimant of fraud, alleging that “the agreements were concluded behind CVG’s back, against its opposition and ignoring its interests,” and that such “bad-faith investments are not protected” by the BIT.⁸⁵ It argued that the claimant’s “bad-faith conduct” also included “acting in secrecy or without transparency; misrepresentation and false statements; disavowal of obligations and circumvention of agreements; and the abuse of legal process.”⁸⁶

Article I(f) of the applicable Canada-Venezuela BIT included an express legality requirement, which stated that:

“[I]nvestment” means any kind of asset *owned or controlled* by an investor of one Contracting Party either directly or indirectly . . . in the territory of the other Contracting Party in accordance with the latter’s laws.⁸⁷

⁷⁷ *Id.*

⁷⁸ Alyx Barker, *Finito! Venezuela Puts End to ICSID Claim*, GAR (Jan. 18, 2013).

⁷⁹ *Id.* ¶ 56.

⁸⁰ *Id.* ¶¶ 93, 140, 161.

⁸¹ *Id.* ¶¶ 93, 95-96.

⁸² *Id.* ¶¶ 98, 100-01.

⁸³ *Id.* ¶ 105.

⁸⁴ *Id.* ¶¶ 109, 129, 137-40, 161, 165.

⁸⁵ *Id.* ¶ 161.

⁸⁶ *Id.*

⁸⁷ *Id.* ¶ 109.

Based on that, Venezuela argued that the claimant's investment was "unlawful" under domestic law and was therefore not entitled to protection under the BIT.⁸⁸ Venezuela emphasized that the "legality requirement" demands conduct in "good faith," both under Venezuelan law and, "more broadly, as a paramount principle governing contractual relations."⁸⁹ It also argued that the legality requirement "is not restricted to the type of legal rules formally defined as law" but that it also extends to "contractual obligations."⁹⁰ For its part, the claimant attempted to rely on the MFN provision of the BIT to invoke the allegedly more favorable provisions of the Venezuela-UK BIT, which did not have a legality requirement.⁹¹

The tribunal was split on whether to accept Venezuela's "illegality of the investment" defense. The majority began its analysis by rejecting the claimant's attempt to rely on the MFN provision, stating that the MFN provision "can only be asserted in respect of investments that are within the scope" of the legality requirement and that it "cannot be used to expand the category of investments to which the BIT applies."⁹² The majority went on to reject Venezuela's argument that the legality requirement applies to all laws including contractual obligations, explaining that "the reference to a host State's 'laws'" in the BIT "is a reference to the laws and regulations made by, or under the authority of, the public authorities of the State, and does not extend to purely contractual obligations."⁹³ The majority highlighted that "obligations created by persons in the exercise of their powers under the general laws of contract are not 'laws', and should not be treated as creating 'requirements' which, if not satisfied" would deprive an "investment" of BIT protection.⁹⁴ The majority concluded therefore that even if the sale of Placer Dome's interest was a breach of contract with CVG, "such breaches would not constitute a violation of Venezuela's 'laws' for purposes of [the] BIT."⁹⁵

After dismissing the "illegality of the investment" defense, however, the majority concluded that there was no breach of the BIT by the host state since the termination of the underlying contract was found to be "justified and legitimate."⁹⁶ The dissenting arbitrator concluded that since the claimant had not made its investment in good faith, which was a principle of Venezuelan

⁸⁸ *Id.*, ¶ 128.

⁸⁹ *Id.*

⁹⁰ *Id.*, ¶ 129.

⁹¹ *Id.*, ¶ 131.

⁹² *Id.*, ¶ 133.

⁹³ *Id.*, ¶ 134.

⁹⁴ *Id.*, ¶ 154.

⁹⁵ *Id.*, ¶ 135.

⁹⁶ *Id.*, ¶¶ 190, 210, 214.

law, the investment was not made in accordance with the host state's laws, and jurisdiction should therefore have been declined.⁹⁷

In contrast, the majority rejected the respondent's argument that jurisdiction should be denied based on the claimant's bad-faith investment. On that issue, the majority adopted a strict and literal reading of the BIT, stating that:

[T]he claim should not be rejected on the ground that the . . . investment was not made in good faith, because good faith is not an independent element of the definition of a protected investment in the BIT.⁹⁸

It is interesting to contrast this statement with that of the *Hamester v. Ghana* tribunal, which found that an "investment will not be protected if it has been created in violation of national or international principles of good faith" because such "general principles" exist independently of the text of the BIT.⁹⁹ Whereas the *Hamester* tribunal implied that the principle of "good faith" is applicable whether or not stated in the BIT, the *Vannessa* tribunal suggested that the principle would not be applicable unless specified as "an independent element."¹⁰⁰ The *Vannessa* tribunal ultimately rejected the case on the merits, finding that the termination of the underlying contract was a "legitimate contractual response."¹⁰¹

The tribunal in *Arif v. Moldova* also rejected the host state's illegality defense and allowed the case to proceed to the merits. The claimant in that case, Franck Charles Arif, a French national, through his wholly-owned Moldovan company, Le Bridge Corp. Ltd., won a tender in 2008 to operate a series of duty free shops at the border crossing between Romania and Moldova.¹⁰² Le Bridge also entered into a lease with Moldovan airport officials, permitting it to operate a duty free shop at the Chisinau International Airport.¹⁰³

The claimant, however, later complained that the two ventures were delayed,¹⁰⁴ subjected to unnecessary inspections¹⁰⁵ and domestic judicial proceedings initiated by local competitors to prevent the opening of the duty free store.¹⁰⁶ These proceedings resulted in the cancellation of the tender that

⁹⁷ *Id.* ¶¶ 113, 169.

⁹⁸ *Id.*, ¶ 127.

⁹⁹ *Hamester v. Ghana*, *supra* note 3, ¶¶ 123-24.

¹⁰⁰ *Vannessa v. Venezuela*, *supra* note 7, ¶ 127.

¹⁰¹ *Id.* ¶¶ 190, 210, 214.

¹⁰² *Arif v. Moldova*, *supra* note 8, ¶¶ 41-44.

¹⁰³ *Id.* ¶ 87.

¹⁰⁴ *Id.* ¶ 1.

¹⁰⁵ *Id.* ¶¶ 125, 200.

¹⁰⁶ *Id.* ¶ 214.

was awarded to the claimant.¹⁰⁷ The claimant subsequently turned to ICSID arbitration.

The dispute in *Arif v. Moldova* was brought under the France-Moldova BIT, which included in its definition of “investment” in “Article 1(1) a condition that the investment be made in conformity with local law.”¹⁰⁸ The respondent argued that since the claimant had “not invested in accordance with Moldovan law,” its alleged “investment” was not entitled to any treaty protection.¹⁰⁹ In response, the claimant argued that its investment was legal and valid.¹¹⁰

The tribunal explained that “[w]here multiple contracts are entered into by an investor, then it is sufficient that the contracts and their good faith performance as a whole satisfy the definition of an investment.”¹¹¹ The tribunal added that the question of “whether a particular right granted by an agreement is valid or invalid may affect liability or the valuation of damages, but is not a question of jurisdiction.”¹¹² Accordingly, the tribunal held that the agreements entered into by the claimant with Moldova “constituted an investment within the meaning” of the BIT, which was sufficient to provide the tribunal with jurisdiction.¹¹³

Also significant was the tribunal’s treatment of Moldovan judicial decisions that found the agreements to be invalid. Moldova had argued that since the agreements were found to be invalid by local courts, they could not have been in compliance with local law.¹¹⁴ The tribunal rejected Moldova’s attempt “to rely on its own law and decisions of its own courts to deny juridical existence to agreements that existed in fact, and were relied upon by both [p]arties.”¹¹⁵ The tribunal explained that:

There are temporal limitations on a jurisdictional argument based on the illegality of an investment, where the legality of the investment has been accepted and acted upon in good faith by both parties over a period of time. This is not a case of a concealed illegality The investment was not made fraudulently or on the basis of corruption. In cases like the present one, the passage of time and the actions of the parties on the mutual assumption of legality cannot be ignored in the determination of jurisdiction¹¹⁶

¹⁰⁷ *Id.* ¶ 213.

¹⁰⁸ *Id.* ¶¶ 135, 326.

¹⁰⁹ *Id.* ¶ 135.

¹¹⁰ *Id.* ¶¶ 160–63.

¹¹¹ *Id.* ¶ 367.

¹¹² *Id.* ¶ 368.

¹¹³ *Id.* ¶ 370.

¹¹⁴ *Id.* ¶¶ 371–73.

¹¹⁵ *Id.* ¶¶ 374–75.

¹¹⁶ *Id.* ¶ 376.

The tribunal therefore appears to have given more weight to the conduct of the parties “over a period of time,” their “good faith” reliance on the agreements, and the “mutual assumption of legality” than to the decisions of the Moldovan judiciary, which had found the agreements to be invalid.

Finally, *Arif v. Moldova* is also significant in that, despite rejecting Moldova’s illegality of the investment defense, the tribunal still underscored that “[i]nvestors have a due diligence obligation” and that “they must be aware of and comply with local regulations.”¹¹⁷ In that regard, *Arif* affirms the same investor requirement of due diligence espoused in *Anderson v. Costa Rica*.

III. THE *SAUR V. ARGENTINA* CASE – WHERE THE TRIBUNAL FOUND THAT THE LEGALITY REQUIREMENT WAS INHERENT IN ALL BITS

Despite the tribunal’s finding that the legality requirement was inherent in all investment treaties, the host state’s illegality defense was again rejected in *SAUR v. Argentina*, where Argentina was instead held liable for expropriation and breach of the fair and equitable treatment provision of the Argentina-France BIT. Unlike the cases discussed above, the applicable BIT did not have a legality requirement.

The claimant, a French water company, brought its claim in 2004 after the provincial authorities failed to implement a service tariff increase under an agreement between the federal government and the claimant.¹¹⁸ The authorities ultimately terminated the contract and renationalized the water services.¹¹⁹

Argentina objected to the tribunal’s jurisdiction, alleging that the claimant “had acted illegally in making a series of secret payments totaling around 22 million pesos to certain parties.”¹²⁰ Argentina argued that the BIT “prevented jurisdiction over claims tainted by such illegal activity.”¹²¹ In response, the “investor denied any illegality” and indicated “that the payments merely constituted salaries.”¹²²

In its June 2012 Award, the tribunal in *SAUR v. Argentina* held that

[t]he legality requirement was inherent to all investment treaties, regardless of whether any formulation on legality was used. On the facts, though, it found no evidence that

¹¹⁷ *Id.* ¶ 243.

¹¹⁸ Clemmie Spalton, *Argentina Held Liable in Water Tariff Case*, GAR (June 13, 2012).

¹¹⁹ *Id.*

¹²⁰ Jarrod Hepburn, *Newly-Released SAUR v. Argentina Decision Touches on Illegality, Test for Expropriation, and Financial “Strangulation” of a Concessionaire*, IA REPORTER (June 14, 2012) [hereinafter Hepburn].

¹²¹ *Id.*

¹²² *Id.*

the investor had breached Argentine law. Relying on the findings of a domestic judicial process commenced against the investor in relation to the payments, the tribunal found that the money was indeed intended to pay salaries and not any other fraudulent purpose.¹²³

The tribunal also found that the principle of good faith precludes investors who engage in “*serious violation of the legal order*” of the host state from benefiting from treaty protection.¹²⁴ Echoing the tribunal’s statement in *Hamester v. Ghana*, regarding how an investment “will not be protected if it is made in violation of the host State’s law” regardless of the text of the BIT, and how such “general principles . . . exist independently of specific language to this effect in the Treaty,”¹²⁵ the tribunal in *SAUR v. Argentina* found that “the principle of legality and good faith exist regardless of whether the treaty expresses it in explicit terms.”¹²⁶ Together, these cases suggest that a legality requirement can be read into a BIT even in the absence of such an express legality provision.

IV. THE *FAKES V. TURKEY* CASE – WHERE THE TRIBUNAL DEFINED THE SCOPE OF THE LEGALITY REQUIREMENT

[I]t would run counter to the object and purpose of investment protection treaties to deny substantive protection to those investments that would violate domestic laws that are unrelated to the very nature of investment regulation.¹²⁷

The investor’s claims in *Fakes v. Turkey* were for US \$19 billion.¹²⁸ The tribunal ultimately found that it did not have to decide on the legality of the investment since it concluded that the claimant had no “investment” under the ICSID Convention or the BIT. Accordingly, the tribunal dismissed the claim in a fifty-page arbitral decision. But in doing so, the tribunal provided a useful analysis on the scope of the legality requirement.

The Dutch-Jordanian national, Saba Fakes, brought the claim in 2007 over an alleged investment in Turkey’s second largest mobile phone operator, Telsim. Fakes, who managed a battery storage business in Jordan, claimed to have acquired a 67% stake in Telsim in 2003 through a series of agreements under which he paid an advance of U.S. \$3,800.¹²⁹ But the tribunal determined that the “very low purchase price” that he claimed to have paid for the shares

¹²³ *Id.* at 2.

¹²⁴ UNCTAD, *Recent Developments in Investor-State Dispute Settlement*, UNCTAD, at 10 (May 2013), available at http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d3_en.pdf.

¹²⁵ *Hamester v. Ghana*, *supra* note 3, ¶¶ 123-24.

¹²⁶ Hepburn, *supra* note 120, at 2.

¹²⁷ *Fakes v. Turkey*, *supra* note 4, ¶ 119.

¹²⁸ *Id.* ¶ 2.

¹²⁹ *Id.* ¶¶ 38, 40.

“cannot be reconciled with” his “valuation of his alleged shareholding at US\$19 billion.”¹³⁰

The claimant’s dispute with Turkey related to the “receivership and subsequent sale by the Turkish authorities of assets held by Telsim.”¹³¹ Fakes argued that Telsim was “grossly mismanaged” by the government while in receivership and was “vastly undervalued” when sold at auction in 2005.¹³²

The case was brought under the Netherlands–Turkey BIT, which had an express compliance with the law requirement. Article 2(2) thereof stated that the BIT

[s]hall apply to investments owned or controlled by investors of one Contracting Party in the territory of the other Contracting Party which are established in accordance with the laws and regulations in force in the latter Contracting Party’s territory at the time the investment was made.¹³³

Turkey objected to the tribunal’s jurisdiction, arguing that the investment had been made in violation of the laws and regulations of Turkey and was therefore not protected under the BIT. Specifically, Turkey argued that the investment was made in breach of its foreign investment law, telecommunication regulations, and competition law.¹³⁴

Interpreting the text of the BIT’s legality requirement, the tribunal explained that the “provision plainly states that the BIT protection shall not apply to investments which have not been established in conformity with the [host state’s] laws and regulationsIf this condition is not satisfied, the BIT does not apply.”¹³⁵

Like the tribunal in *Quiborax v. Bolivia*, the tribunal in *Fakes* also rejected the host state’s argument that the legality requirement applies to all its laws and regulations. Instead, it found that the legality requirement was restricted to

compliance with the host State’s domestic laws governing the admission of investments in the host State. This is made clear by the plain language of the BIT, which applies to “investments . . . established in accordance with the laws and regulations” In the event that an investor breaches a requirement of domestic law, a host State can take appropriate action against such investor within the framework of its domestic legislation¹³⁶

Accordingly, the tribunal restricted the scope of the legality requirement to laws and regulations governing the admission of investments. The tribunal justified this conclusion by explaining that “it would run counter to the object

¹³⁰ *Id.* ¶ 139.

¹³¹ *Id.* ¶ 29.

¹³² *Id.* ¶ 31.

¹³³ *Id.* ¶ 115.

¹³⁴ *Id.* ¶ 120.

¹³⁵ *Id.* ¶ 115.

¹³⁶ *Id.* ¶ 119 (emphasis in original).

and purpose of investment protection treaties to deny substantive protection to those investments that would violate domestic laws that are unrelated to the very nature of investment regulation.”¹³⁷

The tribunal added that “unless specifically stated” in the BIT, “a host State should not be in a position to rely on its domestic legislation beyond the sphere of investment regime to escape its international undertakings vis-à-vis investments made in its territory.”¹³⁸ This statement from the *Fakes* tribunal appears to echo that of the tribunal in *Vannessa v. Venezuela*, which stated that the principle of “good faith” should not be applicable if it “is not an independent element of the definition” of an “investment” in the BIT.¹³⁹

Applying that strict textual reading, the tribunal found that the alleged “violation of the regulations in the telecommunication sector or competition law requirements” did “not trigger the application of the legality requirement” since these laws were not specifically covered by the text of the BIT, which applied only “to investments . . . established in accordance with the laws and regulations in force . . . at the time the investment was made.”¹⁴⁰

After providing a detailed analysis of the scope of the legality requirement, however, the tribunal avoided deciding on the legality issue and found instead that the claimant did “not hold legal title over the share certificates in Telsim and, thus, [did] not have an investment within the meaning” of the ICSID Convention and the BIT.¹⁴¹ The tribunal’s analysis regarding the legality requirement was therefore not essential to its holding. Nonetheless, the *Fakes* case shows that the temporal scope of the legality requirement may be limited to laws applicable to the initiation of the investment. It also shows that having an investment within the meaning of the ICSID Convention may be equally as important to complying with the BIT’s legality requirement.

V. THE *NIKO V. BANGLADESH* CASE – WHERE ILLEGALITY WAS OUTWEIGHED BY EXPRESS CONSENT TO ARBITRATE

The Tribunal is mindful of the importance of the ICSID dispute settlement mechanism and its integrity. In the Tribunal’s view, such integrity is promoted, and not violated, by the adjudication of disputes submitted to the Centre under a valid consent to arbitrate.¹⁴²

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ *Vannessa v. Venezuela*, *supra* note 7, ¶ 127.

¹⁴⁰ *Fakes v. Turkey*, *supra* note 4, ¶ 120 (emphasis in original).

¹⁴¹ *Id.* ¶ 135.

¹⁴² *Niko v. Bangladesh*, *supra* note 9, ¶ 474.

The *Niko v. Bangladesh* case had no applicable BIT. Unlike most of the cases discussed above, there was no express legality requirement mandating compliance with domestic laws. Instead, jurisdiction was based on two agreements that contained an ICSID arbitration clause.

The *Niko* case concerned a Canadian-owned gas producer's dispute against two Bangladeshi state owned entities—the oil and gas company, Petrobangla, and its exploration and production subsidiary, Bapex. The claimant entered into the contracts with the state owned enterprises for the exploitation and supply of gas. The relationship between the parties soured after two blowouts (explosions) occurred in Bangladesh in 2005. After that, Bangladesh and Petrobangla began local court proceedings against the claimant seeking compensation and damages.¹⁴³

Niko brought two ICSID claims against Bangladesh, Petrobangla, and Bapex, seeking a declaration that it was not responsible for the blowouts in one¹⁴⁴ and to recover more than U.S. thirty-five million in the other for gas supplied under the contract.¹⁴⁵

Bangladesh objected to the tribunal's jurisdiction based on *Niko*'s use of corrupt acts to secure favorable terms for the contract. In 2011, a Canadian court convicted *Niko* of corrupt practices over two attempts to bribe the Bangladeshi minister of energy and mineral resources.¹⁴⁶ The company gave him a U.S. \$188,000 Toyota Land Cruiser and treated him to a U.S. \$5,000 “non-business related” expense during a trip to Calgary in 2005.¹⁴⁷ The Bangladeshi media later exposed the gifts, and this led to the minister's resignation.¹⁴⁸

Bangladesh argued that the tribunal should reject jurisdiction based on *Niko*'s corrupt acts. It argued that *Niko*'s conduct offended the “clean hands” doctrine; that ICSID arbitration should only be used for investments made in good faith; and that accepting jurisdiction would jeopardize the ICSID mechanism.¹⁴⁹

The tribunal rejected these arguments and concluded that it had jurisdiction to hear the dispute based on the binding arbitration agreement. It determined that the “integrity” of the ICSID mechanism was “promoted, and not violated, by the adjudication of disputes submitted” under a “valid consent to arbitrate.”¹⁵⁰

¹⁴³ *Id.* ¶¶ 5, 102.

¹⁴⁴ *Id.* ¶ 138.

¹⁴⁵ *Id.* ¶ 4.

¹⁴⁶ *Id.*, ¶¶ 382-85, 389.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.* ¶ 387.

¹⁴⁹ *Id.* ¶¶ 431, 465-66.

¹⁵⁰ *Id.* ¶ 474.

The tribunal also downplayed the claimant's attempted bribery convictions, explaining that they had not affected the outcome of the contracts. In that regard, the *Niko* case shows that tribunals may search for a causal connection between the alleged illegality and the investment. In *Niko*, the tribunal did not find such a connection. Instead, it found that one of the contracts had been concluded prior to the conviction, while another was concluded between "Petrobangla and BAPEX, with the approval of the Bangladesh Government" after the conviction.¹⁵¹ The tribunal, therefore, stated that "[i]f and to the extent" the claimant "had unclean hands, the Respondents disregarded this situation,"¹⁵² and found that under these circumstances, it could not rely on the claimant's illegality to dismiss the claim.¹⁵³

Accordingly, Bangladesh's objections were dismissed. The tribunal, however, agreed that Bangladesh was not a proper party to the proceedings because, unlike Petrobangla and Bapex, it had not given its consent to arbitrate. The tribunal rejected the argument that the conduct or consent to arbitrate of the two state entities could be attributed to Bangladesh.¹⁵⁴

VI. CRITICISM OF THE CASES

[T]his effort by tribunals to narrow states' ability to disclaim jurisdiction under an investment treaty is therefore questionable . . .¹⁵⁵

Article "*In Accordance with Which Host State Laws?*"¹⁵⁶ provides an analysis and criticism of many of the cases discussed above. Specifically, it criticizes the reasoning of

certain tribunals [that] have attempted to limit the range of host state laws with which an investor must comply, posing an obstacle for states seeking to rely on investor illegality. The first proposed limitation is that investors must comply only with the "fundamental principles" of host state law, while the second proposed limitation is that investors must comply only with laws related to investment, and not other laws.¹⁵⁷

Indeed, these limitations were imposed without much textual support in *Hamester v. Ghana*, *Fakes v. Turkey*, *Quiborax v. Bolivia*, and *Metal-Tech v. Uzbekistan*, all of which limited the scope of the legality requirement to "non-trivial violations of the host State's legal order" or to "domestic laws governing the admission of investments," with *Hamester v. Ghana* and *Quiborax*

¹⁵¹ *Id.* ¶¶ 484-85.

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.* ¶ 248.

¹⁵⁵ Hepburn II, *supra* note 11, at 16.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 2.

v. Bolivia further holding that the legality requirement does not apply to a breach of laws during the subsequent performance of the investment.

Moreover, as the article explains, the tribunals in *Quiborax v. Bolivia* and *Metal-Tech v. Uzbekistan* were “chaired by the same arbitrator” and “the award[s] included an identical summary of the scope of the legality requirementIn addition, it is not clear why violation of a state’s foreign investment regime is different to violation of a state’s legal order; presumably the former is contained within the latter.”¹⁵⁸

The author notes that a “further problem” with the “subject-matter limitation” is that “the proposed limitation was not actually decisive” for the “tribunals’ reasoning on investor legality” in *Quiborax v. Bolivia*, *Fakes v. Turkey*, and *Metal-Tech v. Uzbekistan*, and that this “naturally lessens the potential relevance of the cases in forming a settled line of jurisprudence on the issue.”¹⁵⁹

The article therefore suggests that “investors must substantively comply with both host state law and with fundamental principles of law.”¹⁶⁰ The author notes that there is no textual support for limiting the legality requirement to only “fundamental principles,”¹⁶¹ and that as “a doctrinal matter, limiting the investor legality requirement only to investment-related laws looks doubtful.”¹⁶² Finally, the article concludes that “it cannot be said that a subject-matter limitation currently exists to condition the investor legality requirement, nor can it be said that such a limitation should exist[T]his effort by tribunals to narrow states’ ability to disclaim jurisdiction under an investment treaty is therefore questionable.”¹⁶³

CONCLUSION

Other tribunals have already grappled with the question of the scope of . . . legality requirements¹⁶⁴

The cases discussed above generally establish that compliance with the legality requirement is a prerequisite to the adjudication of investor-state disputes by an arbitral tribunal. Even cases that rejected the host state’s “illegality of the investment” defense still engaged in a detailed analysis of the legality requirement and whether it was breached. The investor’s obligation to comply

¹⁵⁸ *Id.* at 16.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 2.

¹⁶¹ *Id.*

¹⁶² *Id.* at 16.

¹⁶³ *Id.*

¹⁶⁴ *Quiborax v. Bolivia*, *supra* note 6, ¶ 265.

with the legality requirement was especially underscored in *Anderson v. Costa Rica* and *Metal-Tech v. Uzbekistan*, both of which highlighted the necessity of such compliance and affirmed that a tribunal cannot assist an investor who has engaged in a corrupt or illegal act in the making of its investment.

The tribunal in *Anderson* also acknowledged the important policy implications of the legality requirement, finding that every country has a fundamental interest in securing respect for its law, and that the requirement serves “crucial” objectives for “the public welfare and economic well-being of any country.”

Attempts by certain tribunals to narrow the scope of the legality requirement to certain “fundamental” and “non-trivial” laws of the host state may therefore give rise to a questionable and unintended jurisprudence that was not foreseen by states when they chose to include an express legality requirement in their BITs.

Interestingly, while some tribunals have limited the application of the legality requirement in this way, other tribunals, such as *Hamester v. Ghana* and *SAUR v. Argentina*, have found that the legality requirement can be read into a BIT even in its absence, with the latter case concluding that the requirement was inherent to all investment treaties.

Anderson v. Costa Rica and *Arif v. Moldova* also highlight that investors have a duty of due diligence to comply with domestic law and local regulations, and that ignorance of the law is no defense to a breach of law by the investor. *Vannessa v. Venezuela* and *Metal-Tech v. Uzbekistan* underscore that the MFN provision of a BIT cannot be used to circumvent its legality requirement, and that the requirement cannot be sidestepped by reference to third party BITs.

One question raised by the cases is whether the principle of good faith can be read into a BIT, as was suggested by *Hamester v. Ghana* and *SAUR v. Argentina*, or whether good faith must be “an independent element” of the BIT, as was suggested by *Vannessa v. Venezuela*.

The tribunals were, however, consistent in their search for a causal connection between the alleged breach and the investment. This search was consistent both in the cases that accepted and the cases that rejected the host state’s illegality of the investment defense. For example, whereas the tribunals in *Anderson v. Costa Rica* and *Metal-Tech v. Uzbekistan* found that the investments were tainted with illegality, the tribunal in *Niko v. Bangladesh* found that the respondents had entered into a contract with the claimant both before and after the claimant was convicted of attempted bribery. Accordingly, the *Niko* tribunal found that the illegality had not changed the outcome of the contracts, and there was therefore no connection between the investment and the illegality. Similarly, the tribunal in *Hamester v. Ghana* found no connection between the claimant’s overstatement of invoices and the investment, as it

concluded that the claimant's alleged scheme to inflate invoices was not determinative of the existence of the contract or the investment. Likewise, the tribunal in *Fakes v. Turkey* found that the alleged breach of regulations in the telecommunication sector or competition law was unrelated to the investment.

Together, the above-discussed cases show that the "illegality of the investment" defense is not always successful. They also illustrate that the boundaries of the legality requirement may be flexible and subject to interpretation, depending on the tribunal, the facts of the case, the alleged illegality and its timing, and the specific language of the legality requirement in the BIT.