The Role of the Domestic Law of the Host State in Determining the ratione materiae Jurisdiction of Investment Treaty Tribunals: The Partial Revival of the Localisation Theory

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Chapter 2: Application of Domestic Law to the Legality Requirement

1. As framed, in this Chapter, I will deal with two questions regarding the application of the host state law to the legality requirement. In Section One, I will examine the legal bases for referring to the laws of the host state in determining issues concerning the legality requirement. In Section Two, I will consider the actual application of domestic law to particular questions regarding the legality requirement.

Section One: The Legal Bases for Referring to the Laws of the Host State

2. When faced with an 'illegality' defence by the respondent state, the first question that should be answered by an arbitral tribunal seized of an investment treaty dispute is the basis and the legal footing for application of the laws of the host state in an international arbitration proceeding. Put differently, an international tribunal applying and interpreting an international investment treaty in an international dispute naturally expects to apply international law to the issues before it,[1] including to the matters regarding jurisdiction, unless there is a plausible reason, like a *renvoi*, which validates reference to and application of another body of law.[2]
3. To be sure, many investment treaties contain provisions expressly referring to the requirement that an investment should be made in accordance with the laws and regulations of the host state.[3] Other treaties do not have such express references, but nevertheless, contain provisions which implicitly require compliance with the laws of the host state at the time of establishing the investment.[4] However, there are treaties which do not contain even an implicit reference to

[1] Generally speaking, an investment treaty is a 'treaty' within the meaning of Article 2(1)(a) of the of the Vienna Convention on the Law of Treaties ("VCLT") (adopted and opened for signature on 23 May 1969, entered into force on 27 January 1980) and is, in principle, and as per the above-mentioned provision as well as Article 31(3)(c) of the VCLT, governed and interpreted by rules of international law.

[2] *Fraport v. Republic of Philippines*, ICSID Case No. ARB/03/25, Award, 16 August 2007 [335], [394]; *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction, 27 September 2012 [47]-[52]; *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award, 04 October 2013 [121]; *Churchill Mining PLC v. Republic of Indonesia*, ICSID Case No. ARB/12/14 & *Planet Mining Pty Ltd v. Republic of Indonesia*, ICSID Case No. ARB12/40, Decisions on Jurisdiction for both Cases, 24 February 2014, both at [86]; M Sasson, *Substantive Law in Investment Treaty Arbitration: The Unsettled Relationship between International Law and Municipal Law* (Kluwer Law International 2017) 1-3; C Schreuer, 'Jurisdiction and Applicable Law in Investment Treaty Arbitration' (2014) 1(1) McGill Journal of Dispute Resolution 2-3.

[3] E.g., Article 1(1) of the Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments, signed on 18 April 1997, entered into force on 01 February 2000. As indicated in the previous Chapter, a comprehensive survey that I did on 60 of the bilateral investment treaties signed by Iran shows that a great majority of these treaties (more than 90%) contain express legality requirements. Furthermore, the rest of the Iranian BITs under consideration entail implicit references to the legality requirement. As such, there is no BIT, amongst the 60 agreements I could access, that does not contain an express or at least an implied reference to the legality requirement. Furthermore, another research that I did shows that all the bilateral investment treaties concluded by Australia, without one single exception, have express and/or implied legality requirements.

[4] An example is the BIT between Armenia and the United Kingdom. This BIT does not contain an express 'legality requirement'. It nevertheless provides in Article 2(1):

> Each Contracting Party shall encourage and create favourable conditions for nationals or companies of the other Contracting Party to invest capital in its territory, and, subject to its right to exercise powers conferred by its laws, shall admit such capital.

the requirement of compliance with the laws of the host state at the time of making an investment.[5] It is submitted that even if no such explicit or implicit reference is made to laws of the host state in the provisions of the relevant investment treaty, it could still be said that, under general principles of law, in order for the investor's case to proceed to the merits, the investment should have been made lawfully, in the sense that it should have been observant of the laws of the host state at the time of its establishment. Therefore, there are two main footings for reference to the laws of the host state to ascertain the legality of an investment at the time of its establishment: (i) reference by the contracting parties to the treaty to the laws of the host state, either explicitly or implicitly; and (ii) general principles of law which require that only lawful investments are eligible for being protected by investment treaties.

4. Both express reference to the laws of the host state and reference to such laws by implication will be scrutinised under the ensuing subsection **(A)**. The discussion will then be followed by an analysis of treaties which contain no reference at all to the requirement that the investment should be observant of the laws of host state at the time of its establishment **(B)**. This subsection would seek to pinpoint the role general principles of law play in requiring an investor to establish its investment in accordance with the laws of the host state. A final subsection will consider the possible role of international law rules in the determination of matters concerning the legality requirement **(C)**.

A. Reference by the Contracting Parties in the Underlying Investment Treaty

5. As was alluded to above, most investment treaties provide that an investment should be made in accordance with the laws of the host state. This requirement clearly emanates from the concern of recipient states to safeguard the application of their laws and regulations while attracting foreign investment. Indeed, it has been argued that one of the disadvantages of foreign investment, particularly for developing countries, is the violation of the laws and fundamental legal principles of host states through corruptive or fraudulent practices of foreign investors, which in certain cases does more harm than the good of attracting foreign investment.[6] In fact, in cases where the investment has been made in violation of the laws of the host state, for instance, by forging or manipulating bidding documents, it is arguable that the public at large incurs a loss, and that loss is the difference between having a really competent investor with high qualifications and an investor with lower qualifications who has been ignorant of the laws of the state. In other words, in such a situation, the state, representing the public, is led to believe, through the bidding documents, that, for example, the investor has strategic partners assuring stable and high-quality supplies, that it owns or controls cutting-edge technology, and that it has ample financial resources. Had it been informed properly of the real and actual legal, financial, and technical qualifications of the investor, the state would, in a proper competitive bidding process, have awarded the bid to another bidder, which could

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The Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Armenia for the Promotion and Protection of Investments, signed on 27 May 1993, entered into force on 11 July 1996.

[5] The Energy Charter Treaty ("ECT") is an example in this respect. See the ECT, signed on 17 December 1994, entered into force on 16 April 1998.

[6] JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (OUP 2013) 19-21 (discussing the risks and costs of foreign investment for host states).

have had better actual capabilities and proficiency.[7] Put differently, the loss suffered by the public in this simple example is the benefits that they have been deprived of had they had a better service provider.[8]

6. Therefore, states keep including such requirements in their investment treaties to address their concern for the due observance of their laws by investors at the time of making their investments. In this respect, the tribunal in *Alasdair Ross Anderson v Republic of Costa Rica* specified that the incorporation of such a condition in the investment treaty between Canada and Costa Rica (the underlying treaty in that dispute which has a legality requirement in Article 1(g)) was a "clear indication of the importance that [the Contracting Parties] attached to the legality of investments made by investors of the other Party and their intention that their laws with respect to investments be strictly followed." It also added that "[t]he assurance of legality with respect to investment has important, indeed crucial, consequences for the public welfare and economic well-being of any country"[9] and that every country "has a fundamental interest in securing respect for its law."[10] Another obvious reason for the inclusion of the legality

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[7] The factual background of the *Inceysa* case is quite similar to the example given above. In that case, the tribunal found that in the bidding documents submitted by Inceysa, the investor did not disclose its real financial condition and that it provided false information regarding the identity and the experience of a strategic partner and its own experience. The tribunal considered these as 'fundamental elements' for adjudicating a bid, as to which the investor had presented untrue information and faulty documents. *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, 02 August 2006 [104], [111]-[118]. According to Carlevaris, "[t]he first arbitration in which an arbitral tribunal devoted a specific and in-depth analysis to the effects of an "in accordance with host State law clause" was *Inceysa*. This case is also the first one in which an ICSID tribunal decided that it lacked jurisdiction on the basis of such a clause." A Carlevaris, 'The Conformity of Investments with the Law of the Host State and the Jurisdiction of International Tribunals' (2008) 9(1) The Journal of World Investment & Trade 40. See also C Knahr, 'Investments "in accordance with the host state law"' (2007) 4(5) TDM 1.

[8] One eminent commentator on corruption in international investment arbitration has articulated the loss suffered by the public at large in a corruptive investment transaction very colourfully: "These hidden handshakes are all the more troubling when one considers that they usually occur within hotels quite literally walled away from the teeming poverty nearby, a visual contrast so evocative of what corruption yields throughout the developing world. For while those within the walls prosper, it is the poor that ultimately bear most of the corrosive effects of transnational corruption." He further brings up a delicate and rational point which is indicative of the loss effectively suffered by the public by stating that: "... payers of bribes will do one of two things to recoup this additional cost: either build the bribe into the price, or provide shortcuts to the quality of the project or product delivered. In either case, the immediate participants in corruption are enriched at the ultimate expense of the public." AP Llamzon, *Corruption in International Investment Arbitration* (OUP 2014) 2, 4. Referring to Rose-Ackerman's "Corruption and Governance", Llmazon further notes that: "… for the larger populace, investments and commercial transactions that are entered into with the aid of corruption are clearly inefficient once one looks at the distortive effect corruption has upon government's resources use prioritizations – whenever officials can influence the quantity and quality of services provided and the identity of beneficiaries, corruption will almost certainly lead to inefficiency." ibid 25-26. Rose-Ackerman, on whose two treatises Llamzon extensively relies in his book, states in this respect: "[t]he impact of high-level corruption goes beyond the mere scale of public investment and lost revenue for the public budget. Top officials select projects and make purchases with little or no economic rationale. For example, if kickbacks are easier to obtain on capital investments and input purchases than on labour, rulers will favour capital intensive projects irrespective of their economic justification [...] Corrupt rulers favour capital intensive projects over other types of public expenditures and will favour public investment over private investment. They will frequently support 'white elephant' projects with little value in promoting economic development." S Rose-Ackerman, 'The Challenge of Poor Governance and Corruption, in Global Crisis, Global Solutions' in B Lombord (ed), *Global Crises, Global Solutions: Costs and Benefits* (CUP 2004) 23.

[9] *Alasdair Ross Anderson et al. v. Republic of Costa Rica,* ICSID Case No. ARB (AF)/07/3, Award, 19 May 2010 [53].

[10] ibid [58].

requirement in investment treaties is recalling the power of the host state to control the entry of foreign investment to its country. In this connection, the tribunal in *Kardassopoulos v. Georgia* noted the obvious point that states retain the power to control investments made in their territory, which would allow them to exclude from protection activities not in accordance with their own legislation.[11]

7. Having queried the reasons for the inclusion of the legality requirement in investment treaties, in the following pages, I will examine the modality by which states have sought to include legality requirements in their investment treaties.

a. Express Reference

8. As stated above, many international investment agreements contain express references to the requirement that an investor should comply with the laws and regulations of the host state at the time of making the investment. For instance, Article 1(1) of the BIT between Iran and Japan provides that:

> The term "investment" refers to every kind of asset, invested directly or indirectly by an investor of a Contracting Party in the Territory of the other Contracting Party in accordance with the laws and regulations of the other Contracting Party …[12]

9. As was mentioned in Chapter 1, in such circumstances, the BIT contains a *renvoi* to host state domestic law. Consequently, it is this body of law that governs the legality requirement. Thus, in *Metal-Tech v. Uzbekistan*, the tribunal noted that its jurisdiction "[…] is governed by the ICSID Convention and by the BIT. Where these treaties are silent on an issue that is relevant to determine jurisdiction, e.g. the manner in which consent is given, such issue is subject to customary international law unless the treaties refer to municipal law. This is in particular so when an investment treaty requires that an investment be made in accordance with host State law."[13]

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[11] *Ioannis Kardassopoulos v. The Republic of Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction, 06 July 2007 [182] (referring to M Sornarajah, *The International Law on Foreign Investments* (2nd edn, CUP 2004) 106: "no State has taken its fervour for foreign investments to the extent of removing any controls on the flow of foreign investments into the host State.") In this respect, a work done by UNCTAD focuses on the issue from a competition point of view. It says that: "Conditioning the coverage of an asset on compliance with local laws has several purposes. It confirms that both foreign and domestic investors have to observe the laws of the land, thereby establishing a "level playing field"..." UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (United Nations 2007) 9. Another commentary by UNCTAD also focuses on this competition aspect of the legality requirement. It also adds that this provision seeks to ensure that the investment activities of the investor are in line with development policies of the host state: "[The legality requirement has the] effect of ensuring that both foreign and domestic investors are required to observe the laws of the land, thereby ensuring a "level playing field". Moreover, on the assumption that the host country's investment laws will be written and applied to further its development policy, this limitation also is intended to ensure that investment is covered only if it is consistent with the host country's development policy, and other policies, such as immigration or internal security, that impact on investment ..." See UNCTAD, *Scope and Definitions* (United Nations 2011) 38.

[12] Agreement between Japan and the Islamic Republic of Iran on Reciprocal Promotion and Protection of Investment, signed on 05 February 2016, entered into force on 26 April 2017.

[13] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [121]. This case was the first investment treaty case which was dismissed on grounds of corruption. It is to be noted that before *Metal-Tech*, the *World Duty Free* tribunal accepted the allegations of corruption put forward by Kenya and dismissed the claimant's case. That case, however, was brought pursuant to an arbitration clause in a contract, not an investment treaty. See CB Lamm, BK Greenwald & KM Young,

10. Having noted this, it should be added that there is no unified or harmonised practice regarding the location of this requirement in investment treaties nor is there any unique standard wording which formulates this condition. In other words, such requirement appears in various parts of different investment treaties with not necessarily identical language. The question then is how and where this requirement is expressed in different investment treaties, and how the location or the wording of the requirement would affect the interpretive assignment of the adjudicating forum if any? The following pages will address these questions.

i. Varying Formulations and Its Impact

11. There are several different forms in which a legality requirement appears in investment treaties. For example, Article 1(g) of the BIT between Canada and Costa Rica, the underlying BIT in *Alasdair Ross Anderson et al v. Republic of Costa Rica*,[14] provides in Article 1(g) 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.[15]

As was mentioned above, Article 1(1) of the BIT between Germany and Philippines, the underlying Agreement in Fraport v. Philippines,[16] also refers to the legality requirement, however, using a different formulation:

> the term "investment" shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State …[17]

12. It is submitted that as long as the concept and the message conveyed is the same, different wordings and formulations in the legality requirement usually do not matter in generally interpreting the clause. To be sure, this is not to argue that one should turn a blind eye on the ordinary meaning of the terms of the treaty, which is an express tool of treaty interpretation under Article 31 of the VCLT. Rather, what is being proposed here is to avoid engaging in a purely textual analysis which totally ignores the core intention of the contracting parties and the object and purpose of an investment treaty. In this regard, one commentator has noted that investment treaty arbitration tribunals have treated and interpreted legality clauses with different formulations in a similar fashion. Although he states in the first place, and quite correctly so, that "[t]he wording of clauses referring to host State law in the various treaties can [..] differ to a significant extent, and important interpretative consequences might flow

'From World Duty Free to Metal-Tech: A Review of International Investment Treaty Arbitration Cases Involving Allegations of Corruption' (2014) 29(2) ICSID Rev-FILJ 328, 329.

[14] See *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9).

[15] See Agreement between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments, signed on 18 March 1998, entered into force on 29 September 1999.

[16] *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2). According to Knahr, *Fraport* was the second case – after *Inceysa* – to deal with an 'in accordance with host state law' requirement in detail and to deny jurisdiction due to a violation of domestic law by the investor. See C Knahr (n 7) 11.

[17] See Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments (n 3).

from this difference …" he goes on to note that: "these clauses presently appear to be interpreted uniformly in the arbitral practice irrespective of their context and wording."[18]

13. To give an example of such 'arbitral practice' offering a similar interpretation of clauses bearing the legality requirement with different wordings, one can refer to the award in *Fraport v. Philippines*.[19] In this case, the tribunal was faced with several provisions of Germany-Philippines BIT that contained references to the law of the host state: Article 1(1) of that BIT providing that for the purpose of this Agreement "[t]he term 'investment' shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State [...]", Article 2(1) providing that: "Each Contracting State shall promote as far as possible investments in its territory by investors of the other Contracting State and admit such investments in accordance with its Constitution, laws and regulations as referred to Article 1, paragraph 1. [...]", and the Protocol to the Agreement, which was concluded on the same day as the BIT, stating at ad Article 2: "As provided for in the Constitution of the Republic of the Philippines, foreign investors are not allowed to own land in the territory of the Republic of the Philippines. However investors are allowed to own up to 40% of the equity of a company which can then acquire ownership of land." The tribunal recognised that there are some linguistic differences between these provisions, but went to consider that this linguistic difference did not appear to indicate an intentional nuance and hence to be legally significant.[20]

14. In short, unless the wording of a legality clause entails express limitations and/or qualifications, an investment treaty tribunal should adhere to the intention of the state contracting parties as reflected in a legality requirement and dismiss cases based on investments made in violation of the laws of the recipient state.

ii. Varying Locations and Its Impact

15. A simple and quick review of different investment treaties shows that the legality requirement appears in various provisions of different investment treaties. Most frequently, this requirement is noticed in 'definitions' clauses.[21] In addition to that, the legality requirement is also observed in the 'scope of application' clauses as well as certain provisions regarding the substantive protection of investment. Below, I will review some of the most recurring locations in which the legality requirement materialises in investment treaties.

1st. *In 'Definitions' Clauses*

16. A majority of investment treaties containing the legality requirement place this condition in the 'definitions' clause of the investment treaty. For example, paragraph (g) of the 'Definition' Article of the BIT between Canada and Costa Rica, which was the underlying BIT in *Alasdair Ross Anderson et al v. Republic of Costa Rica*,[22] reads:

> "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

[18] A Carlevaris (n 7) 37. See also ibid 48.

[19] *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2).

[20] ibid [334]-[342].

[21] See C Knahr (n 7) 1.

[22] *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9).

> investor of one Contracting Party in the territory of the other Contracting Party in accordance with the latter's laws …[23]

17. In addition to this crystal-clear reference to the legality qualification in a 'definition' article, some investment agreements also stipulate that any change in the form of an investment would be covered by the agreement, provided that it is made in accordance with the laws and regulations of the host state. For instance, Article 1(a) of the BIT between Ghana and Guinea reads in the relevant part as follows:

> A change in the form in which assets are invested does not affect their character as investments, provided such change is not contrary to the laws of the Contracting Party in whose territory the investment has been made.[24]

2nd. *In 'Scope of Application' Clauses*

18. There are a smaller number of treaties which contain a legality requirement in the treaty's 'scope of application' provision. Article 11 of the BIT between Austria and the Philippines on 'Application of the Agreement' epitomises treaties in which the legality requirement appears in 'scope of application' clauses:

> This Agreement shall apply to investments made in the territory of one of the Contracting Parties in accordance with its legislation by investors of the other Contracting Party prior to as well as after the entry into force of this Agreement.[25]

19. Another sample of this group is the famous BIT between Spain and El Salvador which was the basis for the case *Inceysa Vallisoletana, SL v Republic of El Salvador*.[26] The clause in the Spain–El Salvador BIT defining 'investments' did not limit eligible investments to those made 'in accordance with law', but two other clauses in the BIT referred to the need for investments to have been made in accordance with the law of the host state. One such clause was Article 2(2) of that treaty concerning the scope of application of the treaty according to which the Agreement:

> "[…] will also apply to investments made before its entry into force by the investors of a Contracting Party in accordance with the laws of the other Contracting Party in the territory of the latter [...]"[27]

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[23] Agreement between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments (n 15).

[24] Article 1 of the Agreement between the Government of the Republic of Ghana and The Government the Republic of Guinea for the Promotion and Protection of Investments, signed on 18 May 2001, not yet entered into force.

[25] Article 11 of the Agreement between the Republic of Austria and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments, signed on 11 April 2002, entered into force on 01 December 2003. See also Article 2 of the Agreement between the Government of the Kingdom of Thailand and The Government of the Republic of India for the Promotion and Protection of Investments, signed on 10 July 2000, entered into force on 13 July 2001.

[26] *Inceysa Vallisoletana, SL v Republic of El Salvador* (n 7).

[27] Agreement for the Reciprocal Promotion and Protection of Investments signed between the Republic of EI Salvador and the Kingdom of Spain, signed on 14 February 1995, entered into force on 20 February 1996. In this regard, see *Inceysa Vallisoletana, SL v Republic of El Salvador* (n 7) [196], [206].

3rd. *In Substantive Protection Clauses*

20. Some treaties refer to the legality requirement in substantive protection clauses of the investment treaty. For example, the BIT between Iran and the Bosnia and Herzegovina places the legality requirement in a provision which addresses protection of investments. Article 4(1) of that treaty says:

> Admitted Investments of investors of one Contracting Party effected within the territory of the other Contracting Party in accordance with the laws and regulations of the latter, shall receive in the other Contracting Party full legal protection and fair treatment not less favourable than that accorded to its own investors or to investors of any third state which are in a comparable situation.[28]

21. Another prominent sample, which was also mentioned above, is the BIT between Spain and El-Salvador, the underlying BIT in *Inceysa v. El Salvador*,[29] which contains another reference to the legality requirement in Article 3(1) concerning the protection of investments and abstention from adopting arbitrary and discriminatory measures. This Article provides in the relevant part: "Each Contracting Party shall protect in its territory the investments made, in accordance with its legislations ..."[30]

22. As was seen, the legality requirement emerges in several locations and various provisions of different investment treaties. Despite this fact, the analysis conducted by some of the above-mentioned adjudicatory bodies in the said investment treaty cases shows that the location of the requirement does not influence its interpretation, and this is so as long as the substance of the clause is largely the same. In this connection, the *Inceysa* tribunal correctly noted that:

> [T]he Claimant is not right to indicate that in order to determine whether its investment falls within the scope of the Agreement, it is necessary to examine only the definition of the term investment, contained in Article 1(2) of the Agreement, where there is no reference to the clause "in accordance with law," and that it is not possible to examine other clauses of the Agreement to determine the type of investments protected by it ... Indeed, if the Contracting States themselves agree that the limitation "in accordance with laws" could be included (as it actually was) in parts of the BIT other than the definition of investment, such as that referring to promotion and admission, it is obvious that the restrictive interpretation sustained by Inceysa is incorrect …[31]

23. This ruling simply means that whether the legality requirement materialises in the 'definitions' clause or elsewhere in the investment treaty, the legal consequences of the requirement remain the same.

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[28] Agreement on Reciprocal Promotion and Protection of Investments between the Government of the Islamic Republic of Iran and the Government of Bosnia and Herzegovina, signed on 27 July 1996, entered into force on 02 June 2009.

[29] *Inceysa Vallisoletana, SL v Republic of El Salvador* (n 7).

[30] Agreement for the Reciprocal Promotion and Protection of Investments signed between the Republic of EI Salvador and the Kingdom of Spain (n 27).

[31] *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (n 7) [197]-[198].

b. Implicit Reference

24. There are many investment treaties that do not expressly refer to the requirement of legality for an investment at the time of its establishment in the 'definitions' or 'scope of application' clauses. Instead, in the pertinent provision regarding 'admission, establishment, and promotion of investments', some treaties include a requirement that the state should admit and promote investments in accordance with its laws and regulations. An example is Article 2 of the BIT between the Netherlands and Cambodia which reads:

> Either Contracting Party shall, within the framework of its laws and regulations, promote economic cooperation through the protection in its territory of investments of nationals of the other Contracting Party. Subject to its right to exercise powers conferred by its laws or regulations, each Contracting Party shall admit such investments.[32]

25. Although provisions of this kind do not expressly circumscribe the scope of application of an investment treaty to investments made legally, however, by providing that promotion, protection, and admittance of investments must be made in accordance with the laws of the host state, by necessary implication, they mean that an investment must be made legally in order to be admitted and protected. In fact, it is inconceivable that the host state would admit, in accordance with its laws, an investment made in violation of the laws of the same state. It is axiomatic that the inclusion of the legality requirement in the admission clause does not limit the observance of legality merely to the admission of investments. It goes beyond that and spreads over the establishment. An admission that should be observant of host state laws presupposes a legally established investment.

26. The viewpoint expressed by Dolzer and Stevens with regard to admission clauses in bilateral investment treaties is that they "record the parties' undertaking to 'promote' investments under the treaty ... as long as they are made in accordance with the host country's legislation."[33] A similar understanding is shared by the tribunal in *Saluka v. Czech Republic*.[34] The underlying Netherlands-Czech Republic BIT contained in its Article 2 the requirement that "each Contracting Party…shall admit such investments in accordance with its provisions of law".[35] The tribunal took note of this provision and stated that:

> [I]t is necessarily implicit in Article 2 of the Treaty that an investment must have been made in accordance with the provisions of the host State's laws.[36]

Further, the tribunal concluded from this provision that:

> [T]he obligation upon the host State to admit an investment by a foreign investor (i.e. in the present context, to allow the purchase of shares in a

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[32] Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of Cambodia and the Kingdom of the Netherlands, signed on 23 June 2003, entered into force on 01 March 2006.

[33] R Dolzer & M Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff Publishers 1995) 51.

[34] *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL.

[35] Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, signed on 29 April 1991, entered into force on 01 October 1992.

[36] *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006 [204].

local company) only arises if the purchase is made in compliance with its laws.[37]

27. Therefore, in cases of implicit reference to the legality requirement too, an investment treaty tribunal should observe the agreement of the parties and dismiss cases based on investments made in violation of the laws and regulations of the host state.

B. The Nature of the Legal Issue

28. There are investment treaties in which no legality requirement appears neither explicitly nor even by implicit terms. It is arguable that the legality requirement also applies to such treaties. In fact, as a general principle, it is the presumed intention of the contracting parties to an investment treaty that only investments made legally and in accordance with the laws of the host state would be protected by the treaty, and that investments made in violation of the laws and regulations of the recipient state would be denied protection. This understanding has been largely endorsed by several arbitral tribunals deciding investment treaty cases.

29. Firstly, in *Plama v. Bulgaria*, the tribunal, deciding a case under the ECT which does not contain a legality requirement, noted that: "Unlike a number of Bilateral Investment Treaties, the ECT does not contain a provision requiring the conformity of the Investment with a particular law. This does not mean, however, that the protections provided for by the ECT cover all kinds of investments, including those contrary to domestic or international law […] The Arbitral Tribunal concludes that the substantive protections of the ECT cannot apply to investments that are made contrary to law."[38]

30. In the same vein, the *Phoenix* tribunal observed that: "[…] States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments made in violation of their laws… These are illegal investments according to the national law of the host State and cannot be protected through an ICSID arbitral process. And it is the Tribunal's view that this condition – the conformity of the establishment of the investment with the national laws – is implicit even when not expressly stated in the relevant BIT…"[39] The tribunal further added that: "The purpose of the international mechanism of protection of investment through ICSID arbitration cannot be to protect investments made in violation of the laws of the host State or investments not made in good faith, obtained for example through misrepresentations, concealments or corruption, or amounting to an abuse of the international ICSID arbitration system. In other words, the purpose of international protection is to protect legal and *bona fide* investments."[40] (Citations omitted)

31. The tribunal in *Hamester v. Ghana* subscribed to the observations of the *Phoenix* tribunal with regard to the requirement of legality: "An investment will not be protected if it has been created in violation of national or international principles of good faith; by way of corruption, fraud, or deceitful conduct; or if its creation itself constitutes a misuse of the system of international investment protection under the ICSID Convention. It will also not be protected if it is made

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[37] ibid.

[38] *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008 [138]-[139].

[39] *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award, 15 April 2009 [101].

[40] ibid [100].

in violation of the host State's law (as elaborated, eg by the tribunal in *Phoenix*)."[41] The tribunal further emphasised that "[t]hese are general principles that exist independently of specific language to this effect in the Treaty."[42]

32. By the same token, in *SAUR International SA v. Republic of Argentina*, the tribunal noted that the requirement of not having committed a violation of the legal regime of the recipient state is a tacit condition inherent in every BIT. The tribunal reasoned that it cannot be understood under any circumstances that a state is offering the benefit of protection through investment arbitration when the investor, to obtain that protection, has committed an unlawful action.[43]

33. In short, as the practice of investment treaty tribunals plainly shows, investments made in violations of the laws of the host state will not be protected, irrespective of whether the underlying treaty contains a legality requirement or not. To be sure, "[r]espect for the integrity of the law of the host state is […] a critical part of development and a concern of international investment law."[44] As observed by the *Hamester* tribunal, the fact that illegal investments should not be protected by international investment law is a "general principle […] that exist[s] independently of the specific language to this effect in the Treaty."[45]

34. Having said that, one should bear in mind that when the terms of the treaty lack any explicit or tacit reference to the legality requirement, although, if made illegally, the investment would not be granted protection, however, as will be discussed later in this Chapter, in such a scenario, the denial of protection should be cloaked under a different guise than it would be under the explicit and implicit legality requirement scenarios. In fact, depending on the specific wording of the treaty in question, lack of legality, as required by the treaty containing an express or implied legality requirement, nullifies consent of the state, and therefore, the jurisdiction of the

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[41] *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award, 18 June 2010 [123].

[42] ibid [124].

[43] *SAUR International SA v Republic of Argentina*, ICSID Case No ARB/04/4, Decision on Jurisdiction and Liability, 06 June 2012 [308] (further observing that the purpose of the investment arbitration system is to protect only lawful and *bona fide* investments and that the absence of an express legality requirement in a particular BIT is not a relevant factor). See also *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award, 30 March 2015 [494] (observing that "a State cannot be expected to have consented to an arbitral dispute settlement mechanism for investments made in violation of its legislation.") Cf *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award, 30 November 2017 [319]-[324] (noting, *inter alia*, that "the Tribunal may not import a requirement that limits its jurisdiction when such a limit is not specified by the parties.") However, it should be borne in mind that in this case, Article 816 of the Canada-Peru FTA was of particular relevance in the Tribunal's determination. This provision identifies the legality requirement as a 'special formality' that the host state is entitled to adopt if it so wishes. Thus, the tribunal concluded that: "Since nowhere in the FTA or otherwise in the record is there an express or implied provision of law to the effect that Peru made use of this option, it can only be concluded that there is no jurisdictional requirement that Claimant's investment was legally constituted under the laws of Peru." See ibid [319]. The tribunal also mentioned that: "The above conclusion does not exclude the possible relevance of illegality or lack of good faith with respect to the merits." See ibid [324].

[44] *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [402].

[45] *Gustav F W Hamester GmbH & Co KG v Republic of Ghana* (n 41) [124]. See also R Moloo, 'A Comment on the Clean Hands Doctrine in International Law' (2011) 8(1) TDM.

tribunal. On the other hand, illegality in the absence of a specific requirement of legality in the treaty at issue culminates in 'unclean hands', which is a requirement of admissibility.[46]

35. In conclusion, as will be further explained later in this Chapter, for dismissing jurisdiction or admissibility,[47] as the case may be, it is sufficient for a tribunal to find non-compliance with the laws of the host state. That is so irrespective of whether the condition of legality is expressly or impliedly referred to by the underlying investment treaty or there is no such requirement in the investment treaty at all.

36. With these observations in mind, there is still an additional separate point that should be covered at this juncture and that is the reliance of certain investment treaty arbitration tribunals on the principles of international law alone or in combination with the laws of the host state in analysing whether a given investment is legal or not. In fact, the question is whether it is necessary and/or useful to rely on the rules of international law to examine the legality of the investment. This topic is addressed below.

C. Relying on Principles of International Law for Dismissing Illegal Investments

37. It has been observed that in several investment treaty awards and decisions, arbitral tribunals reject the legality of the alleged investment in question by substantial recourse to some principles of international law, chief among them being the principles of good faith and international public policy. In fact, sometimes quite unnecessarily, and just for the sake of making the decision seem more cogent and in order to highlight their reasoning regarding the effect of illegality on the jurisdiction of the tribunal or the admissibility of the claim, some arbitral tribunals do not suffice themselves to an analysis of the laws of the host state, and go on to rely also on principles of international law to dismiss the case. For instance, having determined that Metal-Tech had made a series of corrupt payments to facilitate the establishment of its investment, the tribunal in *Metal-Tech v. Uzbekistan* found that those payments were made in violation of Uzbek law, whose "condemnation of corruption" was also "in conformity with international law and the laws of the vast majority of States".[48] Given what was said above about the requirement of legality of investments in accordance with the laws of the host state, even in treaties which do not include an express or implied legality requirement, the question here is: to what extent an extra reference to principles or doctrines

[46] In this regard, see R Moloo (n 45). In the context of state responsibility, the ILC Special Rapporteur, James Crawford, explained that: "The so-called 'clean hands' Doctrine has been invoked principally in the context of the admissibility of claims before international courts and tribunals, though rarely applied". J Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (CUP 2002) 162.

[47] On the distinction between jurisdiction and admissibility, see *Certain Questions of Mutual Assistance in Criminal Matters* (*Djibouti v. France*), Judgment, I.C.J. Rep. 2008 (04 June 2008) p 177, pp 200-201 [48] (indicating that "in determining the scope of the consent expressed by one of the parties, the Court pronounces on its jurisdiction, not on the admissibility of the application."); *Hochtief AG v. The Argentine Republic*, ICSID Case No. ARB/07/31, Decision on Jurisdiction, 24 October 2011 [90] (stating that: "Jurisdiction is an attribute of a tribunal and not of a claim, whereas admissibility is an attribute of a claim but not of a tribunal.") As eloquently put by one commentator, "while jurisdiction is about the scope of the State's consent to arbitrate, admissibility is about whether the claim, as presented, can or should be resolved by an international tribunal, which otherwise has found jurisdiction." See V Heiskanen, '*Menage a` trois*? Jurisdiction, Admissibility and Competence in Investment Treaty Arbitration' (2013) 29(1) ICSID Rev-FILJ 237.

[48] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [290].

of international law is necessary for investment treaty tribunals to deny jurisdiction for illegal investments or to declare claims based on such alleged investments inadmissible?

38. As a point of departure, it is appropriate to begin by considering briefly the relevant rules and principles of international law concerning investments made through abusive processes and bad faith and the rules and principles of international law against corruption. As was stated above, it happens that investments are obtained through fraudulent behaviour, misrepresentations, fabrication of documents, falsifying the facts, concealments, bribery or, more generally, through corruption, or are made in a way that amounts to an abuse of the international investment protection system. In this respect, the *obiter dictum* in *Phoenix v. Czech Republic* is instructive and reflects the position of international law in proscribing the protection of corrupt and abusive investments:

> 100. The purpose of the international mechanism of protection of investment through ICSID arbitration cannot be to protect investments made in violation of the laws of the host State or investments not made in good faith, obtained for example through misrepresentations, concealments or corruption, or amounting to an abuse of the international ICSID arbitration system. In other words, the purpose of international protection is to protect legal and *bona fide* investments.
>
> […]
>
> 106. In the Tribunal's view, States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments not made in good faith. The protection of international investment arbitration cannot be granted if such protection would run contrary to the general principles of international law, among which the principle of good faith is of utmost importance.[49]

39. In fact, there is substantial investment treaty jurisprudence suggesting that the protection of international investment arbitration cannot be granted if according such protection would run contrary to the principles of good faith and international public policy.[50] As has been put forward by Hersch Lauterpacht: "There is no right, however well established, which could not, in some circumstances, be refused recognition on the ground that it has been abused."[51] This understanding is reinforced when one refers to Article 31(1) of the VCLT which requires that treaties should be interpreted in good faith. Article 31(3)(c) of the same Convention also requires an adjudicating forum to take into account, together with the context, "any relevant rules of international law applicable in the relations between the parties." Good faith and international public policy could always be among such principles.

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[49] *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [100], [106].

[50] See, for instance, *Inceysa Vallisoletana, S.L. v. Republic of El Salvador* (n 7) [230]-[231]; *Plama Consortium Limited v. Bulgaria* (n 38) 2008 [143]-[144]; *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [106 *et seq*]; *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, ICSID Case No. ARB/07/14, Award (Excerpts), 22 June 2010 [194]. For a review of ICC Awards with respect to illegality, bribery, and corruption and the effects of such wrongdoing on jurisdiction, admissibility, and merits of contractual claims, see *World Duty Free Company v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award, 04 October 2006 [148]-[155].

[51] H Lauterpacht, *Development of International Law by the International Court* (Stevens & Sons Limited 1958) 164.

40. In this respect, one also has to note that apart from myriads of national legislations and awards rendered by domestic courts as well as international courts and tribunals, there are several international instruments forbidding and combatting transnational corruption and bribery. Among such instruments are the following: The Inter-American Convention against Corruption of 1996,[52] Declaration of the General Assembly of the United Nations adopted on 16 December 1996 against Corruption and Bribery in International Commercial Transactions,[53] the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of 21 November 1997,[54] two EU conventions on corruption—one relating to criminal law and one dealing with civil law— which were adopted by the Council of Europe on 27 January 1999[55] and 04 November 1999 respectively,[56] a Convention on Preventing and Combating Corruption approved by the Heads of States and Governments of the African Union on 11 July 2003,[57] and, lastly, and perhaps most importantly, the UN Convention on Corruption, approved by the General Assembly on 31 October 2003 (Resolution 58/4), which was opened for signature in Mérida, Yucatán, Mexico, from 9–11 December 2003 and thereafter at UN headquarters in New York City, and which was signed by 140 countries. As of August 2018, there are 186 parties to this Convention which include 181 UN member states, the Cook Islands, Niue, the Holy See, the State of Palestine, and the European Union. This latter Convention entered into force on 14 December 2005.[58] [59]

41. Having briefly reviewed the relevant international instruments, the position of investment treaty arbitration tribunals, and some commentators regarding the role and the rules of international law in combatting corrupt and abusive investments, I should now examine the

[52] Inter-American Convention against Corruption, signed on 29 March 1996, entered into force on 06 March 1997 (1996) 35 ILM 724.

[53] 'United Nations Declaration against Corruption and Bribery in International Commercial Transactions' GA Res 51/191, 16 December 1996.

[54] OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, signed on 21 November 1997, entered into force on 17 December 1997 (1998) 37 ILM 1.

[55] Criminal Law Convention on Corruption, signed on 27 January 1999, entered into force on 01 July 2002, 2216 UNTS 225.

[56] Civil Law Convention on Corruption, signed on 04 November 1999, entered into force on 01 November 2003, 2246 UNTS 3.

[57] African Union Convention on Preventing and Combating Corruption, signed on 11 July 2003, entered into force on 05 August 2006 (2004) 43 ILM 1.

[58] United Nations Convention against Corruption, signed on 31 October 2003, entered into force on 14 December 2005, 2349 UNTS 41.

[59] As an aside, one problem with these instruments, as eloquently put forward by Llmazon, is that "[w]hile a number of recent treaties express well-meaning and appropriate condemnation, the consensus and rhetorical vitality of these instruments mask a central problem: international conventions have mostly been confined to the level of general principles and proscriptions, arrogating unto individual State sole responsibility for enacting and enforcing anti-bribery legislation." AP Llamzon (n 8) 2-3. An example of this attitude of dumping the responsibility of fighting corruption on individual states can be tracked at Article 1(1) of the OECD Convention (n 54). According to this provision,

> Each Party shall take such measures as may be necessary to establish that it is a criminal offence under its law for any person intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.

relevance of such rules in the context of deciding upon legality requirement defences in investment treaty arbitration proceedings. In cases where the treaty explicitly provides for compliance with the laws of the host state at the time of making the investment, the focal point and the starting point for an investment treaty tribunal should, in principle, be the municipal laws of the host state. In this regard, Knahr says: "If a violation of national law is at issue, it should primarily be the national law itself to provide an answer to the question of legality or illegality of the action."[60] As a result, good faith, international public policy, and other relevant principles of international law could also be relied upon, not because there is a real requirement or duty to refer to international law, but just to make the decision seem more persuasive. In this respect, a comparison between the approach adopted in *Fraport* and *Inceysa* awards is noteworthy. There is an important difference between the two awards in the approach the two tribunals took in applying domestic law as a ground to evaluate the legality of the investment. Whereas in *Fraport*, the tribunal, in finding illegality on the part of the investor and rejecting its jurisdiction, quite correctly relied extensively on the laws of Philippines, the *Inceysa* tribunal found that the investment was illegal since it violated 'general principles of law'. Although the latter tribunal had generally attached significant importance to the host state law, it nevertheless discussed 'general principles of law' like good faith, *nemo auditur propriam turpitudinem allegans*, public policy, and the prohibition of unlawful enrichment in a comprehensive manner, based on their presumed congruency with the domestic law of El Salvador.[61]

42. Furthermore, it is the present author's opinion that in cases where reference to the legality requirement is implicit in the underlying treaty, applying good faith, international public policy, or other principles of international law for the purpose of dismissing jurisdiction in the case of illegal investments seems more justified as long as these principles are incorporated in the laws of the host state. Such reference could still be warranted if these principles do not form part of the law of the host state but the tribunal refers to them as additional reasons to justify the tribunal's decision.

43. Finally, in cases where the relevant treaty lacks any reference to assessing legality in accordance with domestic law, investment treaty tribunals have correctly dismissed investment claims grounded on corruption, fraud or other kinds of illegality based not only on the domestic laws of the host state but also on principles of international law, including good faith and public policy. In *Plama v. Bulgaria*, for example, the claimant had filed its claims pursuant to the ECT, which, as mentioned above, does not contain a provision requiring investments to be made in conformity with a particular law.[62] The ICSID tribunal observed that "[t]his does not mean, however, that the protections provided for by the ECT cover all kinds of investments, including those contrary to domestic or international law."[63] Finding that Plama's conduct in making its investment violated not only Bulgarian law, but also applicable rules and principles of international law, including the principle of good faith, the tribunal concluded that granting the claimant's investment the protections provided by the ECT would be contrary to the principle of *nemo auditur propriam turpitudinem allegans* and "contrary to the basic notion of

[60] C Knahr (n 7) 17, 28.

[61] *Inceysa Vallisoletana, S.L. v. Republic of El Salvador* (n 7) [243]. In this respect, see C Knahr (n 7) 8, 17, 28 (characterising the *Inceysa* tribunal's approach in this regard to be 'somewhat questionable').

[62] *Plama Consortium Limited v. Bulgaria* (n 38) [138].

[63] ibid [138].

international public policy—that a contract obtained by wrongful means (fraudulent misrepresentation) should not be enforced by a tribunal".[64] This understanding was also specifically confirmed in *World Duty Free*, where the tribunal, deciding an investment contract dispute, which usually does not contain a legality requirement or a similar clause, recognised that:

> In light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus, claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal.[65]

44. Indeed, in such a situation, i.e. lack of any reference to the laws of the host state in the investment treaty or contract for assessing legality, there is a plausible justification for reliance on the principles of good faith, public policy, and *nemo auditur propriam turpitudinem allegans* in deciding the issue of legality in an investment arbitration case. As has been indicated by the WTO Appellate Body, although states are free to conclude treaties and exclude certain rules of international law in their relations, they cannot, however, contract out of the system of international law. In other words, they cannot be deemed to have ignored *jus cogens*.[66] Therefore, an investment treaty tribunal cannot ascribe an intention to the state parties that they could not have had, i.e. the contracting parties to an investment agreement, who have not included a legality requirement in their treaty, could not have agreed to protect investments which were made in violation of good faith and international public policy. Consequently, when an investment treaty lacks any provision regarding the legality requirement, in addition to checking the host state law, a tribunal is well-advised to verify whether the investment violates fundamental principles of international law, like good faith and public policy. To borrow some 'extreme examples' from the *Phoenix v. Czech* tribunal, "nobody would suggest that [international investment] protection [regime] should be granted to investments made in violation of the most fundamental rules of protection of human rights, like investments made in pursuance of torture or genocide or in support of slavery or trafficking of human organs."[67] In a nutshell, if an investment has been obtained violating international public policy or other fundamental principles of international law, it cannot benefit from the investment treaty system, even if the treaty lacks any reference to the legality requirement.

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[64] ibid [138]-[140], [143]-[145].

[65] *World Duty Free Company v Republic of Kenya* (n 50) [157]. In this respect, the tribunal had already quoted Judge Lagergren's observations in ICC Case No. 1110 of 1963 that "corruption is an international evil", which "is contrary to good morals and to an international public policy common to the community of nations". See ibid [148].

[66] *United States - Standards for Reformulated and Conventional Gasoline, Brazil and Venezuela v United States*, Report of the Appellate Body, WT/DS2/AB/R, WT/DS4/AB/R, Report No AB-1996-1, Doc No 96-1597, ITL 013 (WTO 1996), DSR 1996:I, 3, 29th April 1996, World Trade Organization [WTO], p 18. See also, J Pauwelyn, 'The Role of Public International Law in the WTO: How Far Can We Go?' (2001) 95(3) AJIL 539 (saying that: "States in their treaty relations, can contract out of one, more or in theory, all rules of general international law (other than those of *jus cogens*), but they cannot contract out of the system of international law. As soon as States contract with one another, they do so automatically and necessarily within the system of international law.")

[67] *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [78].

45. To sum up, in cases where the investment treaty stipulates the legality requirement, reference to good faith, public policy, and the principle of *nemo auditur propriam turpitudinem allegans* can make a decision seem more reasoned, but such reference is not necessary. When the treaty refers to the legality requirement in implied terms, the reference to such principles seems more justified but again not necessary. Finally, in case the treaty contains no express or implied term concerning the legality requirement, in addition to checking the relevant host state law, the tribunal can safely rely on the relevant general principles of international law as an independent basis to admit the case or to declare it inadmissible.[68]

Section Two: The Actual Application of Domestic Law to Particular Questions Regarding the Legality Requirement

46. With the discussion of the legal basis for the application of domestic law to the legality requirement out of the way, I now turn to the application of domestic law to particular practical questions regarding the operation of the legality requirement. Generally speaking, there are two main questions concerning the legality requirement which should be addressed by reference to the laws of the host state: first, the scope of the legality requirement, and second, the consequence of violation of the laws of the host state and the impact of such violation on the operation of the legality requirement. These two questions will be addressed below in-depth.

A. The Scope of the Legality Requirement

47. So far, I have delineated the meaning of the legality requirement in investment treaties and have discussed the legal basis for the application of host state law to this requirement. A significant question that still comes to mind in the context of the dimension of this requirement is the formal, substantive, and the temporal sphere of application of this so-called ‘in accordance with host state law” condition.

48. An arbitral tribunal seized of the application of a legality requirement in an investment treaty has to determine the range of laws and regulations of the host state, in terms of the character of the lawmaker entity, that are relevant for its legality analysis. In so doing, the tribunal should answer whether only enactments of the Parliament of the host state are pertinent, or whether, in addition, regulations enacted by the cabinet of ministers, a commission of the ministers, or even resolutions of a single ministry or a state entity should also be taken into account. Furthermore, and more importantly, such a tribunal has to specify the kind of laws, in terms of the subject-matter of the law in question, the nature of the law, and the significance of the law, that are relevant for the legality analysis. To embark upon this task, the tribunal should find whether all the laws and regulations of the host state, irrespective of their subject-matter, hierarchy, significance or nature are relevant, or whether the survey should only be limited to the imperative laws of the recipient state or a specific group of such laws with a specified subject-matter.

[68] One question that still arises in the last scenario, i.e., no reference to the legality requirement in the investment treaty, is when international law deems the investment illegal but host state law does not and *vice versa*. The task of the arbitral tribunal seems to be more complex in such episodes. In the author’s opinion, in situations where international law does not extend its protection to an investment due to its illicitness despite host state laws’ position to the contrary, the tribunal should give primacy to the international law. If, however, the investment is deemed illegal in host state law but legal under international law, the tribunal should respect host state laws’ position and refrain from declaring the claim admissible.

49. To contextualise the discussion, in *Saba Fakes v. Turkey*,[69] the underlying BIT provided in its Article 2(2), embodying a legality requirement, that:

> The present Agreement shall 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.[70]

The respondent in that case alleged that the claimant's investment transaction was made in breach of the Republic of Turkey's legislation relating to the promotion of foreign investment, a regulation of the telecommunication sector, as well as Turkish competition law.[71] Therefore, in that case, the tribunal was faced with two questions: (i) whether only legislations are relevant, in which case it only had to consider the violation of the law on encouragement of foreign investment and the competition law of Turkey, or whether other types of laws and regulations not enacted by the Turkish Parliament and laid down by other official governmental entities were also pertinent, in which case it should have also taken into account the regulation of the telecommunication sector. More importantly, the tribunal had to determine what legal subject-matters were relevant for its legality analysis: was it only the law on foreign investment that had to be analysed, or whether laws relating to telecommunication and competition should also have gone under scrutiny. Similarly, and on a related note, the tribunal should have also analysed the laws invoked in terms of their significance and hierarchy and indicated whether all the laws were applicable regardless of their fundamentality, or whether only the most imperative laws of the Republic of Turkey were germane.[72]

50. Despite the rendition of many investment treaty awards and decisions, and myriads of scholarly writings on the issue of the legality requirement in investment treaty arbitration, the precise 'formal' and 'substantive' scope of this requirement remains largely unknown.[73] With one notable exception,[74] most of the tribunals have formulated tests without much analysis and

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[69] *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award, 14 July 2010.

[70] See Article 2(2) of the Agreement on Reciprocal Encouragement and Protection of Investments between the Kingdom of the Netherlands and the Republic of Turkey, signed on 27 March 1986, entered into force on 01 November 1989.

[71] *Saba Fakes v. Republic of Turkey* (n 69) [120].

[72] It is worth observing that this tribunal only briefly dealt with the second question, i.e. the relevance of the laws of the host state by their subject-matter. See ibid.

[73] See J Hepburn, 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (2014) 5(3) Journal of International Dispute Settlement 532-533. See also A Carlevaris (n 7) 46-47 (observing that the interpretation of 'in accordance with host state law clauses' is not relatively clear and consistent with respect to the nature and the magnitude of the breach justifying the dismissal of jurisdiction).

[74] Recently, a decision on jurisdiction was issued in the dispute between 12 Kazakh nationals and the Government of Uzbekistan which deals with the 'formal' and 'substantive' scope of the legality requirement with an admirable thoroughness. See *Vladislav Kim and others v. Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction, 08 March 2017. I should note here, however, that despite the comprehensive manner through which this tribunal handled these questions, I believe that the tribunal has gone too far in drawing up the benchmark for the 'substantive' scope of the requirement. Moreover, when applying the test it had constructed, the majority of the tribunal seems to have gone even further, in that it effectively excluded significant violations of the host state law from triggering the legality requirement on grounds which do not seem justified. It is my considered opinion that the

discussion,[75] and commentators have either favoured expansive or restrictive criteria for outlining the scope of this requirement unaccompanied by needed scrutiny.[76] This lack of transparency in the scope of the legality requirement and the absence of concrete yardsticks for outlining the frontiers of the relevant laws of the host state in undertaking a legality requirement analysis has given rise to a state of 'uncertainty', harming both the investors and host states.[77]

51. In this Section, I will try to reflect all the voices I have heard regarding the 'formal' and 'substantive' scope of the legality requirement and then put together what I believe is the most appropriate benchmark for setting out the 'formal' and 'substantive' boundaries of this requirement. To embark upon this task, I will begin with the less controversial 'formal' scope of the requirement and will try to frame an appropriate gauge for identifying the 'formal' contours of this requirement (**a**). Next, I will deal with the more challenging subject of the 'substantive scope' of the requirement. I will begin with reviewing the standpoints taken in the decisions of investment treaty arbitral tribunals and setting forth the various viewpoints of commentators. Where necessary, I will closely examine those views and decisions (**b**)(**i**). I will follow the discussion by setting out my own opinion about the 'substantive scope' of the legality requirement (**b**)(**ii**). In so doing, I will try to be observant and loyal to the 'rule of interpretation' as enshrined in Article 31 of the VCLT. Additionally, it is necessary to enquire into the 'temporal' aspect of the legality requirement and survey the various effects illegality might have depending on the timing of the occurrence of illegality, including illegality at the time of making the investment and illegality after the establishment of the investment. Relevant in this respect is considering the effect of the completion of the corrupt action, like payment of a bribe to the relevant public official, after the establishment of the investment and the jurisdictional and/or admissibility consequences of this act **(c)**.

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test devised by the tribunal in this case, as well as the consequent result achieved by the majority in applying the test are not based on a sound interpretive look to the legality requirement. This issue will be further dealt with below.

[75] See, for instance, *L.E.S.I. S.p.A. and ASTALDI S.p.A. v. République Algérienne Démocratique et Populaire*, ICSID Case No. ARB/05/3, Decision, 12 July 2006 [83] (stating that: "the mention in the text of conformity to laws and regulations in vigour does not constitute a formal acknowledgement of the notion of investment as understood in Algerian law in a restrictive fashion, but rather, adopting a classic and wholly justified formulation, the loss of protection suffered by any investments made in violation of fundamental governing principles.") (Translated from French); *Desert Line Projects LLC v. The Republic of Yemen*, ICSID Case No. ARB/05/17, Award, 06 February 2008 [104] (stating that the legality requirement in investment treaties is "intended to ensure the legality of the investment by excluding investments made in breach of fundamental principles of the host State's law, e.g. by fraudulent misrepresentations or the dissimulation of true ownership…"); *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award, 29 July 2008 [319] (saying that: "as was determined by the arbitral tribunal in the *Lesi* case, investments in the host State will only be excluded from the protection of the treaty if they have been made in breach of fundamental legal principles of the host country.")

[76] As far as I am aware, a notable exception is the recent article by Jarrod Hepburn who specifically deals with this issue in-depth. See J Hepburn, 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (n 73). The contents of the article are mirrored in his recent book. See J Hepburn, *Domestic Law in International Investment Arbitration* (OUP 2017) 139-155. See also U Kriebaum, 'Illegal Investments' in C Klausegger *et al* (eds), *Austrian Arbitration Yearbook 2010* (Beck, Sta¨mpfli & Manz 2010) 318-329.

[77] Indeed, achieving 'certainty' is one principal reason why certain tribunals have felt compelled to "contribute to the harmonious development of international investment law with a view to meeting the legitimate expectations of the community of States and investors". To cite just one example amongst many, see *Churchill Mining PLC* and *Planet Mining Pty Ltd v. Republic of Indonesia*, ICSID Case No. ARB/12/14 and 12/40, Award, 06 December 2016 [253].

a. The Formal Scope of the Legality Requirement

52. When faced with an illegality objection by the host state, one of the questions for an investment treaty tribunal is the 'formal scope' of the legality requirement. In practice, this question mainly arises in cases where the law allegedly violated does not have the form of legislation enacted by the Legislative body of the recipient state,[78] but is a resolution or a regulation passed or laid down by the Executive or even the Judiciary of that state.[79]

53. Suppose that in a given case, the respondent objects that the investor violated the laws of the host state in making its investment since it covertly, and in breach of the foreign investment cap of the Constitution and foreign investment law of the host state, concluded agreements with its local partners of the bidding consortium, thereby controlling their shareholdings and votes.[80] In addition, assume that in the same case, the host state also contends that in the course of making its investment, the investor also failed to carry out an 'environmental impact assessment' ("EIA") in violation of the resolutions of the environmental organisation of the host state, an entity of the Executive branch of the government. Whereas the first two laws (i.e., the Constitution and the foreign investment law) are most probably captured by a typical legality requirement, it is not clear whether the environmental resolution is also caught by the 'formal scope' of the requirement.

54. In order to find the answer to such questions, the text of the legality requirement is the proper point of departure. Most investment treaties containing a legality requirement, stipulate that investments should be made in accordance with the 'laws' of the host state. Therefore, in order to understand the 'formal scope' of the legality requirement in such treaties, the meaning of the term 'law' as intended and understood by the contracting parties of the investment treaty in question is of critical importance. Certain investment treaties do define the term 'law' for the purposes of, *inter alia*, the legality requirement. For example, Article 1.7 of the BIT between India and Belarus reads:

> "law" includes:
>
> In respect of Belarus: normative legal acts of the Republic of Belarus.
>
> In respect of India:

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[78] The legislative power of a state may have different titles and/or structures in various jurisdictions. In the United Kingdom, the Parliament consists of the 'House of Commons' and the 'House of Lords'. In France, the Parliament consists of the '*Assemblée nationale*' and '*Sénat*'. In Germany, the two Houses of Parliament are the '*Bundestag*' and the '*Bundesrat*'. See R Youngs, *English, French & German Comparative Law* (Routledge 2014) 32-35. In Iran, the 'Islamic Consultative Assembly' and the 'Guardian Council' compose the Legislature. See Principles 62 to 99 of the Islamic Republic of Iran Constitution (1979, as amended in 1989).

[79] The author is aware of only one case in which the issue of the 'formal scope' of the legality requirement was considered separately by an investment treaty tribunal. See *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [378]-[380].

[80] The factual background in *Fraport v. Philippines* was similar to the hypothetical given above. In that case, through 'secret shareholder agreements', Fraport sought to exercise managerial control over Philippine International Air Terminals Co. ("PIATCO"), who on 12 July 1997 had concluded the concession contract for the construction and operation of an international passenger terminal at Ninoy Aquino International Airport in Manila ("Terminal 3") with the Philippine Department of Transportation and Communication ("DOTC"), and, thereby, knowingly orchestrated its investment in flagrant violation of the laws of Philippines, in particular, foreign ownership and control legislation known as the Anti-Dummy Law ("ADL").

(i) the Constitution, legislation, subordinate/delegated legislation, laws & bylaws, rules & regulations, ordinance, notifications, policies, guidelines, procedures, administrative measures/executive actions at all levels of government, as amended, interpreted or modified from time to time;

(ii) decisions, judgments, orders and decrees by Courts, regulatory authorities, judicial and administrative institutions having the force of law within the territory of a Party.[81]

55. As the above definition makes clear, when investing in India, an investor from Belarus has to comply with a broad array of laws extending to regulations laid down by the executive. However, the majority of investment treaties do not contain such definitions. In such circumstances, the wording of the legality requirement itself should guide the tribunal in ascertaining the 'formal scope' of the condition. Thus, if the above-mentioned dispute occurs between an Iranian investor and the Government of the Republic of Korea, the environmental resolution in question, would more likely than not, be captured by the legality requirement of the BIT between the two countries, which provides in the pertinent provision that "[t]he term "investment" refers to every kind of property or asset […] invested by the investors of one Contracting Party in the territory of the other Contracting Party in accordance with the *laws and regulations* of the other Contracting Party …"[82] [emphasis added] Generally speaking, the term 'law' mentioned in this provision is a comprehensive term which can potentially encompass an enforceable resolution by a single state department or a ministry.[83] Furthermore,

[81] Treaty between The Republic of Belarus and The Republic of India on Investments, signed on 24 September 2018, not yet entered into force. Article 1.4 of this Treaty contains a legality requirement: ""investment" means an enterprise constituted, organised and operated in good faith by an investor in accordance with the law of the Party in whose territory the investment is made ..."

[82] Article 1(1) of the Agreement between the Government of the Republic of Korea and the Government of the Islamic Republic of Iran for the Promotion and Protection of Investments, signed on 31 October 1998, entered into force on 31 March 2006.

[83] 'Law' is a generic term which can appear in various different guises. Constitution, organic laws (as will be seen more fully below (see b.ii.2nd *infra*), the phenomenon of 'organic laws' exists in the constitutional law of certain legal regimes: "Organic laws fall between ordinary legislation and constitutional provisions on a scale of difficulty of adoption, amendment and repeal. In addition to their utility in dealing with important subjects whose implementation is rife with technical detail, creating the category can be a useful mechanism for getting over some obstacles in the constitution-writing process …" See M Tushnet, *Advanced Introduction to Comparative Constitutional Law* (Edward Edgar Publishing Limited 2014) 22), statutes, decrees, regulations, and orders issued and adopted by president, cabinet of ministers, a committee of ministers, individual ministries or state departments, as well as certain judicial decisions (depending, of course, on the jurisdiction in question) can all form 'laws'. In this regard, Black's Law Dictionary defines the term 'law' to correspond, *inter alia*, to the following various meanings: "That which is laid down, ordained, or established. A rule or method according to which phenomena or actions co-exist or follow each other. That which must be obeyed and followed by citizens, subject to sanctions or legal consequences, is a "law"… Act of the Legislature deposited in office of Secretary of State, properly authenticated by presiding officers of the two houses, and approved by Governor … body of principles, standards and rules promulgated by government … command which obliges a person or persons and obliges generally to acts or forbearances of a class … constitution or constitutional provision … governmental direction … judicial decisions, judgments or decrees … local rules of decision … municipal ordinance … proclamation of Governor … regulations … resolution passed by Legislature and approved by Governor … revised statutes … rule of civil conduct prescribed by the supreme power in a state … rule of conduct prescribed by lawmaking power of state … rules promulgated by government … statute or enactment of legislative body …" HC Black, *Black's Law Dictionary: Definitions of the Terms and Phrases of American and English Jurisprudence, Ancient and Modern* (West Publishing Co 1968) 1028.

the term ‘regulation’ appearing in the above-cited provision is usually used, in its ‘specific’ sense, to represent rules laid down by the Executive in implementing acts, statutes, and legislation passed by the Legislature.[84] In this sense, a resolution by the environmental organisation in question would also be captured by the term ‘regulation’. The same finding could not have been readily made had the same dispute occurred under the BIT between Kazakhstan and Austria, in which the legality requirement reads: “This Agreement shall apply to investments made in the territory of either Party in accordance with its *legislation* by investors of the other Party prior to as well as after the entry into force of this Agreement.”[85] [emphasis added] The reason for this wrinkle is the use of the apparently more restrictive term of ‘legislation’ rather than the more inclusive terms ‘laws’ and ‘regulations’. From the viewpoint of a Romani-Germanic-educated lawyer, one may find the term ‘legislation’ to cover only the enactment of the Legislature, and not the resolutions or regulations laid down by the Executive.[86]

56. Bearing this in mind, it should be mentioned that in case doubt arises as to the characterisation of the law in question, – as to whether the law at issue is a ‘legislation’ (in its ‘specific’ sense) or a regulation (in its ‘specific’ sense) – one has to refer to the legal system of the host state and determine the status of the law at stake in accordance with the constitutional and public law regime of the of that state.[87]

57. Another point to make in this respect is that it is possible that the investment treaty in question sets out in the legality requirement a number of laws, legislation, and regulations which should be complied with in the process of making the investment. In such a situation, a tribunal can firmly hold that the stipulated laws should have been abided by in the process of establishment of the investment.[88] Whether other laws on top of those expressed laws should have been observed in the process of making the investment, would, of course, depend on the terms of the legality requirement in question.

58. The final point to make in this regard is that in case a domestic legal instrument does not have the force of law, it will not fall within the ‘formal scope’ of the legality requirement. Indeed,

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[84] According to Black’s Law Dictionary, ‘regulation’ means: “The act of regulating; a rule or order prescribed for management or government; a regulating principle; a precept … Rule of order prescribed by superior or competent authority relating to action of those under its control…” See ibid 1451. These meanings seem to represent the term ‘regulation’ in its ‘broad’ rather than ‘specific’ sense.

[85] Article 26(1) of the Agreement for the Promotion and Reciprocal Protection of Investment between the Government of the Republic of Austria and the Government of the Republic of Kazakhstan, signed on 12 January 2010, entered into force on 21 December 2012.

[86] However, it seems that in ‘Common Law’, the term ‘legislation’ bears a more general meaning than what is understood by a ‘Romani-Germanic’ lawyer: “The act of giving or enacting laws; the power to make laws; the act of legislating; preparation and enactment of laws; the making of laws by express decree … Formulation of rule for the future … Municipal ordinances are legislation.” HC Black (n 83) 1045.

[87] See *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [411] (stating that: “The term “legislation” in Article 12 [of the BIT] encompasses those normative actions regarded as “law” by the Host State’s legal system which […] is defined by the normative-legal acts set out in Article 5 of the Uzbekistan Law on Normative-Legal Acts.”)

[88] See, for instance, the Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments (n 3), which in its Protocol refers to a provision of Constitution of Philippines as a law that should be complied with by German investors. The Protocol to the Agreement, which was concluded on the same day as the BIT, states at ad Article 2: “As provided for in the Constitution of the Republic of the Philippines, foreign investors are not allowed to own land in the territory of the Republic of the Philippines. However investors are allowed to own up to 40% of the equity of a company which can then acquire ownership of land.”

an essential prerequisite to fall within the 'formal' ambit of the legality requirement is that the instrument in question should have the force of law and should be binding. Thus, in *Vladislav Kim v. Uzbekistan*, the tribunal, *inter alia*, dismissed an alleged illegality objection by the respondent on the basis that the invoked instrument, i.e., Rules of Exchange Trade of Services in the Republican Stock Exchange, "Tashkent" ("TSE Rules"), did not constitute 'normative-legal acts'.[89]

b. The Substantive Scope of the Legality Requirement

59. The 'substantive scope' of the legality requirement specifies the relevant group of host state's laws, in terms of their subject-matter, hierarchy, significance or nature, which an investment treaty tribunal should consider when assessing the legality of an investment.[90]
60. Disputants in investment treaty arbitrations usually disagree as to the 'substantive scope' of application of the legality requirement. Specifically, they are usually in contention as to whether the requirement extends to violations of all or only specified types of laws and regulations of the recipient state.[91] The case of respondent states is usually that the requirement encompasses any violation of its municipal laws irrespective of the law's subject-matter or significance.[92] On the other hand, claimants usually argue that the 'compliance with the host state law' requirement is triggered only when fundamental laws of the host state are violated.[93]
61. Assume that in an investment treaty case, the jurisdictional question before the tribunal is the illegality objection of the respondent, whereby the host state contends that in making its investment, the investor violated (a) mandatory provisions of development law of the host state regarding equity investment limitation of foreign investors in air transportation sector; (b) a provision of local content law for employing at least half of the board of directors' members of the joint venture from citizens of the host state; and (c) an implementing regulation of the foreign investment law requiring investors to state the full name of all of their major shareholders in investment application forms. In such a case, a preliminary task of the tribunal is to specify the 'substantive scope' of the legality requirement to see which one of these laws falls within the 'substantive' reach of the requirement in order to determine which violation is caught by the legality requirement.
62. According to certain investment treaty arbitral tribunals, only fundamental violations of the host state law count for triggering the legality requirement. Others believe that it is the subject-matter of the law that matters, not the severity of the violation. Finally, most recently a stringent test has been adopted by the tribunal in *Vladislav Kim v. Uzbekistan*. According to this tribunal, the twofold test devised by it "requires a case-by-case analysis examining both the seriousness of the investor's conduct and the significance of the obligation not complied with so as to

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[89] *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [514].

[90] M Polkinghorne & SM Volkmer, 'The Legality Requirement in Investment Arbitration' (2017) 34(2) J Int'l Arb 149, 160.

[91] T Obersteiner, 'In Accordance with Domestic Law' Clauses: How International Investment Tribunals Deal with Allegations of Unlawful Conduct of Investors' (2014) 31(2) J Int'l Arb 265, 276.

[92] See, for instance, *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [239]-[240]; *Saba Fakes v. Republic of Turkey* (n 69) [119].

[93] For instance, in *Saba Fakes v. Turkey*, the claimant alleged that a 'certain level of violation' is required to trigger the legality requirement. According to the claimant, an investment should be considered 'illegal' only if made in violation of a fundamental legal principle. See *Saba Fakes v. Republic of Turkey* (n 69) [118]. See also *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania* (n 43) [300] (the claimant argued that to amount to illegality, there should be a 'serious violation of mandatory public order').

ensure that the harshness of the sanction of placing the investment outside of the protections of the BIT is a proportionate consequence for the violation examined."[94]

63. All these three views will be reviewed and analysed in the sub-section below (i). I submit that while each of the approaches considered below has some merits (some more than others), none of them entails a sound interpretive exercise as prescribed by Article 31 of the VCLT in construing the legality requirement. A watchful travel through the route of treaty interpretation, in accordance with Article 31 of the VCLT, can lead one to adopt a 'balanced interpretation' of the legality requirement using the available interpretive tools embedded in Article 31 of the VCLT (ii).

i. Approaches Adopted in Investment Treaty Arbitrations

64. As was alluded to above, two main approaches can be discerned with regard to the 'substantive scope' of the legality requirement in the decisions of investment treaty tribunals: (i) 'subject-matter approach', according to which it is only the violation of certain types of laws that can trigger the legality requirement. (ii) 'significance-analysis approach', according to which the activation of the legality requirement depends on the significance of the law(s) violated. In this sub-section, I will firstly review and analyse the 'subject-matter approach' and then the 'significance-analysis approach'. As was briefly touched upon above, recently, a decision has been rendered in a dispute between 12 Kazakh nationals and the Government of Uzbekistan. In the decision on jurisdiction in that dispute, the tribunal devised, what it called 'principle-based reasoning'[95] which took into account not only the significance of the violation, but also the behaviour of the investor, and the collective impact that these two factors had on the interest of the host state.[96] This recent test will also be subject to thorough consideration below.

1st. *Subject-Matter Approach (Compliance only with Laws Relating to Foreign Investment)*

65. According to this approach, in order to observe the legality requirement in the course of making the investment, the investor only needs to comply with foreign investment laws of the host state. This theory was put forward by the *Saba Fakes* tribunal[97] and is cited, at least, in two decisions of other investment treaty tribunals without being rejected or distinguished.[98]

66. In *Saba Fakes v. Turkey*, the respondent argued that the investor had established his investment in violation of Turkish law on foreign investment, a regulation of the telecommunications sector, and the competition law of Turkey. On the one hand, the tribunal said that the first alleged violation, i.e., violation of Turkish law on foreign investment, if found to exist, might trigger the legality requirement. On the other hand, it held that breaches of the telecommunications regulations and the competition law of Turkey exceed the 'substantive scope' of the legality requirement and are not covered by it.[99] Thus, the tribunal decided that the 'substantive scope' of the legality requirement was restricted to the laws and regulations 'governing the admission of investments in the host State'. The ICSID tribunal reasoned that

[94] See *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [404].

[95] ibid [399].

[96] ibid [404]-[408].

[97] *Saba Fakes v. Republic of Turkey* (n 69).

[98] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [165]; *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [248].

[99] *Saba Fakes v. Republic of Turkey* (n 69) [120].

its finding was based on the 'plain language' of the underlying investment agreement,[100] which covered 'investments … established in accordance with the laws and regulations' of Turkey.[101] The tribunal also indicated that the object and purpose of the agreement in general also contributed to this view, restraining the above-stated 'laws and regulations' only to laws 'related to the very nature of investment regulation'.[102] Subsequently, according to this tribunal, in case the investor violated any other laws of Turkey, not related to investment laws, the respondent state could not rely on the legality requirement to deny BIT protection to the investor. Therefore, the tribunal found that the respondent could not rely on the investor's alleged violations of competition laws and telecommunications regulations of Turkey to generate the legal consequences of the application of the legality requirement.[103]

67. Unlike the viewpoint according to which investors need only to comply with 'fundamental laws' of the host state, which is based on the analysis of the significance of the laws within the legal scheme of the recipient state (see *infra*), under the present theory, the test is pertinence, i.e. abiding by laws which are, subject-matter-wise, pertinent to the type of the economic operation in question, i.e. laws relating to 'foreign investment'.
68. An investment law of a country may include in addition to its general law on foreign investment[104] – which is usually supplemented and elaborated by regulations and subordinate legislation – separate laws on foreign investment in specific economic sectors.[105] Thus, as it is implied from the *Saba Fakes* tribunal's findings, for satisfying the legality requirement, when establishing its investment, the investor needs only to comply with these laws of the host state.
69. The first obvious problem with this theory is that it is not backed by the 'ordinary meaning of the terms' of a typical legality requirement. While the *Saba Fakes* tribunal does mention that the interpretation it offers 'is made clear by the plain language of the BIT, which applies to 'investments . . . established in accordance with the laws and regulations …',[106] it fails to explain why the 'ordinary meaning' of the unqualified and generic terms of 'laws' and 'regulations' used in Article 2(2) of the underlying investment agreement should be restricted only to foreign investment laws of the host state.[107]
70. Moreover, the tribunal's statement that "it 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" is not also well-reasoned. As set out in the Preamble of the underlying BIT, one purpose of the conclusion

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[100] Agreement on Reciprocal Encouragement and Protection of Investments between the Kingdom of the Netherlands and the Republic of Turkey (n 70).

[101] *Saba Fakes v. Republic of Turkey* (n 69) [119].

[102] ibid.

[103] ibid [120].

[104] JW Salacuse (n 6) 90 (explaining different titles used for describing such laws in various developing and developed countries).

[105] ibid 90-91.

[106] *Saba Fakes v. Republic of Turkey* (n 69) [120].

[107] R Dolzer and C Schreuer, *Principles of International Investment Law* (OUP 2012) 93 (saying that: "Whenever a clause 'in accordance with the laws of the host state' is contained in a treaty, it may be understood to imply that investments made in violation of national laws are not covered by the treaty. Therefore, the words 'in accordance with the laws' relate not just to the laws on admission and establishment but also to other rules of the domestic legal order, including those relating to corruption.") See also J Hepburn 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (n 73) 547-548.

of the Agreement is stimulating 'economic development' in both states.[108] 'Economic development' would be achieved by preserving the 'public interest' of the host state.[109] It borders on inconceivable that investment contracts made in accordance with foreign investment laws, but in violation of, for example, criminal codes of the state in question (for instance, investment contracts brokered by payment of bribes to influential dignitaries of the host state) would serve the 'public interest' or contribute to the 'economic development' of the host state, and not surely to the 'sustainable development' of its economy. Indeed, it is very difficult to ascribe an intention to the contracting parties of international investment agreements, according to which, all of their laws (except those relating to foreign investment), irrespective of their significance and imperativeness, could be breached by investors in the course of making their investment, with the agreement still being applied and with no jurisdiction, admissibility, or substantive consequences for the defiant investors.

71. Furthermore, apart from its interpretive flaws, in practice, although not expressly rejected, this theory has not been supported by other tribunals deciding investment treaty cases.[110] For instance, in *Alasdair Ross Anderson v Republic of Costa Rica*, the tribunal found that the underlying economic operation did not comply with the requirements of the Organic Law of the Central Bank of Costa Rica and that, therefore, the claimants did not acquire their investment in accordance with the laws of Costa Rica.[111] The Organic Law of Costa Rica was not a law directly related to admission and establishment of foreign investments. In another leading case, the *Metal-Tech* tribunal concluded that the investor had made its investment in violation of the Uzbek Criminal Code. Therefore, the tribunal found that the legality requirement is engaged and that it lacked jurisdiction to hear the parties' claims and counterclaims brought under the relevant BIT even though the law violated did not concern laws of foreign investment.[112] Indeed, even those investment treaty tribunals which have cited and relied on *Saba Fakes* with regard to the 'substantive scope' of the legality requirement have not done so on an exclusive basis. Rather, they have considered a wide array of domestic laws to fit within the 'substantive' reach of the legality requirement, not confined to domestic laws on foreign investment. According to these awards, the 'substantive scope' of the legality requirement extends to the ensuing illegalities: (i) "nontrivial violations of the host State's legal order"; (ii) "violations of the host State's foreign investment regime"; and (iii) "fraud…to secure the investment …"[113] Finally, it is worth observing that this theory was not even applied by the *Saba Fakes* tribunal itself. In fact, the tribunal dismissed jurisdiction in this case on another ground.[114]

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[108] See the Preamble of the Agreement on Reciprocal Encouragement and Protection of Investments between the Kingdom of the Netherlands and the Republic of Turkey (n 70).

[109] *Joseph Charles Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010 [272]-[273].

[110] J Hepburn, 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (n 73) 548-549.

[111] *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [57].

[112] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [372]-[373].

[113] *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [266]; *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [165].

[114] The tribunal concluded that the parties to the investment arrangement never intended to give effect to the alleged transfer of shares from Masoud to Mr. Fakes and, instead, agreed to implement an agreement which did not transfer even the legal ownership of the share certificates in Telsim to Mr. Fakes. As a result, the tribunal concluded that the

72. In sum, the standpoint according to which only compliance with the laws relating to the establishment of foreign investment matter for the satisfaction of the legality requirement is neither supported by a sound treaty interpretation exercise nor by the practice of investment treaty tribunals. Of course, as will be analysed *infra*, to meet the legality requirement, most laws relating to foreign investment should be complied with in the course of making the investment. However, as will be explained later, such laws are not the only category of laws of the host state that need compliance by virtue of the legality requirement.[115]

2nd. *Significance-Analysis Approach (Compliance only with Fundamental Laws of the Host State)*

73. The 'significance-analysis approach' seeks to establish that the legality requirement comes into play only when 'fundamental laws' of the host state have been infringed.[116] Interestingly, the main proponents of this approach are tribunals before which the legality requirement was not the main point of jurisdictional contention between the disputants. The opinion of the three investment treaty arbitral tribunals that have favoured this approach to the 'substantive scope' of the legality requirement will be reviewed briefly below.

74. In 2006, in *LESI and Astaldi v. Algeria*, the tribunal stated that investments would be excluded from treaty protection when made in violation of fundamental principles of law in force in the host state.[117] In 2008, the *Desert Line v. Yemen* tribunal opined that the legality requirement is "intended to ensure the legality of the investment by excluding investments made in breach of fundamental principles of the host State's law, e.g. by fraudulent misrepresentation or the dissimulation of true ownership".[118] Similarly, in 2009, in *Rumeli v. Kazakhstan*, the arbitral tribunal held that investments would be denied protection, only if they were made "in breach of the fundamental legal principles of the host country".[119] In short, the notion common in

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arrangement in question did not meet the requirement of a 'contribution', nor the requirements of 'duration' and 'risk' that an investment operation should necessarily have since no rights were actually transferred to the claimant through the underlying arrangement. Put differently, according to the tribunal, the investor had not made any investment in Telsim which would satisfy any of the three criteria for an 'investment' within the meaning of Article 25(1) of the ICSID Convention. *Saba Fakes v. Republic of Turkey* (n 69) [147]-[148].

[115] See J Hepburn, 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (n 73) 549. Hepburn also identifies another pitfall with this approach. According to him, almost all the laws that an investor deals with in the course of establishing its investment are related to foreign investment, and, therefore, there was no reason for the *Saba Fakes* tribunal to exclude competition and telecommunication regulations from the 'substantive scope' of the legality requirement. He says that: "…almost by definition, any host state law that an investment might breach is a law 'related to the very nature of investment regulation', as the *Fakes* tribunal itself put it. If a law does not regulate investment, it seems quite unlikely that an investment could breach it. The tribunal's proposed constraint may therefore not even serve its own stated purpose." ibid 547-548. In this regard, Salacuse properly remarks that foreign investment law is the "basic legal framework for undertaking and operating foreign investment projects." Nonetheless, he observes that such law is not the 'exclusive' law applicable to foreign investment. He opines, quite correctly, that "foreign investment projects also have to deal with and be subjected to a host of other laws, rules and regulations." According to Salacuse, a number of such foreign-investment-related laws are the ensuing: laws governing the acquisition of land, exchange controls, and labour laws. See JW Salacuse (n 6) 91.

[116] *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan* (n 75) [319] (stating that: "investments in the host State will only be excluded from the protection of the treaty if they have been made in breach of fundamental legal principles of the host country.")

[117] *L.E.S.I. S.p.A. and ASTALDI S.p.A. v. République Algérienne Démocratique et Populaire* (n 75) [83].

[118] *Desert Line Projects LLC v Yemen* (n 75) [104].

[119] *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan* (n 75) [319].

these decisions is that the legality requirement is set in motion only in cases where ‘fundamental laws’ of the host state are breached by the investor in the course of making its investment.

75. First and foremost, the obvious flaw of this approach is that it is not supported by the ‘ordinary meaning of the terms’ of a typical legality requirement.[120] A typical legality requirement reads: “This Agreement shall apply to investments in the State territory of one Contracting Party which were carried out in accordance with its legislation by investors from the State of the other Contracting Party …”[121] There is no limiting language in this provision confining the ‘legislation’ of a ‘Contracting Party’ which should be abided by investors to ‘fundamental laws’ of the host state. Probably, it was for this reason that in *Quiborax v. Bolivia,*[122] the tribunal dismissed the claimants’ proposed limitation to the legality requirement. In that case, the claimants advocated a narrow reading of the legality requirement in the underlying investment treaty limited to breaches of fundamental legal principles or of the investment regime of the host state.[123] The tribunal considered such a reading of the legality requirement to be ‘too narrow’, which went ‘beyond the terms of the BIT’, and characterised it as “an attempt to further the investor’s protection without due regard for the State’s interests”.[124]

76. Furthermore, this interpretive approach frustrates certain stated purposes of investment agreements, like ‘economic development of the host state’, which is frequently referred to as one of the objectives of these agreements.[125] It is hardly conceivable that ‘economic development’ of the host state could be achieved if only the observance of a fraction of the laws of the host state is sanctioned by the investment treaty in question. In other words, ‘sustainable development’ of the recipient state cannot be realised if the investor can violate a great majority of the laws of the host state at the time of establishing the investment without facing a sanction on an international plane.

77. Besides, another defect that this approach suffers from is that it gives no test or benchmark according to which one can recognise the ‘fundamental laws’ of the host state. If, for instance, the legality requirement question before the tribunal is whether the violation of taxation laws of the host state at the time of making the investment would activate the ‘in accordance with the laws clause’, this approach does not give the tribunal seized of deciding the dispute a yardstick to determine whether the relevant taxation legal provisions allegedly violated fall within the scope of ‘fundamental laws’ of the host state.

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[120] See J Hepburn, ‘In Accordance with Which Host State Laws? Restoring the ‘Defence’ of Investor Illegality in Investment Arbitration’ (n 73) 534-535.

[121] See Article 12 of the Agreement between the Government of the Republic of Kazakhstan and the Government of the Republic of Uzbekistan on the Promotion and Protection of Investments, signed on 02 June 1997, entered into force on 08 September 1997. This was the underlying BIT in *Vladislav Kim and others v. Republic of Uzbekistan* (n 73).

[122] *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2).

[123] ibid [263].

[124] ibid.

[125] See, for instance, the Preamble of the Agreement between the Slovak Republic and the Islamic Republic of Iran for the Promotion and Reciprocal Protection of Investments, signed on 19 January 2016, not yet entered into force (stating at the fourth recital that the parties seek to “promote investment that contributes to the sustainable development of the Contracting Parties …”); the Preamble of the Agreement Between the Government of Canada and the Government of the People’s Republic of China for the Promotion and Reciprocal Protection of Investments, signed on 09 September 2012, entered into force on 01 October 2014 (providing in its second recital that the parties recognise “the need to promote investment based on the principles of sustainable development.”)

78. In sum, like the previous approach, the 'significance-analysis approach' also does not withstand proper interpretive scrutiny. In addition, the very concept of 'fundamental laws', though having a restrictive feature, is not a clear term and does not effectively help an investment treaty tribunal when faced with specifics in an actual case.

3rd. *Combined-Effect Analysis (Double Analysis of the Significance of the Host State Law Violated Together with the Behaviour of the Investor)*

79. Having reviewed the first two approaches, I now turn to the third and the most recent view on the 'substantive scope' of the legality requirement. As was alluded to above, in *Vladislav Kim and others v. Uzbekistan,*[126] in comparison to the previous approach, i.e., the 'significance analysis approach', the tribunal took one step further in making the 'substantive scope' of the legality requirement even more limited.

80. To query the factual matrix of the case, in 2005, 12 Kazakh investors (claimants in this case) intended to obtain majority shares in two cement plants (namely BC and KC) in Uzbekistan. In so doing, they concluded a complex Share Purchase Agreement ("SPA"),[127] the legality of which was a central matter of dispute between the parties in the subsequent investment treaty case. In the course of the following years, those investors bought further shares in BC and KC from minority shareholders to support their already acquired majority stakes in the cement plants.[128] These transactions together led the investors to ultimately hold an 83% shareholding in BC and an 89% shareholding in KC. The claimants argued that as of 2010, the cement plants (BC & KC) encountered 'a campaign of harassment by Respondent' in the form of criminal and regulatory investigations.[129] This so-called 'campaign', according to the claimants, resulted in a criminal sentence being rendered against BC and four of its managers. The claimants contended that according to this penal judgment, 51% of the capital stock of BC should be transferred to the Uzbek Government.[130] The claimants also argued that in the meantime, previous minority shareholders of KC, represented and espoused by the Government of Uzbekistan, succeeded in a domestic litigation in Uzbekistan to retrieve their stakes, on the ground that they had been forced by the Kazakh investors to sell their shares to them (equivalent to approximately 12% of KC stakes).[131] Countering the claimants' statement of the factual background, Uzbekistan offered a narrative of legally defective transactions concluded by the claimants, illicit payments, and duress.[132] According to the respondent, it was the illegal conduct of the investors in acquiring the shares in BC and KC that gave rise to the domestic criminal proceedings.[133] Therefore, Uzbekistan, *inter alia*, objected that the claimants' investment was not made in compliance with Uzbek legislation and that, therefore, such investment does not attract the protection of the Kazakhstan-Uzbekistan BIT.[134]

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[126] *Vladislav Kim and others v. Republic of Uzbekistan* (n 74).

[127] ibid [128]-[131].

[128] ibid [135].

[129] ibid [138].

[130] ibid [139].

[131] ibid [140].

[132] ibid [142].

[133] ibid [149].

[134] ibid [171].

81. By the defence of illegality of the investment being raised by the respondent, the parties had a dispute regarding the 'substantive scope' of the legality requirement. They disagreed as to how the tribunal was to identify those acts of noncompliance to which the legality requirement applies.[135]
82. Analysing the specifics of the dispute before it, the tribunal began by asserting that a prevailing tendency in investment treaty jurisprudence had been to confine the legality requirement to breaches of 'fundamental laws' of the host state, and noted that previous *fora* have used 'rule-like statements' to formulate the legality requirement's scope of application.[136] However, the tribunal expressed discontent with the trend of setting forth 'rule-like statements', which it considered to be sometimes too alienated from the terms of the underlying investment treaties. Although it acknowledged that these 'rule-like statements' 'provide the comfort of certainty', the tribunal went on to consider such statements as sometimes unjustifiably either under-inclusive or over-inclusive.[137] Therefore, instead of adhering to these so-called 'rule-like statements', the tribunal purported to concentrate its survey on the specific legality requirement in the underlying BIT.[138] According to the tribunal, the 'bare bones language' of this requirement as prescribed by the underlying treaty required the application of a 'principle', as opposed to 'rules'.[139]
83. On that premise, the tribunal went on to opine that for the legality requirement to be triggered, it does not suffice for the law violated to be 'fundamental'. For this panel, in addition to the fundamentality of the law in question, the act of violation should also be flagrant or egregious, thus, requiring an even higher threshold for the coming into play of the legality requirement. In view of this tribunal, what triggered the legality requirement was "noncompliance with a law that results in a compromise of a correspondingly significant interest of the Host State". In this respect, the tribunal specifically stated:

> The phrase "noncompliance with a law that results in a compromise of a correspondingly significant interest of the Host State" is chosen so as to focus more sharply the substantive scope of the legality requirement not on whether the law is fundamental but rather on the significance of the violation. The Tribunal believes that the gravity of the law itself is a central part of the examination but not the sole focal point. It is not only the law, but the act of noncompliance (or in some wordings, the violation) that is key. The seriousness of the act is a combination of both the importance of the requirements in the law and the flagrancy of the investor's noncompliance. The text or standing of the law – although central – does not in and of itself determine whether the legality requirement is triggered. Rather, the law must be considered in concert with the particulars of the investor's violation. An investor may violate a law of some import egregiously or it may violate a law of fundamental importance in only a

[135] ibid [381].

[136] ibid [384].

[137] ibid [399].

[138] Agreement between the Government of the Republic of Kazakhstan and the Government of the Republic of Uzbekistan on the Promotion and Protection of Investments (n 121).

[139] *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [399].

> trivial or accidental way. Seriousness to the Host State is to be determined by the overall outcome, which will depend on the seriousness of the law viewed in concert with the seriousness of the violation.[140]

84. In short, the *Vladislav Kim* tribunal adopted a three-step analysis: **first**, reviewing the significance of the domestic law allegedly violated; **second**, the seriousness of the alleged violation; and **third** whether the combination of these two elements "results in a compromise of a significant interest of the Host State to such an extent that the harshness of the sanction of placing the investment outside of the protections of the BIT is a proportionate consequence for the violation examined".[141]
85. Applying the above-mentioned analytical steps, the tribunal went through various illegalities alleged by Uzbekistan in that case. Specifically, Uzbekistan had contended four different alleged violations of Uzbek law by the investors in making their investment: (i) Fraud in violation of Uzbek Securities Law (in particular, in violation of Order No. 04-103 on "Regulations on the Prevention of Manipulation of the Stock Market" dated 25 June 1999); (ii) failure to register the English SPAs (in particular, in violation of Article 22 of Law No. 218-I); (iii) false disclosure and concealment in registering the Tashkent SPA; and (iv) fraud causing significant harm to the state, BC and KC minority shareholders, the Tashkent Stock Exchange ("TSE"), and the brokers. To see how the tribunal applied its three-step test in practice, and to set the scene for analysing the tribunal's benchmark regarding the 'substantive scope' of the legality requirement, in the ensuing paragraphs, I will go through the first two illegalities alleged by the respondent and how the tribunal addressed them.
86. As to the first alleged violation, i.e. fraud in violation of Uzbek Securities Law, the respondent's defence was based on the alleged illegality in the complicated agreements through which the investors obtained majority shares in BC and KC. This complex setting of transactions involved the conclusion of SPAs under English law for a purchase price of approximately US$34 million. The transaction also involved certain other share purchase agreements registered with the TSE disclosing only a purchase price of US$2.2 million rather than the actual price of US$34 million mentioned above. Uzbekistan contended that through this fraudulent mechanism, the investors manipulated the stock market in violation of Order No. 04-103 which "[p]rohibits any market participants from [p]erform[ing] any act aimed at artificially inflating/underpricing of securities, the product of a false or misleading impression of active trading in order to induce third parties to buy/sell securities at a bargain price for the manipulators", and also provides that "[a] member (group members) of the securities market and/or their customers do not have the right to conclude a transaction of sale and purchase of a particular type of security on the basis of mutual agreement, with the intent to mislead other market participants".[142] According to the claimants, the structure they used was necessary because the legal framework of Uzbekistan was in a state of development at the time. They

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[140] ibid [398]. See also ibid [404]. At paragraph 399 of the Decision, the tribunal specified its goal for setting up the above-mentioned principle by stating that it "does not so much seek to increase the scope of acts captured as a practical matter by existing rule-like statements but rather aims to identify the underlying principle that can provide a more nuanced definition of the limits of the acts of noncompliance that would trigger the legality requirement." See ibid, [399].

[141] ibid [405]-[408].

[142] ibid [426].

also noted that this structure was recommended to them by their broker and the seller of the shares.[143]

87. By a majority, the tribunal held that this alleged violation, i.e. the difference between the transaction's registered and actual price, was not "as egregious as Respondent alleges".[144] The most important factor for the tribunal in reaching its decision in this respect was that Uzbekistan could prove no intention to defraud on the claimants' part. In fact, although the majority admitted that the claimants registered an 'incorrect' price on the TSE,[145] to them, this "deliberate act of entering a false price on the exchange" was not equivalent to the existence of an intention to defraud or manipulate the market.[146] On the other hand, in an ensuing paragraph, the minority opined that the investors' conduct, falls within the definition of the term 'fraud' as understood in Uzbek law, and was a very serious violation, given the existence of a public reporting requirement integral to the operation of an exchange. The minority was also of the view that in order to secure the deal, the claimants intended the market to be given misleading information.[147]

88. The second alleged violation of the laws of the host state concerned the investors' alleged failure to register 'English law' SPAs. Uzbekistan argued that, in accordance with Article 22 of Law No. 218-I, the English SPAs should have been registered with the TSE.[148] On the contrary, the claimants asserted that the English SPAs were not subject to this registration obligation.[149] The tribunal, by majority, doubted whether such registration was necessary under Uzbek law.[150] In any event, it held that the alleged breach was not sufficiently significant to trigger the legality requirement. This holding was principally based on the severity of sanctions Uzbek law had determined for the failure to register. The parties disagreed as to the sanction specified in one of the laws (Order No. 2003-08) for failure to register. The majority, taking side with the claimants, held that the more appropriate translation of the Order provided for the 'invalidity' of the transaction, rather than rendering such transaction 'null and void'.[151] According to the majority, invalidity signified a milder sanction which represented the lower importance of the law.[152] Having concluded that the sanction of 'invalidity' does not herald a serious breach, the majority concluded that "such an act of noncompliance does not result in a

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[143] ibid [429]-[430].

[144] ibid [428]. The tribunal noted that the investment was made in a "highly uncertain legal environment, in which the applicable legal regime was unclear, difficult for any reasonable investor to ascertain, subject to change and still evolving", and that the investors acquired BC and KC in good faith to develop them. ibid [429], [432].

[145] ibid [437]. In this respect, the tribunal mentioned that it "accepts to an extent Claimants' argument that the English SPAs do more than the Tashkent SPAs in terms of gaining a "control Premium" and granting various rights such as a choice of law and choice of court agreement. But those additions in the Tribunal's opinion can't explain fully the difference between the price paid by Claimants in the English SPAs and the price recorded on the Tashkent SPAs." See ibid [483]. See also ibid [503].

[146] ibid [439].

[147] ibid [440].

[148] ibid [442].

[149] ibid [443].

[150] ibid [445].

[151] ibid [460]-[462].

[152] ibid [463]-[464]. In this connection, the majority also noted that the claimants' expert testifying on this point had a legal background whereas the respondent's expert had his background in economics. It also took into consideration the fact that the respondent did not call and cross-examine the claimants' expert.

compromise of an interest of sufficient significance so as to render proportionate the exclusion of the investment from the protections of the BIT."[153] On the other hand, the minority was of the view that the sanction of 'invalidity' for failure to register could not downgrade the seriousness of the investors' deliberate failure to observe Uzbek laws.[154]

89. Other alleged violations of Uzbek law were also dismissed by the majority for the reason that they could not trigger the legality requirement of the underlying investment agreement. Having applied its test to the various illegality allegations raised by the respondent, the majority of the tribunal concluded that Uzbekistan "either has failed to establish that claimants acted in noncompliance with various laws or that such acts of noncompliance do not result in a compromise of an interest that justifies, as a proportionate response, the harshness of denying application of the BIT."[155]

90. Having reviewed the test set out by the *Vladislav* tribunal and the way the test was applied by that tribunal, in the following paragraphs, I will analyse the appropriateness of this test as a benchmark for determining the 'substantive scope' of the legality requirement.

91. **First**, as with the two previous approaches, it seems that the test put forward by the *Vladislav* tribunal is by no means supported by 'the ordinary meaning of the terms' of the legality requirement, nor does the tribunal ultimately so contends. Nowhere does a typical legality requirement confine itself to violations of 'fundamental laws' of the host state. Furthermore, on its face, a typical legality requirement does not place emphasis on the seriousness of the violation on the part of the investor for the activation of the requirement. Therefore, this approach is not supported by 'the ordinary meaning of the terms' of a typical legality requirement.

92. **Second**, to be precise, the 'substantive scope' of the legality requirement has to do with *confining the laws that should be complied with* in the course of initiating the investment, not determining the boundaries of acts of non-compliance.[156] Put differently, the question, in fact, is the scope of the 'legality' requirement, i.e. the 'legal' provisions that should be complied with. Thus, in my opinion, it is not accurate to say that the 'substantive scope' of the requirement concerns determining the types of acts of non-compliance. Whereas, the former view (focus on laws rather than acts) concentrates on the laws of the host state that should be abided by, the latter standpoint (focus on acts rather than laws) pays particular attention to the behaviour of the investor, and, as a result, the 'intentions' of the investor.[157] Thus, inevitably,

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[153] ibid [464].

[154] ibid [465].

[155] ibid [541].

[156] In this respect, see M Polkinghorne & SM Volkmer (n 90) 149, 160 (saying that: "The legality requirement's subject-matter scope determines which of the host State's laws a tribunal should take into account when assessing the investment's legality.")

[157] At paragraph 403 of its Decision, the *Vladislav* tribunal admits to some extent that taking into account the investor's motives could be considered as a factor in the activation of the legality requirement:

> For this Tribunal, focusing on the seriousness of non-compliance, both in terms of the seriousness of the law and the action taken by the investor, *makes the good faith of the investor something that is considered as a factor in the overall assessment of the proportionality between the violation and the sanction*. An action in good faith possibly may render an act of noncompliance less serious, but – depending on the seriousness of the law violated – not necessarily. It may be that the law alleged to be violated has as an element of a violation that bad faith or a specific intent is required. Likewise, it may be

in most instances, a tribunal has to engage in ascertaining the investor's subjective 'motive' or 'intention' for committing the illegality and try to discover the possible *mens rea* of the investor which is really a criminal proceedings' assignment.[158] [159] The task of an investment treaty tribunal is not to establish the committing of a crime or imposing criminal punishments on the recalcitrant investor, but rather to establish whether host state law has, in fact, been breached.[160] Of course, in case a deliberate violation is found, the finding of illegality would be more robust

> that the law alleged to be violated provides an exception if the act is undertaken in good faith when, for example, due diligence is exercised. [emphasis added]

See *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [403]. See also ibid [469]-[475]. Further, the tribunal includes the role the investor's intention can play in determining the significance of the violation by asking the following test questions:

> What does the investor's intent suggest as to the seriousness of the investor's conduct? Where a particular state of mind is not required for the violation, does the intentionality of the investor's conduct suggest a more egregious act? In contrast, does an act of noncompliance that is mere accident suggest a less egregious act? Whether intent as an aggravating factor, or lack of intent as an excuse, is to be considered may be indicated by the law itself.

See ibid [407], second bullet point.

[158] On this point, Carlevaris aptly points out that it "is in fact more difficult to determine the investor's good faith and knowledge of the causes of the illegality than the identity of the norms allegedly violated and the seriousness of the breach." See A Carlevaris (n 7) 47. In the same vein, Knahr commentates that a subjective assessment "seems problematic since it will probably be difficult in many instances to determine whether an investor had actually acted in good faith or whether he had knowingly committed a violation of a host state's domestic law. Hence, an objective assessment of the severity of the violation … seems preferable." See C Knahr (n 7) 17.

[159] Of course, in cases where the relevant legal provision of the law of the host state requires the existence of an 'intention' as a condition for the consummation of a crime or wrongdoing and as a requisite for the imposition of criminal or legal sanctions, the tribunal has to ascertain the required 'intention'. Nonetheless, as explained below, this should not transform an investment treaty tribunal into a national criminal court. In most, if not all cases, the investor is sophisticated enough not to commit a notable illegality unintentionally. Talking in the context of corruption, Llamzon quite correctly suggests that investors acting in this way always know the illegality of their actions yet decide to engage in corruption anyway, either overtly or tacitly. AP Llamzon (n 8) 5. In this connection, the minority in *Vladislav Kim* also observed that one reason showing that the actual purchase price of the shares was intentionally concealed from the Exchange was that the investors were "highly sophisticated international businessmen, with no doubt intimate knowledge of such matters." See *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [476]. In case doubt arises as to the intentional or unintentional nature of the actions or omissions of a sophisticated investor in cases where the presence of intention is a condition of the consummation of a wrongdoing, the more appropriate standard of proof to be applied by an arbitral tribunal is 'circumstantial evidence'. In this respect, in connection with the existence of corruption, a plainly significant criminal label, the tribunal in *Metal-Tech v. Uzbekistan*, relying on paragraph 303 of the *Oostergetel* Award, remarked that it would "determine on the basis of the evidence before it whether corruption has been established with reasonable certainty. In this context, it notes that corruption is by essence difficult to establish and that it is thus generally admitted that it can be shown through circumstantial evidence." *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [243]. The *Oostergetel* tribunal had earlier observed that "[f]or obvious reasons, it is generally difficult to bring positive proof of corruption. Yet, corruption can also be proven by circumstantial evidence." See *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*, UNCITRAL, Final Award, 23 April 2012 [303]. Consequently, if in such cases, an investment treaty tribunal can ascertain the intention of the investor to commit the illegality with 'reasonable certainty' by reference to 'circumstantial evidence', it has properly carried out its arbitration assignment.

[160] In this connection, Pierre Mayer points out that "[a]n arbitrator who declares an illegal contract to be null does not usurp the role of guardian of public order; he does not even *sanction* - in the sense of punishment – conduct he deems to be illicit. Rather, what he does is to recognise the illicitness as such, and likewise recognise the nullity which is its result; in sum, he only *states the law*, which is part of his normal duty." [emphases in the original text] See P Mayer, 'Mandatory Rules of Law in International Arbitration' (1986) 2 Arb Int'l 278.

from an equity perspective. However, as will be later explained in this Chapter, lack of intention of the investor in breach of the laws of the host state does not excuse the investor's illegality.[161]

93. A possible pitfall of the *Vladislav* tribunal's proposed test would be that, if proven to be unintentional, even significant violations of mandatory laws of the host state could be excluded from the capture of the legality requirement, a result that is very hard to be ascribed to the intention of state contracting parties to an investment treaty. For instance, if the foreign investment cap in infrastructural projects in country "A" is 50%, and the foreign investor, allegedly unaware of this mandatory legal limitation, acquires directly and indirectly 60% of the shares of the project company, under this test, it could be still absolved from this illegality because of its lack of bad faith.[162]

94. **Third**, the *Vladislav* tribunal considered the possibility that a significant law could be breached in a 'trivial' way. As a result, it concluded that not every violation of fundamental laws of the host state could trigger the legality requirement.[163] To me, it is hardly conceivable that a 'fundamental law' could be violated in a 'trivial' way. In fact, when a fundamental law is breached, the breach cannot be characterised as 'trivial': such a breach remains a 'breach' which cannot be classified severity-wise. To illustrate the point, two examples will be given below: **One**: suppose that according to foreign investment law of country "A", the foreign investment participation cap in the sanitation sector is 49.99%. It is clear that provisions regarding foreign investment cap are fundamental.[164] Now, suppose that investor "B", in violation of that law, acquires 50% of the shares of a joint venture project company in the

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[161] As the tribunal in *Alasdair Ross Anderson v Republic of Costa Rica* said, each investor "must meet [the legality] requirement, regardless of his or her knowledge of the law or his or her intention to follow the law". *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [52]. In other words, the intention of the investor and his/her knowledge of the laws and regulations of the host state at the time of making the investment have no role to play in the consideration of compliance with the legality requirement, unless the law allegedly violated stipulates the requirement of 'intention'. See also C Knahr (n 7) 17.

[162] In this respect, the very concept of 'mitigating factors' used by the tribunal (see *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [448]), referring to the obscurity and instability of the host state law and good faith of the investor is an inapposite use, not only because 'mitigation' as a term of art is not used for issues of responsibility, but is designed and intended to exonerate the non-performing party from 'liability for harm suffered by the aggrieved party to the extent that the harm could have been reduced by the latter party's taking reasonable steps' (For the definition of mitigation see UNIDROIT Principles Of International Commercial Contracts 2016, Article 7.4.8 (Mitigation of Harm)), but also since topics like 'good faith' or 'the obscurity of the laws of the host state' are only defences that could be raised against a committed illegality, not issues that should be analysed when considering whether the illegality itself has occurred. Cf *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) fn 405.

[163] ibid [398].

[164] Referring, *inter alia*, to the regulation of limiting equity investment to a specified maximum percentage of voting control in an enterprise in a given sector, Salacuse opines that the policy assumptions behind such regulation "is that government control of the entry by foreign investment in particular sectors is necessary to protect important national interests, such as national security or strategic economic industries." See JW Salacuse (n 6) 92. According to Salacuse, the prohibitions and limitations usually apply in sensitive industries, like armaments, telecommunications, power generation and distribution, transportation, and the exploitation of petroleum and natural resources. See ibid 93. On this point, in *Phoenix*, the tribunal found: "In the Tribunal's view, States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments made in violation of their laws. If a State, for example, restricts foreign investment in a sector of its economy and a foreign investor disregards such restriction, the investment concerned cannot be protected under the ICSID/BIT system. These are illegal investments according to the national law of the host State and cannot be protected through an ICSID arbitral process." See *Phoenix Action Ltd v. Czech Republic* (n 39) [101].

sanitation sector, and investor "C" acquires 70% of another project company in the same field. Although the level of non-compliance is different, both investors "B" and "C" have violated a fundamental law. Indeed, no one could say that by only acquiring %00.01 extra to the lawful cap, investor "B" has violated the law in a 'trivial' way. **Two:** assume that the tender regulations of the host state, in a mandatory provision, require foreign bidders not to: (a) have any existing project in the host state in the related economic field at the time of bidding; (b) have any active project in the countries with which the host state does not have normal political ties at the time of bidding; and (c) have shareholders or stakeholders who are nationals, citizens, or residents of countries with which at the time of bidding the host state does not have normal political and economic ties. Suppose that despite assuring that none of these conditions apply to them, the winner of the bid disregards only the first, and the runner-up, all the three legal conditions. Although the severity of non-compliance differs in the two cases, the violation by the 'winner' cannot be characterised as 'trivial' since it is still a violation of a fundamental requirement of a law of great importance to the host state.

95. **Fourth**, as frequently emphasised by the *Vladislav* tribunal,[165] the test of 'proportionality' was the most important gist behind the principle set by the tribunal for determining the 'substantive scope' of the legality requirement. After conducting a comparative study, Bucheler concludes that 'proportionality' may constitute a 'general principle of law' under Article 38(1)(c) of the ICJ Statute that may be relevant to the construction of investment treaties.[166] However, in the application of this principle, he warns against the risk of arbitrary outcomes due to uncertainty as to what interests matter in a proportionality analysis and what weight they carry in adjudicating an international dispute. In this respect, he makes a right comparison between domestic law and international law by noting that value orders provided by internal constitutions alleviate the concern on the domestic level, while international law might not have a unitary system comparable to that of a domestic situation to determine the importance and the weight of the interests at stake.[167] The admonished risk is very well present here. The *Vladislav* tribunal has given specific weight to the interests of the investor,[168] while not giving an equivalent weight to the interests of the host state. In addition, whereas the interests of the investor have been highlighted in this Decision, their duty to observe and respect the laws of the host state in the process of making the investment has been given short shrift. The tribunal states, "[t]he denial of the protections of the BIT is a harsh consequence ..."[169] That is definitely correct. One should, however, be mindful that benefiting from investment treaty protection is

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165 *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [396]-[397], [400]-[404], [408], [413].

166 G Bucheler, *Proportionality in Investor-State Arbitration* (OUP 2015) 82-83.

167 ibid 66.

168 *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [393]-[396].

169 ibid [396].

also a great advantage.[170] This amazing package of substantive and procedural protections should not be granted to any investor, but just to eligible investors with clean-hands.[171]

96. **Fifth**, the test offered by the *Vladislav* tribunal is very difficult to apply in certain circumstances involving serious violations of host state law, like criminal code provisions on the prohibition of fraud. For this very reason, when applying the test it devised in the general part to specific illegality allegations raised by Uzbekistan, the majority had to admit that the illegality of fraud was serious enough to trigger the legality requirement, and that the good faith of the investor and the uncertainty in the legal system of the host state "would not, of themselves, be exculpatory for a Claimant whose noncompliance with a Host State law inherently was of sufficient seriousness to render proportionate the loss of treaty protection."[172] Therefore, the *Vladislav* tribunal admitted that in certain situations the fundamentality of the law in question is the end of the matter, and that the adjudicating forum should not go further and inquire about the subjective motives of the investor in violating the legal provision(s) of the host state or examine the contemporaneous transparency of the law of the host state.
97. **Finally**, as admitted by the *Vladislav* tribunal,[173] the principle as suggested by it is very 'case-specific'. Such an intensively 'fact-based' test does not create sufficient clarity, certainty, stability, and predictability desired by both states and investors.[174] Such an intensively fact-based principle would not also facilitate decision-making for investment treaty tribunals.
98. Based on the foregoing, the test devised by the *Vladislav* tribunal is not the most appropriate test one can craft for drawing the 'substantive' borders of the legality requirement. That said, the tribunal's novelty and thoroughness in dealing with this matter should be greatly admired and appreciated.

ii. The Proposed Solution

99. Having reviewed all the viewpoints on the 'substantive scope' of the legality requirement, in the following pages, I will offer my own point of view regarding the 'substantive' reach of this condition.

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[170] In this respect, Bucheler says that "[t]hrough a combination of substantive treaty protections, procedural tools, and robust enforcement mechanisms, the current system of investor-State arbitration constitutes one of the most effective means for the protection of non-State actors in international law." G Bucheler (n 166) 301. See also T Gazzini, *Interpretation of International Investment Treaties* (Hart Publishing 2016) 39, 49 (stating that: "[investment treaties] ensure foreign investors an increasingly sophisticated legal protection both in terms of normative standards and procedural remedies, without imposing on them any obligation … investment treaties amounted to a normative break-through as these treaties may pave the way to the direct access by the investor to international tribunals.") In this respect, referring to the dispute settlement clause of the ECT, the *Plama* tribunal mentions that: "By any standards, Article 26 is a very important feature of the ECT which is itself a very significant treaty for investors, marking another step in their transition from objects to subjects of international law…" and that: "…for a covered investor, Article 26 is a very important feature of the ECT; and as a remedy exercisable by an investor by itself and in its own right against the host state ... Under the ECT, the covered investor is more than an object of international law …" *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 08 February 2005 [141], [150].

[171] On this point, the *Mamidoil* tribunal correctly points to the fact that in "exchange for their acceptance to enter into investment treaties and giving their consent to the resolution of investment disputes by arbitral tribunals, States expect that such protection would extend only to investments that have been made lawfully." See *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania* (n 43) [291].

[172] *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [435].

[173] ibid [400].

[174] See (n 77 *supra* and the accompanying text).

100. A typical legality requirement reads: "“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."[175] By a mere 'textual' or 'literal' approach to treaty interpretation,[176] by looking only at the 'ordinary meaning of the terms' of the legality requirement in the context in which they usually appear, one has to take sides with the argument of host states who frequently posit that legality requirement extends to any breach of any law of the recipient state.[177] Put differently, the position of host states is supported by the generic and unqualified use of the terms 'laws', 'legislation', and 'regulations' without any attributes, particularisation or specification of such 'laws', 'legislation' or 'regulations' in the legality requirement.

101. However, treaty interpretation is a combined exercise in which all the tools and elements of interpretation should be analysed and weighed together.[178] Therefore, together with the

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[175] See Article 1(g) of the Agreement between the Government of the Republic of Costa Rica and the Government of Canada for the Protection and Promotion of Investment (n 15). This was the underlying BIT in *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9).

[176] Fitzmaurice has distilled 6 principles of treaty interpretation from the practice of the International Court of Justice from 1951 to 1954. The first and the second of such principles are the 'principle of actuality (or textuality)' and 'natural meaning'. According to the first principle, "texts must be interpreted as they stand, and, *prima facie*, without reference to extraneous factors" and according to the second principle, "[p]articular words and phrases are to be given their normal, natural, and unstrained meaning, in the context in which they occur." See G Fitzmaurice, 'The Law and Procedure of the International Court of Justice 1951-1954: Treaty Interpretation and Other Treaty Points' (1957) 33 BYIL 203, 211-213.

[177] For instance, in *Saba Fakes v. Turkey*, the respondent contended that any violation of any of the host state's laws would result in the illegality of the investment within the meaning of the BIT, and would preclude such investment from benefiting from the substantive protection offered by the BIT. See *Saba Fakes v. Republic of Turkey* (n 69) [119]. In the same vein, in *Quiborax v. Bolivia*, the respondent asserted that the legality requirement in the underlying BIT covered all the laws and regulations of the recipient state. Specifically, Bolivia contended that the Bolivia-Chile BIT "does not draw a distinction between serious and non-serious breaches of the laws; it covers both alike". See *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [240]. See also T Obersteiner (n 91) 276.

[178] It should be borne in mind that Article 31 of the VCLT entails the 'rule' of interpretation of treaties: all the means of interpretation referred to in this provision should be considered in totality, as the "process of interpretation is a unity". The Report of the International Law Commission is instructive in this respect: "Having regard to certain observations in the comments of Governments, the Commission considered it desirable to underline its concept of the relation between the various elements of interpretation in article 27 [now Article 31] and the relation between these elements and those in article 28 [now Article 32]. Those observations appeared to indicate a possible fear that the successive paragraphs of article 27 might be taken as laying down a hierarchical order for the application of the various elements of interpretation in the article. The Commission, by heading the article "General rule of interpretation" in the singular and by underlining the connexion between paragraphs 1 and 2 and again between paragraph 3 and the two previous paragraphs, intended to indicate that the application of the means of interpretation in the article would be a single combined operation. All the various elements, as they were present in any given case, would be thrown into the crucible, and their interaction would give the legally relevant interpretation. Thus, article 27 is entitled "General rule of interpretation" in the singular, not "General rules" in the plural, because the Commission desired to emphasize that the process of interpretation is a unity and that the provisions of the article form a single, closely integrated rule. In the same way the word "context" in the opening phrase of paragraph 2 is designed to link all the elements of interpretation mentioned in this paragraph to the word "context" in the first paragraph and thereby incorporate them in the provision contained in that paragraph. Equally, the opening phrase of paragraph 3 "There shall be taken into account together with the context" is designed to incorporate in paragraph 1 the elements of interpretation set out in paragraph 3. …" Report of the International Law Commission on the Work of Its Eighteenth Session, Geneva, 4 May-19 July 1966 (1966) (Vol. II) YB ILC 219-220. See also *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case

'text' and 'the ordinary meaning of the terms' in their 'context', one should also take into account the 'object and purpose' of the treaty. In addition, a treaty should always be interpreted in 'good faith'.[179]

102. With this important interpretive observation in mind, in determining the 'substantive scope' of the legality requirement, one has to appreciate the 'object' of the treaty, i.e., the economic operation as to which the legality requirement should be applied. This economic operation is international investment. International investment is a complex process.[180] In such a complicated process, involving numerous transactions, various formal and administrative procedures, and the necessity to deal with many public authorities over a good period of time, inadvertent mistakes could be made, thus violating certain laws and regulations of the host state which are not of vital importance or of mandatory nature.

103. Bearing this important point in mind, two of the most frequently stated 'purposes' of investment treaties are 'creating conditions which are favourable for investments' and 'stimulating private business initiatives'.[181] Such purposes would definitely be defeated if protection under the very same agreement were to be denied due to very small mistakes and mere technicalities that may understandably occur in such a complex process and are in most instances 'curable'.[182]

104. By now it has become clear that focusing merely on the text of the requirement does not lead one to safe waters. Indeed, paying heed to the 'object' and 'purpose' of investment treaties

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No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, 21 October 2005 [91] (aptly observing that: "Interpretation under Article 21 [sic] of the Vienna Convention is a process of progressive encirclement where the interpreter starts under the general rule with (1) the ordinary meaning of the terms of the treaty, (2) in their context and (3) in light of the treaty's object and purpose, and by cycling through this three step inquiry iteratively closes in upon the proper interpretation.")

179 See *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5 (formerly *Giovanna a Beccara and Others v. The Argentine Republic*), Decision on Jurisdiction and Admissibility, 04 August 2011 [646] (stating that: "The principle of good faith is a fundamental principle of international law, as well as investment law.")

180 See *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999 [72] (indicating that "An investment is frequently a rather complex operation, composed of various interrelated transactions, each element of which, standing alone, might not in all cases qualify as an investment"); *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3 (also known as: *Enron Creditors Recovery Corp. and Ponderosa Assets, L.P. v. The Argentine Republic)*, Decision on Jurisdiction, 14 January 2004 [72] (noting that "an investment is indeed a complex process including various arrangements, such as contracts, licences and other agreements leading to the materialization of such investment, a process in turn governed by the Treaty"); *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines,* ICSID Case No. ARB/03/25, Dissenting Opinion of Mr. Bernardo M. Cremades, 19 July 2007 [36] (stating: "Foreign investment occurs within a sophisticated legal framework of foreign ownership, tax, antitrust, administrative, labour, environmental and other regulations as well as the law relating to obligations arising directly from contractual relations.") In this respect, two commentators have correctly observed that "[a]n investment is often a process rather than an instantaneous act." They also note that "a typical investment is not a simple event. An investment operation is often composed of a number of diverse transactions and activities, which must be treated as an integrated whole. Therefore, an investment is a complex process involving diverse transactions which have a separate legal existence but a common economic aim". See C Schreuer & U Kriebaum, 'At What Time Must Legitimate Expectations Exist?' in J Werner & A Heydar Ali, *A Liber Amicorum: Thomas Wälde: Law Beyond Conventional Thought* (CMP Publishing 2009) 269-270.

181 See R Dolzer & M Stevens (n 33) 20-21 (referring to the Preamble of the Treaty between the Federal Republic of Germany and the Kingdom of Swaziland concerning the Encouragement and Reciprocal Protection of Investments, signed on 05 April 1990, entered into force on 07 August 1995.)

182 For the 'curability' of an illegality and its effect on the activation of the legality requirement, see *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania* (n 43) [494].

shows that one should not be entangled in a mere 'textual' impasse in the interpretive exercise. To get rid of this 'textual' predicament, some have suggested that rather than 'the ordinary meaning of the terms', the boundaries of the requirement can be identified by reference to the 'object and purpose' of the treaty.[183] The 'object' and 'purpose' of investment treaties are usually recorded in their preambles.[184] Several objectives are referred to in the preambles of investment treaties, the most conventional of them being: "(a) the general desire of the parties to intensify and to develop their economic relations; (b) … the need to create conditions which are favorable for investments of nationals of either State in the territory of the other State; and (c) the conviction that the protection of such investments will lead to the stimulation of private initiative and to the promotion of the prosperity of both States concerned."[185] One investment treaty tribunal has indicated that one could get assistance from some of these objectives to distinguish the contours of the legality requirement. Thus, in the context of interpreting Article 12 of the BIT between Kazakhstan and Uzbekistan on "Application of the Agreement",[186] entailing a legality requirement, the *Vladislav* tribunal made reference to some of the goals mentioned in the Preamble of that BIT and noted:

> It is the combination of desiring to "promote greater economic cooperation" and the fact that an act not in compliance with legislation under Article 12 excludes an investment from the scope of application of the BIT generally, that indicates the necessary substantive limits on the legality requirement. Given the aim of encouraging investment through the provision of some measure of security, it is not plausible that the drafters of the BIT intended to include minor acts of noncompliance as a basis for denying jurisdiction.[187]

105. Of course, the purposes of a treaty as recorded in its preamble can be used to shed light on the scope of the legality requirement to some extent, i.e., to exclude from the legality requirement the violation of *de minimis* laws of the host state. Preambles, nonetheless, cannot serve a tribunal when specific and more difficult jurisdictional questions arise. Preambles in investment agreements are usually written in a much generalised pattern that one could hardly grasp any specific – in contrast to general – interpretation use for jurisdictional purposes from the recitals recorded therein. In *HICEE v. Slovak Republic*, in interpreting the phrase "invested

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[183] *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [391]-[394].

[184] Several tribunals have considered the objectives of investment agreements to be recorded in their preambles. See, for example, *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 03 August 2004 [81] (saying: "The Tribunal shall be guided by the purpose of the Treaty as expressed in its title and preamble"); *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Decision on Jurisdiction, 22 February 2006 [80] (saying that the interpretation it arrives at is supported "by the object and purpose of the BIT". For displaying the object and purpose of the BIT, the tribunal goes on to cite certain recitals of the BIT Preamble.)

This is, of course, not to suggest that the 'object and purpose' of investment agreements are exclusively recorded in their preambles. The title of the agreement, its opening articles, as well as other agreements or instruments forming the context of the treaty remain relevant. See T Gazzini (n 170) 157-158.

[185] See R Dolzer & M Stevens (n 33) 20-21. See also UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (n 11) 3-4.

[186] Article 12 of the Agreement between the Government of the Republic of Kazakhstan and the Government of the Republic of Uzbekistan on the Promotion and Protection of Investments (n 121).

[187] *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [394].

either directly or through an investor of a third State", the tribunal considered the investor's jurisdictional argument that the terms used in the Preamble of the BIT between the Netherlands and Slovak Republic[188] show that the Parties intended the scope of the Agreement to be broad and inclusive, rather than narrow:

> In the Tribunal's view, the wording chosen for the Preamble by the Parties is studiously neutral, and refers more to the goal of the stability of expectations than to any preconception as to the Agreement's coverage and scope. The Tribunal observes that, in general, the purpose of bilateral investment treaties can be taken to be the encouragement of investment, on a mutual and reciprocal basis, while balancing the interests of the investors and of the receiving State in that regard; in and of itself, however, that says nothing about where the balance has been drawn in the particular treaty in question […] The Tribunal does not therefore find anything in the object and purpose of the present Agreement that would help in any material way to determine the question of interpretation before it.[189]

106. In a similar vein, in *Plama v. Bulgaria*, the claimant had, *inter alia*, placed much reliance on the object and purpose of the Bulgaria-Cyprus BIT to broaden the scope of the MFN clause of the treaty,[190] which provides in its Preamble that one of the goals of the treaty is "the creation of favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party." The tribunal declined to grant this stated purpose as reflected in the Preamble of the BIT a high weight in interpreting the MFN clause. It observed that:

> Such statements are as such undeniable in their generality, but they are legally insufficient to conclude that the Contracting Parties to the Bulgaria-Cyprus BIT intended to cover by the MFN provision agreements to arbitrate in other treaties to which Bulgaria (and Cyprus for that matter) is a Contracting Party. Here, the Tribunal is mindful of Sir Ian Sinclair's warning of the "risk that the placing of undue emphasis on the 'object and purpose' of a treaty will encourage teleological methods of interpretation [which], in some of its more extreme forms, will even deny the relevance of the intentions of the parties".[191]

107. By the same token, more recently, in *Government of the Lao People's Democratic Republic v. Sanum Investments Ltd*, the High Court of Singapore, held that: "[i]t is a truism to say that the purpose of any BIT is to promote investments. But it does not follow from this general

[188] See the Preamble of the Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic (n 35).

[189] *HICEE B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2009-11, Partial Award, 23 May 2011 [116].

[190] Agreement between The Government of the People's Republic of Bulgaria and The Government of the Republic of Cyprus on Mutual Encouragement and Protection of Investments, signed on 12 November 1987, entered into force on 18 May 1988.

[191] *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (n 170) [193] (referring to I Sinclair, *The Vienna Convention on the Law of Treaties* (Manchester University Press 1984) 130.)

proposition that every ambiguity found in such treaties should invariably be resolved in favour of the investor."[192]

108. Finally, in *Saluka v. Czech Republic*, the tribunal had before it the preambular language in the Czech-Netherlands BIT. The Preamble set out the objectives of the Treaty in the following terms:

> Desiring to extend and intensify the economic relations between [the Contracting Parties] particularly with respect to investments by the investor of one Contracting Party in the territory of the other Contracting Party,
> Recognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment is desirable…[193]

109. In a famous comment, the tribunal noted that one cannot merely rely on these generally stated purposes to tilt towards the benefits of the investor to the detriment of the rights of the host state. Instead, the tribunal emphasised on the necessity of adopting a 'balanced approach' in interpreting the treaty:

> … The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations.[194]

110. The necessity to have a 'balanced approach' to treaty interpretation is more nuanced when interpreting the legality requirement. Referring to the positions of the parties concerning the

[192] *Government of the Lao People's Democratic Republic v. Sanum Investments Ltd*, Judgment of the Singapore High Court, 20 January 2015 [2015] SGHC 15 [124].

[193] Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic (n 35).

[194] *Saluka Investments B.V. v. The Czech Republic* (n 36) [300]. Similarly, Gazzini opines that: "International investment treaties pursue two main objectives. On the one hand, they aim to stimulate the flow of foreign investment and create a stable and predictable environment for their management; on the other hand, they promote the economic development of the host State and the co-operation between the States concerned." T Gazzini (n 170) 34. He also comments elsewhere that "when the treaty aims to pursue more than one objective, the interpreter must take them all into account to the extent they are relevant, in a balanced and unbiased manner." ibid 161. See also ibid 163. Additionally, see *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction, 27 April 2006 [70] (stating that: "This Tribunal considers that a balanced interpretation is needed, taking into account both State sovereignty and the State's responsibility to create an adapted and evolutionary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow."); *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006 [307].

‘substantive scope’ of the legality requirement which really represented the two ends of the spectrum: a very narrow interpretation by the investor and a very expansive interpretation by the state, the *Quiborax* tribunal gave its word to none and recalled the fundamentality of a ‘balanced approach’ in drawing the lines of the legality requirement:

> The Parties disagree about the scope of the legality requirement. The Claimants advocate a narrow reading of this requirement limited to breaches of fundamental legal principles or of the investment regime. The Respondent opposes an expansive construction encompassing any breach of its legal order irrespective of its seriousness or timing. The Tribunal is of the opinion that neither interpretation is entirely correct, the interpretation of the Claimants being too narrow and that of the Respondent too broad. The Claimants’ interpretation goes beyond the terms of the BIT, in an attempt to further the investor’s protection without due regard for the State’s interests. By contrast, the Respondent’s expansive view neglects the investor’s interests with the result that an investment could be deprived of any treaty protection for any breach of the host State’s legal order – however slight – committed at any time. This approach would create deleterious incentives, as host States would be in a position to strip investors of treaty protection by finding any minor breach at any time.
>
> Neither view is consistent with the objectives of the BIT, the Preamble of which states that the Parties “recogniz[e] the need to promote and protect foreign investments in order to support the economic prosperity of both States” and “wish[] to strengthen the economic cooperation to benefit both States.” […] Accordingly, within the limits set by the applicable treaty interpretation rules, the Tribunal favours a balanced interpretation that takes account of the need to protect foreign investments, on the one hand, and of the State’s other responsibilities, on the other.[195]

111. To draw the threads from these citations, one can distill two significant points from the above-cited authorities: (i) statements of purposes in preambles of investment treaties are too generalised to provide meaningful guidance when faced with particularised questions of jurisdiction. (ii) creating a favourable climate for investors is one but not the only purpose of international investment agreements. Such agreements should also serve state contracting parties in that they should set the scene for the economic development of the host states. Therefore, a tribunal charged with interpreting an investment treaty should seek to strike a balance between the interests of the investors and those of the host state by offering a ‘balanced approach’ to interpretation.

112. So far, I have established that neither ‘the ordinary meaning of the terms’ of a typical legality requirement nor ‘the object and purpose’ of investment treaties, when considered individually and in isolation, can pinpoint the boundaries of the ‘substantive scope’ of the legality requirement. Another element for interpretation as enshrined in Article 31 of the VCLT is ‘good faith’. A ‘good faith’ interpretation would require a legality requirement to be

[195] *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [263]-[264].

interpreted effectively.[196] When applying a treaty which contains a legality requirement, an investment treaty tribunal should interpret the requirement effectively and should refrain from staying indifferent to the violation of the laws of the host state in the process of establishment of the investment. By including the legality requirement in an investment treaty, state parties to the agreement have indirectly entrusted the adjudicating forum with the task of safeguarding their laws from violation by the investor with the consequence that if an investor does not observe the laws of the host state, it cannot benefit from international protection under the agreement.[197]

113. Where do these observations leave me? Having noted these important interpretive points, one feels the need for a 'balanced' and 'effective' interpretation of the legality requirement while remaining loyal to the 'ordinary meaning of the terms' of the legality requirement. As will be explained in detail below, in my opinion, the lower end of the laws of the host states, i.e. *de minimis* laws, are excluded from the 'substantive scope' of the legality requirement. The higher end of such laws, i.e. fundamental laws of the host state, are included in the 'substantive scope' of the legality requirement. The median of the laws of the host state, i.e. ordinary laws, are also included in the substantive reach of the legality requirement, provided that they are violated by the investor in order to secure the investment or guarantee its success.

114. Having the above interpretive observations in mind, in the following three sub-sections, I will discuss each group of host state laws, setting out the specific reasons and supporting case law for inclusion or exclusion of such laws from the 'substantive scope' of the legality requirement.

1st. *Violation of de minimis Laws of the Host State*

115. As stated above, in my opinion, violation of mere technicalities and *de minimis* laws of the host state does not set the legality requirement in motion. It is, of course, correct that violation of any law is an illegal act under domestic law. It was stated by Lord Goff in *Tinsley v Milligan* that the common law rules on illegality do not distinguish 'between degrees of iniquity'.[198] Precisely for this reason, states, not infrequently, argue in investment treaty cases, where the legality requirement is at stake, that the requirement covers all the laws of the host state, and that a violation of each of these laws and regulations triggers the application of the requirement. To give two examples, in *Saba Fakes v. Turkey*, the respondent contended that any violation of any of the host state's laws would result in the illegality of the investment within the meaning of the BIT and would preclude such investment from benefiting from the substantive protection offered by the BIT.[199] In the same vein, in *Quiborax v. Bolivia*, the respondent asserted that the legality requirement in the underlying BIT covered all the laws and regulations

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[196] R Gardiner, *Treaty Interpretation* (2nd edn, OUP 2015) 179-181.

[197] As stated above, states insert legality requirements in their investment treaties to address their concern for the due observance of their laws by investors at the time of making their investments. In this respect, the tribunal in *Alasdair Ross Anderson v Republic of Costa Rica* specified that the incorporation of such a condition in the investment treaty between Canada and Costa Rica (the underlying treaty in that dispute which has a legality requirement in Article 1(g)) was a "clear indication of the importance that [the Contracting Parties] attached to the legality of investments made by investors of the other Party and their intention that their laws with respect to investments be strictly followed." It also added that "[t]he assurance of legality with respect to investment has important, indeed crucial, consequences for the public welfare and economic well-being of any country." *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [53].

[198] *Tinsley v Milligan* [1994] 1 AC 340, 362.

[199] *Saba Fakes v. Republic of Turkey* (n 69) [119].

of the recipient state. Specifically, Bolivia contended that the Bolivia-Chile BIT "does not draw a distinction between serious and non-serious breaches of the laws; it covers both alike".[200]

116. The viewpoint that supports the inclusion of all the laws and regulations of the host state in the 'substantive scope' of the requirement has certain proponents in the field of investment treaty arbitration. For instance, in *Mytilineos Holdings SA v Serbia and Montenegro*, the arbitrator appointed by Serbia wrote a dissenting opinion to the Partial Award on Jurisdiction, and opined that jurisdiction should have been denied, because the investor did various violations of domestic laws of the host state, such as the investor's failure to specify in the investment contracts the amount of money invested in the host state.[201] It is quite obvious that a requirement as per which an investor should cite the amount invested in the contract is not usually a critical requirement of law. On the contrary, it seems to be a *de minimis* legal provision, the failure to comply with which can easily be 'cured'.[202] Furthermore, in a recent article, Zachary Douglas comments that carving out 'technical' or '*de minimis*' violations of the host state law from the 'substantive scope' of the requirement is not logical.[203] Finally, a relatively recent work by UNCTAD also goes to the same direction by indicating that "[l]imiting the applicability of an investment agreement only to investments made in accordance with applicable laws and/or approval procedures is intended to induce foreign investors to ensure that *all local laws and regulations* are satisfied in the course of establishing an investment."[204] [emphasis added]

117. To be sure, as was touched upon above, by just looking at the text of a typical legality requirement or 'the ordinary meaning of terms' used therein, one cannot find a substantive limitation excluding from the scope of the requirement trivial or *de minimis* laws of the host state. That is because such clauses are usually written in an inclusive and general pattern using generic terms, like 'laws' and 'regulations' with no qualifier.[205]

118. However, it was explained above that through a sound interpretive exercise, one cannot solely focus on 'the ordinary meaning of the terms'. In addition to that, one has to pay heed to the 'object' and 'purpose' of the investment treaty in question, and as an underlying principle, always construe the treaty in 'good faith'.[206] The 'object' of an investment treaty is international investment the establishment of which is usually a lengthy and complicated process. In the process of establishment of an international investment, certain *de minimis* laws could unsurprisingly be breached. To hold that such violations trigger the exclusionary function of the legality requirement is neither in line with the 'purpose' of 'promoting

[200] *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [240].

[201] *Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia*, UNCITRAL, Dissenting Opinion from the Arbitral Award on Jurisdiction by Dobrosav Mitrović, 06 September 2006, pp 4-6.

[202] For the 'curability' of an illegality and its effect on the activation of the legality requirement, see *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania* (n 43) [494].

[203] Z Douglas, 'The Plea of Illegality in Investment Treaty Arbitration' (2014) 29(1) ICSID Rev-FILJ 155, 176.

[204] UNCTAD, *Scope and Definition* (n 11) 38.

[205] *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [389]; T Obersteiner (n 91) 276.

[206] (See paragraphs 196-199 *supra* and the accompanying texts). Indeed, the requirement that an investment treaty should be interpreted in 'good faith' is reinforced by considering that states might find it more convenient to take advantage of mere technicalities of their own laws to deprive investors of treaty protection by resorting to the legality requirement. In this regard, see A Carlevaris (n 7) 47; *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania* (n 43) [483].

investments' nor observant of the requirement of interpretation in 'good faith', in particular when the breach in question is 'curable'.

119. In this respect, many investment treaty tribunals have spelled out that the violation of *de minimis* laws of the host state does not trigger the legality requirement: As the most famous ruling in this respect, in *Tokios Tokeles v Ukraine*, faced with the respondent's allegation that the investment in question has not been made in accordance with the laws and regulations of Ukraine, the tribunal held that the investor's economic activity was not illegal, and the fact that the investor had made use of a wrong legal title in the registered name of its company and had omitted signatures on certain documents were so trivial to merit the dismissal of its claim based on the legality requirement. The tribunal stated that:

> [e]ven if [the tribunal] were able to confirm the Respondent's allegations, which would require a searching examination of minute details of administrative procedures in Ukrainian law, to exclude an investment on the basis of such minor errors *would be inconsistent with the object and purpose of the [BIT]*.[207] [emphasis added]

120. Likewise, in *Metalpar v. Argentina*, in the course of making the investment, the investor failed to register a company within the prescribed time in violation of the law of Argentina. The respondent asserted that this is an illegality which would preclude jurisdiction because the investment was not made in accordance with the laws of Argentina. The tribunal dismissed this argument, reasoning that "the lack of adequate registration could be sanctioned by refusing to register certain documents of the company, through a notice of warning, or by imposition of a fine on the company or its directors, but it would be disproportionate to punish this omission to register by denying the investor an essential protection such as access to ICSID tribunals."[208]

121. By the same token, in *Hamester v. Ghana*, the tribunal stated that the investor's submission of false invoices "might not be in line with what could be called "*l'e´thique des affaires*". However, according to the tribunal's viewpoint, such minor irregularities did not amount, in the circumstances of the case, to a fraud that would activate the legality requirement.[209] In the same vein, in *Alpha Projektholding v Ukraine*, the adjudicating forum concluded that a few minor defects in the paperwork submitted by the investor is not sufficiently critical to prevent ascertaining jurisdiction due to the application of the legality requirement.[210] Similarly, in *Quiborax v Bolivia*, the tribunal dismissed Bolivia's various illegality defences on the basis that the alleged illegalities were accidental and negligible errors and omissions in company records.[211] In a similar fashion, in *Hochtief v. Argentina*, the respondent asserted that Hochtief's loan transactions had not all been recorded as prescribed by Argentine financial legislation and that, therefore, the loans had not been made in accordance with the laws and regulations of Argentina as required by Article 2(2) of the Argentina-Germany BIT. The tribunal held that there is not "a sufficient basis for rejecting the claims concerning the loans

[207] *Tokios Tokeles v. Ukraine*, ICSID Case No ARB/02/18, Decision on Jurisdiction, 29 April 2004 [86].

[208] *Metalpar S.A. and Buen Aire S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/5, Decision on Jurisdiction, 27 April 2006 [84]. (Translation adopted from paragraph 137 of *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [397]).

[209] *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana* (n 41) [138].

[210] *Alpha Projektholding GmbH v. Ukraine*, ICSID Case No ARB/07/16, Award, 08 November 2010 [297].

[211] *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [280]-[281].

on the basis of their non-registration under Argentine regulations".[212] The tribunal drew on previous cases, and noted that other tribunals have focused on compliance with "fundamental principles of the host State's law".[213] According to *Hochtief* tribunal, "investments that are […] dependent upon government approvals that were not in fact obtained, or which were effected by fraud or corruption can be caught by a provision such as Article 2(2) of the Argentina-Germany BIT. But not every technical infraction of a State's regulations associated with an investment will operate so as to deprive that investment of the protection of a Treaty that contains such a provision."[214] Finally, in *Mamidoil v. Albania*, the tribunal focused its attention on the 'good faith' aspect of the interpretation of the legality requirement and said that "[s]tates must not be allowed to abuse the process by scrutinizing the investment *post festum* with the intention of rooting out minor or trivial illegalities as a pretext to free themselves of an obligation" or the "consequences of its standing agreement to arbitrate".[215]

122. In addition to the wealth of case law cited above, a prevailing opinion amongst commentators is that violations of *de minimis* laws of the host state should not be the trigger for the legality requirement.[216]

123. Therefore, an interpretation that takes into account the 'object' and 'purpose' of the treaty and is conducted in 'good faith' would exclude a violation of *de minimis* laws of the host state from the 'substantive scope' of the legality requirement. For this reason, violation of *de minimis* laws of the host state by the investor should not lead to a successful plea of illegality by the state.

124. Notwithstanding what has just been said, it might be problematic in certain cases to decide which laws are '*de minimis*' with the result that the investment violating them still qualifies as being 'in accordance with' the laws of the host state and which laws are not '*de minimis*' with the result that their violation constitutes an infringement of the national law of the host state and hence would prevent an investor or an investment from enjoying protection under an investment treaty.[217]

125. In order to discern the *de minimis* nature of any domestic law, an investment treaty tribunal could be assisted by legal expert testimony on issues of the host state law. In addition, certain

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[212] *Hochtief AG v. The Argentine Republic*, ICSID Case No. ARB/07/31, Decision on Liability, 29 December 2014 [200].

[213] ibid [199].

[214] ibid.

[215] *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania* (n 43) [483].

[216] See, e.g., J Hepburn, 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (n 73) 545-546 (looking at the issue from a 'textual' and 'good faith' point of view and remarking that: "The phrasing typically used does not require investments to be 'in substantial accordance with' host state law, but only to be 'in accordance with' host state law" and that "[i]nvestors ought not to be penalized to the extent of losing their ability to claim under investment treaties when they have breached only minor formalities in local laws. States may also be tempted to abuse very technical rules in their own laws to catch out investors unfairly"); A Carlevaris (n 7) 47 (approaching the issue from a teleological viewpoint and commenting that "[t]o exclude from protection under a BIT assets and activities which are covered by the definition of investment, but present minor irregularities under domestic law, would defeat the purpose of promoting investments, which is the main *raison d'etre* of both the Washington Convention and the numerous bilateral and multilateral investment instruments. Such an interpretation of the requirement would have a paradoxical effect in case of formal errors or other irregularities of minor importance. Furthermore, this interpretation may likely be abused by States that are obviously in a better position to take advantage of every minute detail of their legal system"); C Knahr (n 7) 24.

[217] See C Knahr (n 7) 24.

yardsticks could always be of service to the tribunal in recognising such laws, like whether the violation of the law is 'curable', whether the violation is sanctioned by the law at all, or whether it is simply sanctioned by an indeed nominal fine. Thus, if, for instance, the investor fails or forgets to fill in one blank area in a bidding document, for example, to announce the turn-over of the previous fiscal year of its company, this cannot be considered as a critical violation of the laws of the host state. After all, it is not a misrepresentation, and not surely an influential one. Furthermore, it is easily 'curable' by simply providing information when the defect is recognised. An actual example of such errors can be found in *Tokios Tokeles v. Ukraine* case.[218] In this case, Ukraine argued that the investments of *Tokios Tokeles* were not made in accordance with the laws of the host state since the claimant had not registered its subsidiary properly because only 'subsidiary enterprise' and not 'subsidiary private enterprise', as the claimant's subsidiary was called, was an accepted legal form under the laws of Ukraine.[219] It is clear, as the *Tokios Tokeles* tribunal correctly noted,[220] that the violation of such *de minimis* laws, which concern negligible formalities, does not trigger the legality requirement.

126. Having said that, I should note that another type of violation that could be characterised as a 'constructive' trivial breach is a violation of host state law which acts not in favour, but to the detriment of the investor itself. In *Inmaris Perestroika Sailing Maritime Services GmbH and Others v. Ukraine*,[221] one question before the tribunal was whether by failing to register the investment contract in accordance with Ukraine's Law on Foreign Investments Regime, the claimant has committed an illegality that should be remedied by denying jurisdiction. The tribunal reviewed Ukraine's Law and held that although registration of certain investment contracts is 'mandatory' under Ukrainian law, this is "in the sense that such registration is required if the parties to the contract wish to take advantage of legal protections for foreign investors, as well as certain tax and customs benefits that are conferred on foreign investments, under the laws of Ukraine." It further noted that while "the Law stipulates that contracts with foreign investors for "joint investment activity" should be registered, it also states the consequences of a failure to do so: "[u]unregistered foreign investments shall not provide privileges and guarantees stipulated by this Law."" Therefore, the tribunal concluded that the Law did not suggest that unregistered investments are illegal as such, and, thus, held that the claimants' investments was not contrary to Ukrainian law, and, therefore, outside the Treaty's protection by virtue of the fact that claimants did not avail themselves of the benefits of Ukraine's foreign investment law through registration of their contracts.[222]

127. All in all, two kinds of violations of host state law can be considered to be out of the 'substantive scope' of the legality requirement: (i) violation of mere curable legal formalities

[218] *Tokios Tokeles v. Ukraine* (n 207).

[219] ibid [83].

[220] ibid [86].

[221] *Inmaris Perestroika Sailing Maritime Services GmbH and Others v. Ukraine*, ICSID Case No. ARB/08/8, Decision on Jurisdiction, 08 March 2010.

[222] ibid [144]-[145]. However, it should be noted that under certain international investment agreements, in order to gain BIT protection, the investor has to obtain a license from internal foreign investment authorities of the host state. For instance, Article 2 of the Agreement on Reciprocal Promotion and Protection of Investments between the Government of the Republic of Turkey and the Government of the Islamic Republic of Iran, signed on 21 December 1996, entered into force on 13 April 2005, provides: "This Agreement shall only apply to investments approved by the competent authorities of the host Contracting Party." Under such circumstances, failure to get an investment license culminates in the inapplicability of the treaty to the recalcitrant investor due to its failure to fulfil a stipulated threshold condition of the subject-matter of the agreement, i.e. investment. See Chapter 1, p 49.

with no substantial or very light sanctions under the laws of the host state, i.e., *de minimis* laws of the host state; (ii) violation of laws which their infringement does not harm the state in any way and are solely aimed at protecting the interests of the investor itself.

2nd. *Violation of Fundamental Laws of the Host State*

128. It goes without saying that, according to 'the ordinary meaning of the terms' of a typical legality requirement, fundamental laws of the host state, at the highest end of the spectrum of importance, are admittedly within the 'substantive scope' of the legality requirement. Indeed, an 'effective interpretation' would dictate that without the inclusion of such laws in the 'substantive scope' of the legality requirement, the clause would be absolutely devoid of any meaning and effect. It is arguable that the significance of such laws for states is so high that, without the involvement of such laws in the legality requirement, the purpose of economic development would not be achieved.[223] In fact, it is very hard to ascribe an intention to a state contracting party to an investment agreement according to which the state would offer international substantive and procedural protection to an investment which has been made in violation of the 'fundamental laws' of the host state.

129. The fact that such laws are subsumed within the 'substantive' reach of the requirement is confirmed by several investment treaty tribunals: In 2006, in *LESI and Astaldi v. Algeria*, the tribunal stated that investments would be excluded from treaty protection when made in violation of fundamental principles of law in force in the host state.[224] In 2008, the *Desert Line v. Yemen* tribunal opined that the legality requirement is "intended to ensure the legality of the investment by excluding investments made in breach of fundamental principles of the host State's law, e.g. by fraudulent misrepresentation or the dissimulation of true ownership".[225] Similarly, in 2009, in *Rumeli v Kazakhstan*, the arbitral tribunal held that investments would be denied protection if they were made "in breach of the fundamental legal principles of the host country".[226] In addition to the ones just mentioned, almost all authorities cited so far are in agreement that fundamental laws of the host state are certainly subsumed under the 'substantive scope' of the legality requirement, though some believe that they are not the only laws that should be complied with when making the investment.

130. That being said, one should bear in mind that the difficult question is not whether 'fundamental laws of the host state' fall squarely within the 'substantive scope' of the legality requirement. This is absolutely settled. Rather, the real question in practice is how to discern such laws? Indeed the phrase 'fundamental laws of the host state' is vague itself and is not a 'judicially operational' term and, thus, needs clarification.[227]

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[223] U Kriebaum (n 76) 319.

[224] *L.E.S.I. S.p.A. and ASTALDI S.p.A. v. République Algérienne Démocratique et Populaire* (n 75) [83].

[225] *Desert Line Projects LLC v Yemen* (n 75) [104].

[226] *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan* (n 75) [319].

[227] In the context of assessing the usefulness of the literal definitions offered for the standard of 'fair and equitable treatment', the *Suez* tribunal correctly observed that:

> What, then, is the meaning of "fair and equitable treatment" with respect to the investments undertaken by the Claimants? Philosophers and scholars have devoted tomes to the subject of fairness […] While their work is helpful in understanding the abstract concept and its implications, it does not answer a fundamental and practical question that every arbitral tribunal must answer: By what criteria, standard, or test is an arbitral tribunal to determine whether the specific treatment accorded to the investments of a

131. An articulation of the violations of 'fundamental laws' of the host state is offered by the tribunal in *Teinver v. Argentina*, which takes an inventory of the forms of illegal conduct which can set going the legality requirement:

> (a) lack of authorization to sign the agreement;
>
> (b) fraud or critical omission with regard to an investor's self-presentation during the bidding process;
>
> (c) engagement in any corruption; or
>
> (d) failure to comply with bidding or other procurement requirements.[228]

132. This seems a rather good but not very precise stocktaking of the relevant significant violations. Depending on the jurisdiction, the first type of violation (i.e. lack of authorisation to sign the agreement) renders a contract either invalid, incapable of being performed, unenforceable, null and void, or voidable. Therefore, it is a fundamental breach of host state law.[229] The second type of breach (i.e. fraud and misrepresentation) is undoubtedly a significant violation, the triggering effect of which has also been approved by other tribunals.[230] The third type of violation (i.e. corruption) is the prime example of a significant violation activating the exclusionary effect of the legality requirement. Other tribunals have endorsed this.[231] Finally, as to the fourth type of violation, i.e. failure to comply with bidding or other procurement requirements, it should be said that laws relating to bidding and procurement are usually of mandatory or otherwise important nature since they deal with 'public interests' and 'essential public needs'. However, as exemplified above, not every failure to abide by such laws is equivalent to a violation of fundamental laws of the recipient state. For instance, if just one box is left unfilled in a bidding application form concerning the name of one of the shareholders, it does not seem that such a violation would bend important

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> particular foreign investor in a given context is or is not "fair and equitable."? To say that "fair and equitable" means " just," "even-handed," "unbiased," or "legitimate," as some tribunals have done […] is quite frankly to state a tautology. Such formulations are not *judicially operational* in the sense that they lend themselves to being readily applied to complex, concrete investment fact situations, like those found in the present cases. [footnotes omitted] [emphasis added]

See *Suez, Sociedad General de Aguas de Barcelona, S.A.and Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19 (formerly *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A.and Vivendi Universal, S.A. v. Argentine Republic*), Decision on Liability, 30 July 2010 [221]. Similarly, the phrase 'fundamental laws of the host state' used by certain tribunals and commentators is not very helpful and does not assist an investment treaty tribunal when faced with actual specific questions.

[228] *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction, 21 December 2012 [327].

[229] The better approach, however, is to single out issues relating to the formation of the investment agreement and discuss them while dealing with the issue of creation and existence of property rights/interests. However, this would largely depend on the way the respondent has framed its defensive structure and whether it has raised the defence of the inexistence of the investment or has just brought and organised its defence under the single guise of illegality.

[230] See, e.g., *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (n 7); *Desert Line Projects LLC v Yemen* (n 75) [104]; *Plama Consortium Limited v. Republic of Bulgaria* (n 38) [136]-[137], [140]. In the context of the issue of legitimate expectations, see *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL, Arbitral Award, 26 January 2006 [164] (noting that due to its misrepresentations vis-à-vis the Mexican authorities, the claimant could not reasonably rely on a representation made by a Mexican state entity).

[231] *World Duty Free Company v Republic of Kenya* (n 50); *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2).

provisions of bidding laws and regulations of the receiving country. This defect is perfectly 'curable'.

133. Another investment treaty tribunal also lists a number of violations that hit the 'fundamental laws of the host state'. According to the *Hochtief* tribunal, "investments that are […] dependent upon government approvals that were not in fact obtained, or which were effected by fraud or corruption can be caught by a provision such as Article 2(2) of the Argentina-Germany BIT…"[232] Although the violation of the laws relating to anti-bribery and prevention of corruption does seem to trigger the legality requirement, the tribunal fails to offer a more comprehensive list of fundamental laws of the host state.

134. In my opinion, the better and the more practical view would be to identify the 'fundamental laws' by reference to their character and their position within the hierarchy of the legal system of the host state. In this way, an investment treaty tribunal would have more useful and concrete tests at hand, rather than unclassified lists of certain limited number of laws addressed in a few cases decided before. In my viewpoint, three categories of laws compose such 'fundamental laws' for the purpose of the 'substantive scope' of the legality requirement: (i) constitutional laws; (ii) organic laws; and (iii) mandatory or compulsory laws.

135. As to the first category, i.e. constitutional laws, I note that on top of all the laws of a state stands the Constitution. A Constitution, in its broad sense, is a law which "attributes power to public authorities", "regulates the fundamental relations between public authorities" and "regulates the fundamental relations between the public authorities and the individual".[233] Constitutions usually contain provisions on "private property rights", "the ability of foreigners to secure legal rights in land", and "foreign investors' freedom to make and enforce contracts".[234] Be that as it may, it is possible that certain principles and/or articles in the Constitution would never meet foreign investments in practice like principles exclusively concerning the political rights of the nationals of the state concerned, like the right to vote. It is also possible that certain provisions of the Constitution do not set forth fundamental principles. Those non-economic and nonessential rules could be said to be excluded from the scope of the legality requirement as far as 'fundamental laws of the host state' are concerned.[235]

136. Turning now to the second category, in certain legal systems, a statutory layer exists between the Constitution and ordinary laws. These legal instruments are called 'organic statutes', or as per Article 46 of the French Constitution, '*lois organiques*'. Organic statutes are laws and rules which regulate and control significant political and economic matters which are not regulated by the Constitution.[236] Clearly, such laws are also of cardinal importance and should fit within the phrase 'fundamental laws of the host state'. In *Alasdair v. Canada,* the

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[232] *Hochtief AG v. The Argentine Republic* (n 212) [199].

[233] AW Heringa, *Constitutions Compared: An Introduction to Comparative Constitutional Law* (4th edn, Intersentia 2016) 3-4.

[234] See JW Salacuse (n 6) 89. For instance, Article XVI, Section 11(1) of the Constitution of the Philippines prohibits any foreign ownership in the mass media sector. Additionally, under Section 2 of Article XII of the Constitution of the Republic of Philippines, the only persons qualified to acquire or hold lands in the public domain are Filipino citizens and corporations 60 percent of whose capital is owned by Filipino citizens. See the 1987 Constitution of the Republic of the Philippines.

[235] J Hepburn, 'In Accordance with Which Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (n 73) 539.

[236] AW Heringa (n 233) 149-150.

tribunal found that the violation of the Organic Law of the Central Bank of Costa Rica triggers the legality requirement.[237]

137. The third category is ‘mandatory’ or ‘compulsory’ laws of the host state. In contrast to ‘voluntary laws’, the synonyms ‘mandatory laws’, ‘obligatory laws’, ‘compulsory laws’, or ‘imperative laws’ (*ius cogens* in Latin) are composed of rules which are applicable regardless of the wills of the persons who are influenced by those rules.[238] In my view, ‘mandatory laws’ of the host state are necessary ingredients of ‘fundamental laws of the host state’. Such laws have been defined to include provisions of law designed to protect the political, social, and economic organisation of a country.[239] As such, mandatory laws are pertinent to the ‘public interest’ of the state concerned.[240] Having this general definition of mandatory laws in mind, below, I will try to introduce some of the usually salient relevant mandatory laws of the host state.

138. Criminal laws are usually amongst – and could be characterised as prime examples of – the mandatory laws of the host state. Crimes involving corruption, particularly bribery,[241] as well

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[237] *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [55].

[238] R Youngs (n 78) 86. According to Articles 3(3), 3(4), 6(2) and 8(1) of the Rome I Regulation on the Law Applicable to Contractual Obligations, mandatory laws are provisions that cannot be derogated from by agreement. Furthermore, as per Article 9(2) of the same Regulations, mandatory laws “are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract”.

[239] *Joined Cases C-369/96 Jean-Claude Arblade, Arblade & Fils SARL and C-376/96 Bernard Leloup, Serge Leloup, Sofrage SARL* [1999] ECR I-8453 [30].

[240] According to Pierre Mayer, mandatory laws are the reinforced and elevated version of the rules of public policy. P Mayer (n 160) 278. See also M Blessing, ‘Mandatory Rules of Law versus Party Autonomy in International Arbitration’ (1997) 14(4) J Int’l Arb 23-24.

[241] *World Duty Free Company v Republic of Kenya* (n 50); *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2).

as crimes involving fraud[242] have been decided by investment treaty tribunals to trigger the legality requirement.[243] [244]

139. Mandatory laws of the host state are not limited to criminal laws. Certain laws relating to foreign investment are also of a mandatory nature. Thus, failure to obtain mandatory licenses prescribed by foreign investment law of the host state would also culminate in breach of fundamental and mandatory laws of the host state, which would, in turn, trigger the legality requirement.[245] For the same reason, more general economic laws relating to ownership and control of key public infrastructure (like airports, rail and road transport, energy grids, etc.) and key public entities, like anti-dummy, tender, and public procurement laws are also included within the framework of mandatory laws of the host state.[246] A specific practical example of such laws is the Anti-Dummy Law of Philippines at issue in *Fraport v Philippines*.[247] In that case, a breach by the investor, which deprived Philippines' nationals of the minimum

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[242] *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (n 7); *Desert Line Projects LLC v Yemen* (n 75) [104]. Particularly, in this connection, the *Vladislav* tribunal correctly held that:

> [T]he Tribunal may conclude, on the basis of an examination of the law of the Host State and the facts that pertain to an allegation, that there has been non-compliance with legislation sufficient to trigger the legality requirement. *In this regard, the commission of a criminal offence under Article 168 [on prohibition of fraud], if established, would constitute an illegality sufficient to cause the investment to fall outside the scope of Article 12 of the BIT as the loss of the protection of the BIT, and the vitiation of the Tribunal's jurisdiction, would be a proportionate response to an illegality of such significance.* [emphasis added]

See *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [522].

[243] On a related note, Douglas identifies another problem with asserting jurisdiction with respect to investments made in violation of the penal laws of the host state. He opines that to grant a civil remedy to a person who has violated the criminal law also results in undermining the deterrent effect of the criminal law. See Z Douglas (n 203) 167. This, indeed, would be another ill-effect of ignoring the violation of 'fundamental laws' of the host state for the purposes of the legality requirement.

[244] I should add here that in case the investment is illegal under domestic law '*per se*', to borrow examples from the *Phoenix* tribunal, like "investments made in pursuance of torture or genocide or in support of slavery or trafficking of human organs", one could, beyond the shadow of a doubt, hold that the investment is not protected by the investment treaty, *inter alia*, because it amounts to illegality under an 'in accordance with the host state law' requirement. See *Phoenix Action Ltd v. Czech Republic* (n 39) [78]. In *Mytilineos v. Serbia*, dismissing the respondent's objection to granting investment protection to the claimant on the basis of alleged non-compliance with the laws of the host state, the tribunal made note of the fact that the investment operation itself was not illegal *per se*. It cited and relied on *Tokios Tokeles*, paying regard to the fact that it was critical for the *Tokios Tokeles* tribunal that the investment activity as such was legal: "The [*Tokios Tokeles*] tribunal rejected this claim and found that Claimant's activity was covered by the definition of investment under the BIT since those investment activities in the publishing business were not illegal under the law of the host State. The tribunal further suggested that minor registration irregularities are harmless errors as long as the investment was not 'illegal *per se*'." *Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia*, UNCITRAL, Partial Award on Jurisdiction, 08 September 2006 [151]. [Footnote omitted]; T Obersteiner (n 91) 276.

[245] *Hochtief AG v. The Argentine Republic* (n 212) [199].

[246] *Desert Line Projects LLC v Yemen* (n 75) [104]; U Kriebaum (n 76) 320; P Mayer (n 160) 288, fn. 29 and the accompanying text (saying that the most widely held opinion is that rules of public law are a subset of mandatory rules of law.); M Blessing (n 240) 23-24; R Youngs (n 78) 86.

[247] *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2).

shareholding required under the above-mentioned law, culminated in a violation of a mandatory or a fundamental provision of the law of the recipient state, and consequently, set the legality requirement of the underlying investment treaty in motion.

140. In addition, laws of mandatory nature could also be of classical civil nature, like the conditions for the validity of a contract.[248] For instance, submitting false financial or technical information or misrepresenting financial or technical capabilities, in case such false information and misrepresentations induce the state to select a bidder as a winner of a bidding process[249] — which not only might involve the breach of criminal and tender laws of the host state but also may violate rules of classical civil nature regarding conditions for validity of contract — may activate the legality requirement.

141. A number of other laws which aim to protect the public interest and the public policy of the host state are also inside the realm of mandatory laws of the host state.[250] According to Pierre Mayer, the most frequently-encountered mandatory laws in international arbitration, all of which seek to safeguard the 'public interest' and the 'public policy' of the host state, are the following: competition laws, currency control laws,[251] environmental protection laws, measures of embargo, blockade, or boycott, and laws designed to protect parties presumed to be in an inferior bargaining position, such as wage-earners or commercial agents.[252]

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[248] *Plama Consortium Limited v. Republic of Bulgaria* (n 38) [136]-[137], [140] (finding that the claimant had violated Articles 27 and 29 of the Bulgaria's Obligations and Contracts Acts). See also AFM Maniruzzaman, 'International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview' (1990) 7(3) J Int'l Arb 53–64, 53 (saying that "[t]here are certain matters which fall within the exclusive jurisdiction of the host country's national law, as may be described the "reserved domain" of the national law. These matters relate to the validity of the contract in form and substance ..." He further goes on to elaborate on his proposition, indicating, in the context of 'concession contracts', that: "The laws relating to the form and conditions of the grant of concession, the power of the conceding authority, the necessity or otherwise of a ratification of the agreement and the observance of such other constitutional or administrative formalities which may be required in order to give effect to the concession, are all matters falling within the domain of the national law of the conceding State." ibid 58. See also R Youngs (n 78) 86 (exemplifying compulsory laws by formal legal conditions set forth for certain contracts, saying that: "One example of compulsory law is the requirement that certain types of contract shall conform to preconceived matters … [f]or instance, a contract to create a property right must usually create only one that is of a kind already recognised by law …")

[249] A similar situation occurred in *Inceysa Vallisoletana S.L. v. Republic of El Salvador*. However, in a blameworthy approach, the tribunal in that case did not determine which of the positive laws of El Salvador were breached by the investor.

[250] In the context of conflict of laws, Maniruzzaman indicates that "matters as the State may require to be performed in the public interest under its mandatory public law rules … fall within the exclusive jurisdiction of the host country's national law, as may be described the "reserved domain" of the national law". AFM Maniruzzaman (n 248) 53.

[251] With respect to the importance of exchange control regulations, one commentator notes that "violations of exchange controls normally constitute criminal offences in the foreign country concerned and often result in severe penalties including fines and imprisonment or both." See JW Salacuse (n 6) 84.

[252] P Mayer (n 160) 275. See also AFM Maniruzzaman (n 248) 57-58 (giving some examples of such laws: "…import-export rules; foreign exchange regulations; competition laws; taxation laws; measures of embargo, blockade or boycott; expropriation, nationalization and confiscations, etc.") In addition, a survey on some of the most recent model BITs and concluded investment treaties reveals certain areas of 'public interest' which the states have highlighted their preservation even in the preamble of these instruments. For instance, the sixth recital of the Preamble of the US Model BIT (2012) emphasises that the "protection of health, safety, and the environment, and the promotion of internationally recognized labor rights should not be sacrificed for achieving other investment treaty objectives." See also the preamble of the Agreement for the Promotion and Protection of Investment between the Government of the Republic of Austria and the Government of the Kyrgyz Republic, signed on 22 April 2016, not yet entered into force (stating, *inter alia*, that the Contracting Parties agree that the other objectives in the treaty "can be achieved without

142. Having identified a number of mandatory laws which stand as decent candidates to fit within the definition of the term ‘fundamental laws’ of the host state, one should admit that in certain instances it is difficult for an investment treaty arbitral tribunal to ascertain the mandatory nature of a given legal provision.[253] Nevertheless, there exist certain clues which could assist an arbitration tribunal in resolving this issue. The best tool to recognise the ‘imperativeness’ of a given rule of law is the legal provision itself, or the interpretive rules included in the legal Act or Code embodying the provision at stake.[254] Therefore, if the pertinent article stipulates that the rules contained therein cannot be derogated from by agreement, or more explicitly says that the rule in question is obligatory, mandatory, imperative, compulsory, etc. the tribunal can easily determine that the law at issue has a mandatory nature, the violation of which is equivalent to ‘non-compliance’ with the laws of the host state for the legality requirement’s purpose.[255] However, not all the legal provisions are crystal-clear as to their nature. In many cases, the laws are silent as to whether they are

relaxing health, safety and environmental measures of general applications”, and that they recognise that: “the development of economic and business relations can promote respect for internationally recognised labour rights”.) In the same vein, certain treaties include an apparently non-legally binding commitment by the contracting parties to abstain from relaxing the ‘public interest’ protection standards as a means of attracting or maintaining investment in their territories. See, for instance, Article 15 of the Agreement between Canada and Mongolia for the Promotion and Protection of Investments, signed on 08 August 2016, entered into force on 24 February 2017 (stating that: “The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.”) The most comprehensive articulation of laws preserving public interests of the host state in an illustrative manner has been set out by Article 12(1) of the Indian Model BIT (2015).

> **Article 12: Compliance with Law of Host State**
>
> 12.1 Investors and their Investments shall be subject to and comply with the Law of the Host State. This includes, but is not limited to, the following:
>
> (i) Law concerning payment of wages and minimum wages, employment of contract labour, prohibition on child labour, special conditions of work, social security and benefit and insurance schemes applicable to employees;
>
> (ii) information sharing requirements of the Host State concerning the Investment in question and the corporate history and practices of the Investment or Investor, for purposes of decision making in relation to that Investment or for other purposes;
>
> (iii) environmental Law applicable to the Investment and its business operations;
>
> (iv) Law relating to conservation of natural resources;
>
> (v) Law relating to human rights;
>
> (vi) Law of consumer protection and fair competition; and
>
> (vii) relevant national and internationally accepted standards of corporate governance and accounting practices.

[253] As mentioned rightly by Pierre Mayer, the mere argument of the state that the law in question is mandatory does not suffice. See P Mayer (n 160) 292.

[254] R Youngs (n 78) 86.

[255] For instance, as per Articles 22 and 48 of Iran’s Notarial Law (1932), sale of immovable properties in Iran should be notarised. Thus, if a sale contract is concluded without the formal requirement of notarisation, the buyer cannot prove and rely on the acquisition of ownership by virtue of the sale contract before government offices, administrative agencies or courts.

‘permissible’ or ‘mandatory’.[256] In such situations, the tribunal could be handed with the guiding principles in the Constitution of the host state[257] and the decisions of judicial organs of the host state interpreting the nature of such laws (preferably if those decisions have been made by the highest judicial authorities of that state). Furthermore, and as always, the panel could be helped with an expert legal opinion on matters of host state law.[258]

143. A final point to make is that a ‘good faith’ interpretation necessitates the inclusion of only mandatory provisions of compulsory laws, not just any provision which pops up in laws with a general compulsory label. To elaborate on this point, it is widely known and accepted that penal codes are considered to be mandatory laws.[259] However, not all the provisions of such codes are so significant. The significance level of a provision can be recognised, *inter alia*, by reference to the sanction or punishment prescribed by the relevant provision of the code for the crime at stake. For certain offences, criminal punishment is a negligible fine. Thus, violation of such provisions could be said to fall outside the scope of the legality requirement. On the other hand, the sanction of imprisonment, compulsory dissolution of a company, and forfeiture of assets are heavy punishments which speak in favour of the significant nature of the violation.[260] Infringing such provisions of law would, in all likelihood, be caught by the legality requirement. The same observation can be made with respect to mandatory civil liability laws. Thus, in case the civil violation is sanctioned by the legal act being declared as void, invalid or voidable, the provision in question is most probably a fundamental provision. On the other hand, in case the violation is curable and not sanctioned by the legal act being declared as void or voidable, the provision in question is often not fundamental.[261]

144. In conclusion, if a violation on the part of the investor concerns fundamental provisions of the laws of the host state, including its Constitution, its organic laws, or its mandatory laws, then the violation triggers the operation of the legality requirement. Under this rule, if the violation concerns an insignificant provision within a law with a mandatory label, like a misdemeanour sanctioned by payment of a small fine, then the violation could not be said to activate the legality requirement.

3rd. *Violation of Ordinary Laws of the Host State*

145. So far, I have demonstrated that, first, the violation of *de minimis* laws of the host state does not trigger the legality requirement, and, second, the violation of fundamental laws of the

[256] See A Sayed, *Corruption in International Trade and Commercial Arbitration* (Kluwer Law International 2004) 38 (saying that “[T]he imperative nature of any given law is normally established by reference to the letter of the particular enactment, which could contain … an explicit legislative intent signifying that such a legislation is imperative.” However, he goes on to admit that in most cases, an explicit statement in the law to specify its mandatory and imperative nature is unavailable, and it is the task of the judge or the arbitrator to determine the nature of the law or legislation in question). See also R Youngs (n 78) 86.

[257] J Hepburn, ‘In Accordance with Which Host State Laws? Restoring the ‘Defence’ of Investor Illegality in Investment Arbitration’ (n 73) 538-539.

[258] See Chapter 4.

[259] See paragraph 138 *supra*.

[260] For instance, under Iranian law, the punishment for bribery is, *inter alia*, forfeiture of property and/or imprisonment from 6 months to 5 years. See Article 3 of the Aggravating the Punishment for the Crimes of Embezzlement, Bribery, and Fraud (1988).

[261] Cf *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [406], second bullet point. On this point, Knahr expresses the opinion that “actions either leading to civil liability or constituting criminal offences under domestic law would be illegal, consequently not being “in accordance with host state law”. C Knahr (n 7) 24.

host state triggers the legality requirement. Having formed an opinion with respect to the two ends of the spectrum of the laws of the host state, I should now turn to the third group of such laws, i.e. ordinary laws. It goes without saying that by merely carving out the trivial violations of the host state from the 'substantive scope' of the 'in accordance with the law' clause, one cannot limit the scope of the legality requirement to only fundamental laws of the host state.[262] The simple reason is that there lies another body of laws between *de minimis* laws and fundamental laws, those laws being ordinary laws of the host state. Put differently, there is a gap between *de minimis* laws and fundamental laws of the host state which is filled by ordinary laws of that state. This gap has been noticed by some commentators. According to one commentator, there are different sorts of violations of host state law: from the violation of significant laws to the violation of trivial legal technicalities with a grey area sitting in between. Kriebaum notes in this respect that:

> It is clear that not every minor infraction will lead to a denial of investment protection. Only breaches of fundamental norms of a legal order will have such an effect. The significance of the contravention to host State law will be the most important factor in the decision whether the legitimacy of the investment as a whole is at stake. Sometimes the gravity of the contravention on its own will not provide an exact line between cases where investment protection should be denied and those where it should be upheld. *At the two ends of the spectrum – very important norm and minor formality – decisions will be easy to take*.[263] [emphasis added]

Thus, she takes cognizance of the fact that there are other violations of the laws of the host state as to which – in contrast to the cases of infringement of fundamental laws and *de minimis* laws of the host state – decision-making is not easy. With that said, she then goes on to pinpoint factors for decision-making in situations where the laws sitting in the middle of these two spectrums have been violated by the investor.[264]

146. Certain tribunals have voiced that the legality requirement can be activated by the violation of any of the 'prevailing laws' of the host state, and, thus, have effectively opined that the requirement is not just limited to fundamental laws. In *Anderson v. Costa Rica*, the tribunal held that in order to assess the legality of the establishment of the investment, "one must of necessity examine how the possession or ownership of that property was acquired and in particular whether the process by which that possession or ownership was acquired complied with *all of the prevailing laws"*.[265] [emphasis added] Therefore, according to this tribunal, the 'substantive scope' of the legality requirement is not merely confined to laws relating to

[262] See *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [395].

[263] U Kriebaum (n 76) 319. On this matter, Carlevaris opines that the decisions rendered until 2008 "failed to enter into a detailed analysis of this question, and provide no guidance as to the distinguishing criteria - either by reference to the seriousness of the violation or to the nature of the provisions allegedly violated - between significant wrongful acts that entail exclusion from protection and minor irregularities which would not have this exclusionary effect. Although one can approve of the distinction to be drawn between insignificant administrative irregularities, such as those apparently invoked in *Tokios Tokeles*, and serious wrongful acts that might possibly amount to criminal offences, as in *Inceysa*, less extreme situations would be difficult to assess." A Carlevaris (n 7) 47.

[264] U Kriebaum (n 76) 320 *et seq.*

[265] *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [57].

foreign investment, or only to fundamental laws, but covers all the laws and regulations that are applicable to acquiring possession and/or ownership. Such laws could be of fundamental or ordinary nature.

147. Bearing these points in mind, one should consider situations in which the violation concerns normal and ordinary laws, which neither could be characterised as fundamental laws, nor as mere technicalities. It is the opinion of the present author that violation of ordinary laws of the host state would also trigger the legality requirement if the investment at stake could not have been made or could not have been successful but for the violation of the ordinary law(s) in question. I find support for this view in the ordinary meaning of the terms used for expressing a legality requirement. A typical legality requirement would provide: "The term "investment" refers to every kind of property or asset … invested by the investors of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the other Contracting Party …"[266] This provision plainly links the act of 'investing' to the observance of the laws of the host state. Thus, according to 'the ordinary meaning' of the terms of this provision, if an investment cannot be realised or established without the violation of the laws of the host state, that investment is caught by the exclusionary effect of the legality requirement.

148. Assume that an investment regulation of the host state requires foreign investors in the field of infrastructure to obtain, among other things, a construction authorisation before commencing the project. Suppose that the investor fails to obtain a construction permit, without which the investment operation could not have commenced. The investor nevertheless goes on and commences the project. In the wake of a dispute, upon consideration and analysis by an investment treaty tribunal, it becomes clear that under the circumstances and based on the available evidence, due to lack of the required technical standards, the construction permit would, more likely than not, have been denied by the pertinent authority had the investor applied for it. In this situation, the investor has apparently not violated a mandatory rule of host state law but has secured the investment by infringing an ordinary law of the host state. This is a situation which, according to my thesis, triggers the legality requirement. On the other hand, if according to the same regulation, the investor was required to acquire a license from the central bank of the recipient state not as a condition precedent for the commencement of the project, but only for the purpose of the legal channeling of investment revenues and proceeds, in case the investor fails to obtain such a permit, not because it could not get the license or the license would have been denied by the central bank, such violation cannot be considered as one activating the legality requirement. Indeed, whilst both violations of the investment regulation in question occurred in the process of the establishment of the investment, only the former, i.e., the failure to obtain the construction permit, was linked to the very establishment of the investment and allowed its commencement in violation of the law.

149. This view is supported by two prominent decisions which highlight that one should check the link between the acquisition or the success of the investment and compliance with the laws of the host state. I borrow the first support from the above-mentioned text in the *Anderson v. Costa Rica* award, where the tribunal expresses that: "one must of necessity examine how the possession or ownership of that property was acquired and in particular whether the process

[266] See Article 1(1) of the Agreement between the Government of the Lebanese Republic and the Government of the Islamic Republic of Iran on The Reciprocal Promotion and Protection of Investments, signed on 28 October 1997, entered into force on 14 May 2000.

by which that possession or ownership was acquired complied with all of the prevailing laws".[267] Thus, according to this tribunal, if possession or ownership of the investment is not acquired in accordance with the laws of the host state, the legality requirement acts to deprive the investor of investment treaty protection. A yet better support for this proposition can be found in the *Fraport* Award. In examining whether the making of the investment was tainted with illegality, the tribunal considered the effect of illegality on the profitability of the investment and its role in securing the investment. The Tribunal held:

> … Another indicator that should work in favour of an investor that had run afoul of a prohibition in local law would be that the offending arrangement was not central to the profitability of the investment, such that the investor might have made the investment in ways that accorded with local law without any loss of projected profitability.[268]

The tribunal had already dealt with the specific facts of the case and had found that Fraport considered that without the illegal arrangements the investment could not operate in a profitable way:

> … In the context of the internal Fraport documents, the secret shareholder agreements show that Fraport from the outset understood, with precision, the Philippine legal prohibition but believed that if it complied with it, the prospective investment could not be profitable.[269]

The tribunal further noted that:

> The record indicates that … local counsel explicitly warned that a particular structural arrangement would violate a serious provision of Philippine law. Moreover, the violation qua violation was explicitly discussed at the level of the Board of Directors. In view of the due diligence study prepared by financial experts (who had apparently not been briefed on the local law restrictions), the investor, Fraport, concluded that the only plausible way for its equity investment to prove profitable was to arrange secretly for management and control of the project in a way which the investor knew were not in accordance with the law of the Philippines. This was accomplished by Article 2.02 of the […] Shareholders' Agreement of 6 July 1999 which allowed Fraport […] to have a casting and controlling vote over matters which fell within its 'area of expertise and competence'. Thus the violation could not be deemed to be inadvertent and irrelevant to the investment. It was central to the success of the project. The awareness that the arrangements were not in accordance with

[267] *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [57]

[268] *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [396].

[269] ibid [355].

> Philippine law was manifested by the decision to make the arrangements secretly and to try to make them effective under foreign law [...][270]

150. According to these two authorities, in particular, the second, in case the making or the success of the investment is hinged on the violation of the laws of the host state, the violation would trigger the legality requirement. In such situations, without committing the illegality, the investor would not have secured the investment or would not have made a successful investment. Hence, the illegality would taint the core of the investment. Thus, the critical question to be asked by the court or tribunal is whether the investor could have successfully made the investment or could have made an investment which was successful, but for the violation of host state law?

151. In terms of doctrinal support for this idea, Kriebaum considers 'the importance of the offending arrangement for the profitability of the investment' as a 'further element' in analysing the compliance with the host state law for the purpose of the legality requirement.[271] In contrast, the present Thesis suggests that 'the importance of the offending arrangement for the profitability of the investment' is not just a 'further element' in the analysis scheme, but could be a separate basis for dismissing a case on jurisdiction or admissibility, as the case may be, when the violation in question concerns, not necessarily a fundamental law of the host state, but also a normal or ordinary law of the recipient state, provided that such violation is an inevitable element for the making of an investment or its success.

152. Therefore, the second type of legality-triggering situation focuses both on the effect that the violation of a law has on the making or the success of the investment as well as the nature of the law violated. Subsequently, unlike in cases of violations of the fundamental laws of the host state, a situation in which ordinary laws have been violated entails a more fact-specific and a more case-by-case analysis.

153. Having said that, I should emphasise that not all violations of the ordinary laws of the host state would trigger the requirement. It could very well happen that ordinary laws of the host state are violated, nonetheless, there is no link between the very establishment or the success of the investment and the violation of the law. This absence of a link could be evidenced, *inter alia*, by the 'curability' of the breach. In *Mamidoil v. Albania*, the respondent argued that the claimant had not obtained a number of critical licenses (including construction, environmental, and exploitation permits). On the other hand, Mamidoil asserted that Albania had "consistently acknowledged the legality of the investment" over the last 12 years. The tribunal found that Mamidoil had failed to obtain the exploitation and construction permits and that these failures were more serious than 'minor administrative errors'. The tribunal dismissed Mamidoil's view that respondent's preliminary approval of the project created an obligation for Albanian authorities to issue the permits. Rather, according to the tribunal, such an obligation would have only arisen once the claimant properly applied for the permits. The tribunal also found that as of 2003, Albania had consistently insisted that the authorisations are lacking.[272] The tribunal also noted that Albania had, nevertheless, offered to cure the claimant's illegality. According to the tribunal, this proved that "in that State's own appreciation, the illegality of the investment was susceptible of being cured". Thus, the tribunal upheld jurisdiction and

[270] ibid [398].

[271] U Kriebaum (n 76) 323.

[272] *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania* (n 43) [468], [472].

decided to assess the legal importance of the absence of permits as a matter of merits.[273] As can be seen from this example, if an ordinary law of the host state is violated but the violation is not central to the making of the investment, the tribunal can assert jurisdiction since the legality requirement is not engaged.

154. In conclusion, the 'substantive scope' of the legality requirement includes fundamental laws of the host state (including its Constitution, its organic laws (if any), and mandatory provisions of law) as well as its ordinary laws, when the very establishment or the success of the investment depends on the compliance or non-compliance with such ordinary laws.

c. Temporal Scope of the Legality Requirement

155. Another relevant question regarding the scope of the legality requirement that needs to be answered is whether it is only the illegality at the time of making the investment which is captured by the legality requirement and culminates in dismissing jurisdiction (or admissibility) or whether illegalities committed after the initiation of the investment are also caught by the requirement and are taken into account in dismissing jurisdiction (or admissibility).

156. Both the ordinary meaning of the terms of a typical legality requirement and the practice of investment treaty arbitration speak in favour of limiting the consideration of illegality for jurisdictional purposes to violations of the host state law at the time of the establishment of an investment and not extending its temporal reach to violation of the recipient state's laws after the establishment of the investment. In other words, non-compliance with host state law is relevant for jurisdictional purposes only when it occurs in the course of initiation of an investment. Therefore, if the investor commits a crime pursuant to the establishment of its investment, although this illegality might be raised by the host state as a defence to the merits of the case, such a defence cannot bar the tribunal's jurisdiction.[274] To explain the point, it is noteworthy to review some relevant jurisprudence.

157. In *Fraport v. Philippines*, the respondent had alleged that legality of investment is relevant for jurisdictional purposes, both at the initiation and during the operation of the investment.[275] The tribunal only accepted the first limb of Philippine's argument, that legality as a jurisdictional condition was relevant only at the time of making the investment.[276] In *Metal-Tech v. Uzbekistan*, the interpretive dispute between the parties revolved around the sentence "[t]he term 'investments' shall comprise any kind of assets, implemented in accordance with the laws and regulations of the Contracting Party in whose territory the investment is made …" in Article 1(1) of the underlying investment treaty. The claimant contended that the legality requirement in the underlying BIT must be interpreted as a bar to the jurisdiction only where the establishment of the investment was tainted by illegality.[277] Uzbekistan countered this argument by positing that the tribunal lacked jurisdiction over this dispute because the claimant's investment was 'implemented', i.e. made and operated, in violation of Uzbek law.[278]

[273] ibid [494]-[495].

[274] It should, however, be noted that state parties to an investment treaty are free to formulate the clause in a way that it also covers illegalities occurred during the operation of the investment as a bar to jurisdiction.

[275] See *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [344].

[276] ibid [345].

[277] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [107(x)].

[278] ibid [110 (i)].

Taking a textual as well as a contextual interpretative approach, the tribunal found that the disputed term 'implemented' meant 'established' and 'made', rather than 'established and operated' as was suggested by the respondent. This led the tribunal to the conclusion that according to the BIT, illegality was a bar to jurisdiction only when the unlawful action occurred at the time of the establishment and making of the investment.[279] In the same vein, in *Quiborax v. Bolivia*, the respondent had alleged that the legality requirement of the Chile-Bolivia BIT covered any breach, regardless of when the breach is committed.[280] The tribunal decided that the 'temporal scope' of the legality requirement is limited to the establishment of the investment, and does not extend to its subsequent performance.[281] Based on this finding, the tribunal dismissed the relevance of two allegedly illegal conducts in its jurisdictional analysis on the basis of their occurring pursuant to the establishment of the investment.[282]

158. In summary, both the typical language of regular legality requirements in investment treaties as well as the prevailing practice of investment treaty arbitration speak in favour of limiting the consideration of illegality for jurisdictional purposes to violations of the host state law at the time of the establishment of investment.

159. Having said that, two technical points regarding the temporal scope of the legality requirement shall not be forgotten. First, in analysing whether a violation of the laws of the host state has occurred at the time of making the investment, as has been emphasised by one tribunal, the relevant analysis "has to be performed taking into account the laws [of the host state] in force at the moment of the establishment of the investment" rather than later modifications in legislation.[283] Second, it should be pointed out that in cases of bribery or conspiracy, the fact that illicit payments for securing an investment were made after the establishment of the investment should not influence the reality that investment itself was made illegally and it was only the compensation for the illegal interference of the official(s) concerned or third parties carrying clout that was paid thereafter. Thus, the ICISD panel in *Metal-Tech v. Uzbekistan* found that although payments to certain individuals post-dated the establishment of the claimant's investment, as the payments were intended to compensate the services they had rendered in securing the investment for Metal-Tech, the actual date of the payments could not influence the tribunal's temporal analysis of the legality requirement in the sense that the investment itself was made illegally.[284]

d. Conclusion

160. In this subsection, I analysed the 'formal', the 'substantive', and the 'temporal' scope of the legality requirement. Whereas the 'formal' scope of the requirement has not caused so much controversy, the 'substantive' reach of this requirement has been subject to heated discussions.

161. As to the 'formal' scope, I noted that certain treaties do determine in detail the 'formal' ambit of the legality requirement. With regard to other treaties not having such level of detail,

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[279] ibid [185]-[193].

[280] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia* (n 2) [239], [249].

[281] ibid [266].

[282] ibid [274], [277]. See also *Vladislav Kim and others v. Republic of Uzbekistan* (n 74) [410] (noting that "The legality requirement is limited to the time that the investment is made.")

[283] *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [103].

[284] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [267]-[273].

unless otherwise defined by the treaty in question, the use of the term 'legislation' in the legality requirement tends to signify a more specific concept in comparison to the term 'law'. Therefore, in many instances, the investment treaties that use the term 'legislation' tend to exclude other sources of law not enacted by the Legislature, for instance, regulations laid down by the Executive. At the same time, however, I mentioned that this depends on the pertinent jurisdiction. Thus, in case doubt arises as to the meaning and scope of the term 'legislation', refer must be had to the public law of the host state. Additionally, it was stated that the term 'law' has been defined to encompass, in addition to legislation enacted by the Legislature, other sources of regulation and decision-making. Therefore, unless otherwise provided by the treaty in question, if an investment treaty requires compliance with the 'laws' of the host state, in order to be protected under the investment treaty, the investor has to comply with the legislation laid down by the Legislature and the regulations enacted by the Executive which are in force at the moment of establishing its investment.

162. Turning to the 'substantive scope' of the requirement, it was submitted that the first point of reference for determining the 'substantive scope' of the legality requirement is the investment treaty itself. Contracting parties to investment agreements are naturally free to pinpoint the specific classes of the recipient state law that should be abided by in order to gain protection under investment treaties. A few investment treaties spell out certain laws compliance with which is required at the time of making the investment, though not in an exhaustive manner.[285] However, a great majority of investment treaties do not even benefit from such non-exhaustive illustrations. Vague and generic terms like 'laws of the host state', or 'legislation of the host state' frequently emerge in legality requirements.

163. Although generally formulated, there does not seem to be significant support for the idea that the legality requirement is without limitation. Almost all of the scholars and authorities tend to circumscribe the reach of the requirement by some sort of test. However, the tests offered for such circumscription by investment treaty tribunals and scholarship are not sound when looked at from the prism of a proper interpretive approach nor, in many instances, are such tests useful in practice. For example, to say that the 'substantive scope' of the legality requirement is limited to 'fundamental laws of the host state', although enlightening to a limited extent, does not effectively assist an investment treaty tribunal when faced with specificities of the case.

164. The solution should not detour from its path which is Article 31 of the VCLT. Thus, in proposing the solution, I have tried, to the extent possible, to remain loyal to 'the ordinary meaning' of a typical legality requirement, by simultaneously, endeavouring to offer an interpretation which is observant of the 'object' and 'purpose' of the treaty and done in 'good faith' in line with the principle of 'effective interpretation'. It is submitted that pursuant to an interpretive exercise on the basis of Article 31 of the VCLT: (i) an 'effective interpretation' watchful of the 'object' and 'purpose' of the treaty would require that *de minimis* laws of the host state be excluded from the 'substantive scope' of the legality requirement; (ii) an 'effective interpretation' based on the 'ordinary meaning of the terms' of a typical legality requirement

[285] For instance, the Protocol of the BIT between Germany and Philippines, which was concluded on the same day as the BIT, states at ad Article 2: "As provided for in the Constitution of the Republic of the Philippines, foreign investors are not allowed to own land in the territory of the Republic of the Philippines. However investors are allowed to own up to 40% of the equity of a company which can then acquire ownership of land." Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments (n 3).

which is considerate of the 'object' and 'purpose' of the treaty would reasonably lead one to accept that fundamental laws of the host state, including in particular the Constitution of the host state, its organic laws, and the mandatory laws of the host state, are squarely within the 'substantive scope' of the requirement; and (iii) an 'effective interpretation' based on the 'ordinary meaning of the terms' of a normal legality requirement – and, indeed, a 'balanced' approach to interpretation – results in confirming that ordinary laws of the host state are also inside the 'substantive' orbit of the requirement provided that their violation was made in order to acquire the investment or to guarantee the success of the investment.

165. This overall conclusion is to some extent supported by the two awards chaired by Gabrielle Kaufmann-Kohler.[286] According to these two awards, the 'substantive scope' of the legality requirement extends to the ensuing situations: (i) 'nontrivial violations of the host State's legal order'; (ii) 'violations of the host State's foreign investment regime'; and (iii) 'fraud…to secure the investment …'[287] Similarly, the solution adopted by this Thesis excludes trivial breaches from the scope of the legality requirement. It also includes, as these decisions implicitly do, violation of mandatory laws of the host state regarding foreign investment regime and criminal laws, though the decisions do not enumerate other laws of fundamental nature. Finally, both my solution and these two identical articulations of the 'substantive scope' of the legality requirement in the two mentioned awards tend to include ordinary laws of the host state within the reach of the requirement. The subtle difference is that according to my approach, ordinary laws are engaged provided that the violation is made to secure the investment or to guarantee its success. In contrast, the approach taken by these two decisions just includes 'nontrivial' breaches without further qualifying it. However, when talking about fraud, they do mention that fraud would be a trigger to the legality requirement if it is committed to secure the investment.

166. Finally, with regard to the 'temporal' reach of the legality requirement, both the 'ordinary meaning' of a typical legality requirement in investment treaties as well as the prevailing practice of investment treaty arbitrations support limiting the consideration of illegality for jurisdictional purposes to violations of the host state law at the time of the establishment of investment.

B. The Consequences of the Legality Requirement

167. It goes without saying that the legality requirement has a limiting function. In other words, it limits the scope of application of the investment treaty in the sense that, if activated, it prevents an investor from availing itself of the protection of the investment treaty standards.[288] Indeed, an arbitral tribunal deriving its jurisdiction from an investment treaty is bound by the treaty's scope of application. Thus, illegality usually culminates in lack of jurisdiction.

168. However, the issue is not as simple as depicted above in both theory and practice. One has to deal with the general and specific consequences of illegality and consider whether illegality

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[286] *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2); *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2).

[287] *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia* (n 2) [266]; *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [165].

[288] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia* (n 2) [255]. A study by UNCTAD also considers the inclusion of the 'in accordance with the law' clause as a 'narrowing technique' used in international investment agreements. UNCTAD, *Scope and Definitions* (n 11) 5, 28-29.

affects jurisdiction, admissibility, or as some have indicated, the merits of the claim. Should a jurisdictional analysis prevail, delving into an academic analysis, one should also consider the main reason for lack of jurisdiction in case of illegality: does, as the *Phoenix* tribunal has put it, illegality lead to the absence of one of the elements of the term 'investment', or is the lack of jurisdiction due to the fact that the host state has not extended its consent to illegal investments? If the latter is correct, is it a matter of lack of consent, lack of jurisdiction *ratione materiae*, or both?

169. In addition, illegality does not always occur in a very crystal-clear manner by the investor committing an obvious crime in the process of making the investment and by the tribunal merely dismissing the case. Special circumstances may arise in various cases, including cases where the public officials of the host state are actively engaged in the corrupt or otherwise illegal investment process, either by awareness or by direct or indirect involvement. In such situations, the investor, who might have had good faith, or had no option but to grease the unclean palms, might come up with a defence of *estoppel* or acquiescence and ask the tribunal to allow it to pass the jurisdictional barriers built by the respondent state.

170. This Section thus deals with these two issues in turn: first, the general and specific consequences of the legality requirement and second, the possible defences by an investor to an illegality defence raised by the host state.

a. General and Specific Consequences of the Legality Requirement

171. As was stated above, defences of illegality, corruption, and fraud have become regular defences by host states in many international investment arbitration cases in recent years. The reason for raising such defences from a substantive point of view is, in the first place, that host states are rightly entitled to deny protection to investors who have occupied investment opportunities, most of the times to the exclusion of others, without complying with the laws and regulations of the host state. In addition, the litigation strategy reason for the respondent state's illegality defence is that, if pleaded successfully, the host state would, on most occasions, have the whole investor's case dismissed as a matter of lack of jurisdiction or inadmissibility.[289] The general and specific legal consequences of illegality will be explained below.

i. General Consequence of Illegality

172. As a matter of common sense, it is obvious that international protection through investment treaties cannot be granted to investments that are flagrantly made contrary to the laws of the host state. In this connection, the tribunal in *Teinver v. Argentina* observed that: "It is widely acknowledged in investment law that the protections of the ICSID dispute settlement mechanism should not extend to investments made illegally…"[290] Indeed, granting protection to such investments would undercut all the concerns for legality which are inherent in the very inclusion of the legality requirement in investment treaties. Although the violation in question

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[289] See C Knahr (n 7) 18 (anticipating in 2007 that the awards in *Fraport* and *Inceysa* could "open the gate" for states to make alleged violations of their domestic law by investors a regular objection to the jurisdiction of ICSID Tribunals.) See also *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [43] (stating that considering the all-encompassing nature of the respondent's defence, a finding of illegality by the tribunal "would constitute a complete bar to the entire case advanced" by the claimants.)

[290] *Teinver v. Argentina* (n 228) [317]. See also *Plama Consortium Limited v. Bulgaria* (n 39) [138]-[139]; *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [100]-[101]; *Gustav F W Hamester GmbH & Co KG v Republic of Ghana* (n 41) [123]-[124]; *SAUR International SA v Republic of Argentina* (n 43) [308].

is a violation of the laws of the host state, due to the express or implied *renvoi* to the laws of the host state in the underlying treaty, such violation takes an international effect, which effect would be the denial of international substantive and procedural protection to the illegal investment.[291] It has been asserted by some commentators that there is no known ICSID case in which the tribunal admitted the claims after finding that the claimant had made its investment in violation of the host state's laws through corruption, fraud, or other serious illegality.[292] Therefore, the general consequence of illegality is denial of international substantive and procedural protection to investments made illegally.

ii. Specific Consequence of Illegality

173. It is submitted that in case the relevant legal provisions or principles of the host state law are not observed by the investor in the process of establishing its investment, then the express or implied legality requirement of the investment in the underlying investment treaty is not satisfied, and, therefore, the tribunal would lack jurisdiction to decide the case on its merits. The simple reason is that in such a scenario, the investment in question would not fit in the treaty's scope of application, and, thus, would be excluded from the jurisdictional realm of an investment treaty tribunal which derives its jurisdiction from that investment treaty.[293]

174. A very well-known example of dismissing jurisdiction due to illegality is the *Fraport* case.[294] In *Fraport v. Philippines*, the tribunal held that the claimant had made its investment in violation of the laws of Philippines, in particular, foreign ownership and control legislation known as the Anti-Dummy Law ("ADL"). The tribunal found that through 'secret shareholder agreements', Fraport sought to exercise managerial control over Philippine International Air Terminals Co. ("PIATCO"). PIATCO had concluded the concession contract for the construction and operation of an international passenger terminal at Ninoy Aquino International Airport in Manila ("Terminal 3") with the Philippine Department of Transportation and Communication ("DOTC") in 1997. The tribunal concluded that through these 'secret shareholder agreements', Fraport knowingly orchestrated its investment by circumventing the ADL and in flagrant violation of the ADL.[295] Rejecting Fraport's argument that the issue as to whether the Philippine laws were abided by would only be of municipal not international legal significance, the tribunal held that "[a] failure to comply with the national law to which a treaty refers will have an international legal effect."[296] The tribunal ended up deciding that because there was no 'investment in accordance with law', it lacked jurisdiction *ratione materiae* and, therefore, dismissed the case in its entirety.[297]

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[291] See *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [394].

[292] CB Lamm, BK Greenwald & KM Young (n 13) 349.

[293] See *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [372]. Of course, as has already been explained, depending on the terms of the treaty in question, in such a case, another course of action for an investment treaty tribunal is to rule that the claims presented to arbitration are inadmissible and to reject the case on this basis rather than to dismiss the case on jurisdiction. See Section One *supra*, Subsections B & C.

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

[295] *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [125], [309], [319]-[322], [354]-[355].

[296] ibid [394].

[297] ibid [401]. This decision was annulled by an ICSID Annulment Committee, consisting of Peter Tomka, Dominique Hascher, and Campbell McLachlan, on the ground that there was 'a serious departure from a fundamental rule of

175. In another leading case, decided 6 years later, the *Metal-Tech* tribunal found, as a factual matter, that the investor had paid certain individual consultants (including an Uzbek government official and the brother of the then Prime Minister of Uzbekistan) to use their position in the Uzbek Government and their family relationship to the Prime Minister, respectively, to facilitate the establishment of Metal-Tech's investment, in violation of the Uzbek Criminal Code and the legality requirement of the investment treaty. Therefore, the tribunal found that it lacked jurisdiction to hear the parties' claims and counterclaims brought under the relevant BIT.[298]

176. Another notable example in this respect is the award in *Alasdair Ross Anderson et al v. Republic of Costa Rica*[299] which concerned claims brought by 137 Canadian individual nationals against the Government of Costa Rica, alleging that the host state had failed to provide proper vigilance and regulatory supervision over its finance system, which negatively affected their investments, in violation of the BIT provisions regarding full protection and security, fair and equitable treatment, due process of law, and protection against expropriation.[300] The alleged investment made by the claimants was funds deposited with a scheme instituted by two Costa Rican individuals, Villalobos brothers, in exchange for a high interest rate on their deposit and repayment of the principal amount.[301] In deciding the dispute, the tribunal found, as a threshold matter, that it was "clear that the transaction by which the Claimants obtained ownership of their assets (i.e. their claim to be paid interest and principal by Enrique Villalobos) did not comply with the requirements of the Organic Law of the Central Bank of Costa Rica and that therefore the Claimants did not own their investment in accordance with the laws of Costa Rica."[302] The tribunal, thus, found that:

> 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.[303]

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procedure'. The Committee found that substantial materials which were produced after the oral procedure formed the basis of the tribunal's ruling on illegality. The departure from a fundamental rule of procedure was that the tribunal did not permit submissions from the parties on these heavily relied upon evidence. In other words, the Committee held that since the right to be heard and the right to have adequate opportunity for rebuttal had not been observed by the tribunal, there was a serious departure from the principles of natural justice. See *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines*, ICSID Case No. ARB/03/25, Decision on the Application for Annulment of Fraport AG Frankfurt Airport Services Worldwide, 23 December 2010 [177]-[178], [218], [227], [246]-[247].

[298] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [372]-[373].

[299] *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9).

[300] ibid [16].

[301] ibid [18].

[302] ibid [57]. Article 116 of the Organic Law of the Central Bank of Costa Rica provides that only entities expressly authorised by law may engage in financial intermediation in Costa Rica, and Article 157 of the same Law criminalises engaging in financial intermediation without authorisation. Ley Orga´nica del Banco Central de Costa Rica No 7558 (1995). See ibid [54].

[303] ibid [55].

The tribunal thus concluded that it lacked jurisdiction over the dispute because there was no investment made in accordance with the laws of Costa Rica, and, therefore, dismissed the whole case.[304]

177. Despite what was said above, it should be recalled that certain tribunals, arbitrators, and commentators have suggested that in the case of illegality, the issue should be considered as a question of merits rather than as a matter of jurisdiction (or admissibility). The prime examples for adoption of such a view are the awards in *Plama v. Bulgaria*[305] and *Malicorp v. Egypt.*[306] In *Plama*, for example, the tribunal decided to hear the allegation of the investor's fraudulent misrepresentation in the merits phase of the case. After a full hearing of all the relevant evidence and arguments, the tribunal was able to conclude that the respondent's case of fraudulent misrepresentation by the claimant had been proven. For the tribunal, the consequence of such a finding was not the vitiation of the tribunal's jurisdiction but the dismissal of the claimant's claims on the basis that its unlawful investment would not be protected by the substantive protections of the ECT.[307]

178. The first point to be noted in this respect is that in *Plama*, the case was brought under a treaty which did not contain a legality requirement, i.e., the ECT. Therefore, the abstention by the tribunal from rejecting the case on jurisdictional grounds is not strange since there is nothing in the ECT to directly and expressly confine the scope of the application of the Treaty, and, therefore, the tribunal's jurisdiction, to legal investments. Once again, everything goes back to the text of the pertinent treaty. In *Metal-Tech v. Uzbekistan*, the tribunal rightly mentioned that: "[T]he Contracting Parties to an investment treaty may limit the protections of the treaty to investments made in accordance with the laws and regulations of the host State. Depending on the wording of the investment treaty, this limitation may be a bar to jurisdiction, i.e. to the procedural protections under the BIT, or a defense on the merits, i.e. to the application of the substantive treaty guarantees."[308] Bearing this in mind, in cases of illegal investments with a treaty stipulation forbidding illegality, the claim should be dismissed on jurisdiction since legality is a jurisdictional condition provided by the treaty. One commentator has provided a cogent explanation for this jurisdictional consequence of illegality, explicating that, in such circumstances, the case should be dismissed on jurisdiction rather than on the merits:

> "In accordance with host State law clauses" are one of the available means by which States can limit their consent to arbitration by excluding investments made in breach of the host country law, and hence not worthy of protection. There seems to be no plausible ground for excluding illegal investments only from substantive protection under the BITS and not from

[304] ibid [59]. See also *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, 02 August 2006 [209] (stating that "it is important to repeat that […] the legality of the investment is a premise for this Tribunal's jurisdiction.")

[305] *Plama Consortium v. Republic of Bulgaria* (n 38) [130].

[306] *Malicorp Ltd v. Arab Republic of Egypt*, ICSID Case No ARB/08/18, Award, 07 February 2011 [119]. Judge Bernardo M. Cremedas seems to be a believer of such a view too. He adopted this viewpoint in his Dissenting Opinion in *Fraport v. Phillipines*. See Dissenting Opinion of Mr. Bernardo M. Cremades in *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines*, ICSID Case No. ARB/03/25, 19 July 2007 [37]-[38], [40]-[41].

[307] *Plama Consortium v. Republic of Bulgaria* (n 38) [143].

[308] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [127].

> jurisdictional protection as well. The offer of arbitration (or of any other dispute settlement mechanism) is in fact an integral and extremely relevant part of the promotion and protection regime assured by BITS. The clauses in question are therefore proper limits to the jurisdiction of tribunals constituted pursuant to the international instruments in which the clauses are contained.[309]

179. In the same vein, in *Inceysa v. El Salvador*, the tribunal held that contracting parties signing investment treaties have broad discretion to limit their consent to arbitration, and hence, the jurisdiction of arbitral tribunals, to disputes that meet certain criteria determined by them. In view of the tribunal, it was "perfectly valid and common" for states to exclude from their consent and from the jurisdiction of the tribunal certain types of disputes or to limit their consent to disputes that are within the limits indicated in investment treaties.[310]

180. Moreover, and quite apart from the reasoning above, according to the *Phoenix* tribunal, in manifest cases of violation of host state law, the consideration of 'judicial economy' would militate against asserting jurisdiction by the tribunal.[311] Therefore, to promote 'judicial economy', in cases where the illegality is so manifest, the claim based on an illegal investment should be dismissed on jurisdiction.

181. To recap, in cases where the legality requirement is stipulated in the underlying investment treaty, or in instances where such requirement is implied from other terms and provisions of the treaty, non-compliance with the laws of the host state should culminate in the dismissal of jurisdiction. Conversely, if there is no trace of the legality requirement in the relevant international agreement, as explained earlier in this Chapter, the better course of action for the adjudicating forum is to dismiss the case, not on jurisdictional grounds, but either on the ground of inadmissibility or as a matter of merits. In the latter situation, to promote 'judicial economy' when the circumstances so require, the better course of action seems to be dismissing the case on admissibility grounds rather than on the merits.

iii. The Missing Jurisdiction Limb

182. So far, I have concluded that a violation of the laws of the host state at the time of making the investment should move a tribunal to dismiss the case on jurisdictional (or admissibility) grounds. The question that remains is what leg or legs of the jurisdiction chair are missing when illegality occurs? Does the illegality break the subject-matter jurisdiction leg (or the so-called jurisdiction *ratione materiae*), or does it damage the *ratione voluntatis* leg of the jurisdiction chair? As a point of departure, it should be noted that for an investment treaty tribunal to be able to decide a case on its merits, it has to make sure that four jurisdictional requirements are met: *ratione personae*, *ratione temporis*, *ratione materiae*, and *ratione*

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[309] A Carlevaris (n 7) 49. For further commentary, see C Knahr (n 7) 17-18.

[310] *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (n 7) [184]. See also ibid [195].

[311] *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [104]. Similarly, deciding whether to consider the alleged illegalities as a matter of jurisdiction or merits, the *Minnotte* tribunal thought it imperative to analyse whether the alleged illegalities were "so manifest, and so closely connected to the facts (such as the making of an investment) which form the basis of a tribunal's jurisdiction as to warrant a dismissal of claims *in limine* for want of jurisdiction." See *David Minnotte and Robert Lewis v. Republic of Poland*, ICSID Case No. ARB(AF)/10/1, Award, 16 May 2014 [132].

voluntatis.[312] The first two jurisdiction legs are by their nature obviously out of the question for present purposes. Therefore, there remain two legs at the front of the jurisdiction chair: *ratione materiae* and *ratione voluntatis*.

183. There are two different approaches adopted by investment treaty tribunals with regard to the missing jurisdictional limb in the case of illegality: A very limited number of tribunals have considered legality to be an element of the objective definition of an 'investment'. On the other hand, a majority of investment treaty tribunals have opted for the view that, in case of an illegality, jurisdiction does not exist due to the non-existence of a stipulated legal condition for an 'investment', which is the core subject-matter of an investment treaty, and, thus, non-satisfaction of the *ratione materiae* condition. Interestingly, most of the tribunals of the second group have at the same time taken the position that illegality of investments nullifies consent and, thereby, negates *ratione voluntatis*.

184. Starting with the viewpoint adopted by the first group, according to which legality is an element in the objective definition of an 'investment', the *Phoenix* tribunal, which seems to be the biggest advocate of this approach, expressly included the legality requirement within the elements of the so-called '*Salini* test'.[313] Thus, according to this tribunal, the legality of an investment is an element of the objective definition of 'investment'.[314]

185. The other approach, i.e. lack of jurisdiction because of absence of a stipulated legal condition of an 'investment', opposes the inclusion of the legality element in the objective definition of 'investment' and believes, depending on the language of the treaty at stake, that the legality requirement is a component of consent or legal (rather than economic) element of an 'investment'. In *Metal-Tech v. Uzbekistan*, the tribunal said that:

[312] See M Sornarajah, *The International Law on Foreign Investment* (n 3) 359-360. See also *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [54].

[313] *Phoenix Action, Ltd. v. The Czech Republic* (n 39) [114].

[314] This objective definition is most frequently referred to as the '*Salini* test' according to which the term 'investment' implies the presence of the following elements: (i) a contribution of money or other assets having economic value, (ii) a certain duration over which the economic activity is implemented, (iii) assumption of risk, and (iv) a contribution to the host state's development. *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001 [52]. See also *Jan de Nul N.V. v. Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Decision on Jurisdiction, 16 June 2006 [91]. It deserves mention that not all the subsequent investment treaty tribunals have followed all the requirements of the definition of 'investment' as identified by the '*Salini* test'. Indeed, some tribunals have simply ignored the test and some have applied the test less stringently. See, e.g., *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008 [307-322]. That being said, a majority of tribunals have adopted the criteria almost verbatim or with some variations. As such, the '*Salini* test' remains the dominant theory for the objective definition of the term 'investment' though sometimes with certain amendments. For a recent decision on the applicability of the '*Salini* test' see *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v. Republic of Kenya*, ICSID Case No. ARB/15/29, Award of the Tribunal, 22 October 2018 [291 *et seq*]. It is also worthy of note that this test has impacted investment treaty rulemaking. Indeed, several recent investment treaties list 'the commitment of capital or other resources', 'the expectation of profit', and 'the assumption of risk' (all elements of the '*Salini* test') in definitions of the term 'investment'. See, for instance, Article 8.1 of Comprehensive Economic and Trade Agreement (CETA) between Canada, of the One Part, and the European Union And Its Member States, signed on 30 October 2016, not yet entered into force, defining the term 'investment' in the following way: "investment means every kind of asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, which includes a certain duration and other characteristics such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk …".

> [T]he Contracting Parties to an investment treaty may limit the protections of the treaty to investments made in accordance with the laws and regulations of the host State. Depending on the wording of the investment treaty, this limitation may be a bar to jurisdiction, i.e. to the procedural protections under the BIT, or a defense on the merits, i.e. to the application of the substantive treaty guarantees.
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> […]
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> Respondent submits that it "consented to arbitrate only those disputes concerning lawfully implemented investments. Where, as here, the investment at issue was made and implemented contrary to the laws and regulations of the Republic of Uzbekistan, Respondent has not granted its consent to arbitrate before ICSID a dispute concerning that investment." Whether the Respondent's consent covers the present dispute depends on the content of the BIT and in particular on Article 8(1) thereof. If the requirements set in Article 8(1) are not met, then the Respondent has not consented to submit the present dispute to ICSID arbitration and the *ratione voluntatis* condition required by Article 25(1) of the ICSID Convention is not satisfied.[315]

186. Apparently adopting an interpretive approach based on Article 31(1) of VCLT, the *Saba Fakes* tribunal indicated that the 'legality' of an investment cannot be incorporated into the definition of the term 'investment' in Article 25(1) of the ICSID Convention "without doing violence to the language of the ICSID Convention".[316] The tribunal then went on to conclude that the legality of investment is a matter of consent rather than the economic definition of the term 'investment':

> As far as the legality of investments is concerned, this question does not relate to the definition of "investment" provided in Article 25(1) the ICSID Convention and in Article 1(b) of the BIT. In the Tribunal's opinion, while the ICSID Convention remains neutral on this issue, bilateral investment treaties are at liberty to condition their application and the whole protection they afford, including consent to arbitration, to a legality requirement of one form or another. This is precisely the case of the Netherlands-Turkey BIT, which contains such a requirement in its Article 2(2) […]
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> […]
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> […] This provision plainly states that the BIT protection shall not apply to investments which have not been established in conformity with the

[315] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [127], [129]. See also ibid [372]-[373].

[316] *Saba Fakes v. Republic of Turkey* (n 69) [112]. In this case, jurisdiction was ultimately dismissed by the tribunal not due to the illegality of the investment but because the tribunal concluded that "Mr. Fakes has not made any investment in Telsim which would satisfy any of the three criteria for an investment to exist within the meaning of Article 25(1) of the ICSID Convention". The tribunal, accordingly, dismissed the claims for lack of jurisdiction and ordered Mr. Fakes to pay all of Turkey's fees and costs, finding that it did not need to determine "whether Mr. Fakes' transaction was conducted in accordance with the Respondent's laws and regulations relating to the admission of investments in Turkey and, thus, satisfied the requirement of legality set forth by the BIT to qualify as an investment protected by that instrument". ibid [147]-[149].

> Respondent's laws and regulations, the term "investment" having been defined in Article 1(b) of the BIT. If this condition is not satisfied, the BIT does not apply. As a result, the Contracting Party cannot be deemed to have given its consent to arbitrate the dispute under Article 8(3) of the BIT and there would therefore be no consent to the Centre's jurisdiction within the meaning of Article 25(1) of the ICSID Convention.[317]

187. Finally, in *Quiborax v. Bolivia*, the respondent had asserted that the legality requirement was an element of the '*Salini* test'.[318] The arbitral panel disagreed.[319] In its analysis, the tribunal opined:

> … [T]he Tribunal is of the view that neither conformity to the laws of the host State nor respect of good faith are elements of the definition of investment. The Contracting Parties to the BIT have limited the protections of the treaty to investments made in accordance with the law of the host State. This limitation may be a bar to jurisdiction, i.e. to the procedural protections under the Treaty, or to the application of the substantive treaty guarantees as a matter of merits … That does not mean that these elements are part of the definition of investment. *An illegal or bad faith investment remains an investment. It may not be a protected investment, i.e. deserve protection in the sense that access to treaty arbitration and/or substantive treaty guarantees may not be granted, but that is a different matter*.[320] (emphasis added)

188. These criticisms of the *Phoenix* approach seem to be well-placed. The whole idea behind the so-called '*Salini* test' is a definition of the term 'investment' from an economical point of view. If one reviews the elements enumerated for the test, one realises that these factors (contribution of economic resources, risk, duration, and regularity of profit and return) are all economic characteristics of an investment.[321] Having this in mind, it is hardly arguable that 'legality', as a legal attribute, is an economic feature of this type of economic operation. In fact, whereas the '*Salini* test' seeks to identify an 'investment' from an economic perspective, the legality requirement intends to examine the protectability of an 'investment' by the investment treaty from a legal point of view.

189. Another line of reasoning which reveals the inaccuracy of the *Phoenix* decision in including the legality requirement as an element of the '*Salini* test' is the array of awards and decisions which rule that the 'legality requirement' in an investment treaty has nothing to do with the

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[317] ibid [114]-[115].

[318] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia* (n 2) [199].

[319] ibid [219].

[320] ibid [226]. The tribunal went on to consider the legality requirement as an element of jurisdiction *ratione materiae*: "… [I]n order for the Tribunal to conclusively ascertain whether or not it has *ratione materiae* jurisdiction over Quiborax and NMM, it must examine Bolivia's next objection." Bolivia's next objection was non-compliance with the laws of Bolivia in making the investment. ibid [237], [282].

[321] Sasson believes that the term 'investment' was originally a feature of economic analysis rather than an issue in international treaties protecting the rights and properties of aliens. See M Sasson (n 2) 101-102. Dolzer and Schreuer also opine that, in contrast to terms like 'rights', 'property', and 'interests', which have acquired legal meanings, the term 'investment' has its origin in economic terminology. See R Dolzer & C Schreuer (n 107) 60.

definition of investment according to the laws of the host state. To give only one example amongst many, in *Salini v. Morocco,* the state party to the dispute invoked Article 1(1) of the Italy-Morocco BIT, which entails a legality requirement and refers to the term 'investments' in the following way: "the categories of assets invested ... in conformity with that Party's laws and regulations". Morocco asserted that the underlying investment transaction relied upon by the claimant in this case did not fall within the scope of the notion of investment as defined under Moroccan law as required by Article 1(1) of the BIT, and, therefore, no investment existed under Article 25(1) of ICSID Convention. Put differently, the respondent state argued that the legality requirement of the BIT would mean that the notion of investment must be exclusively interpreted according to the domestic law of the host state. The tribunal rejected this argument by stating that 'in accordance with host State clauses' concern the validity of the investment and not its definition. It particularly said that this provision "… seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal."[322]

190. Having said that, there remains a confusion as to the reasoning of the proponents of the second view, i.e. those who believe that illegality results in no jurisdiction due to the absence of a *legal* condition attributed to the term 'investment' by the contracting parties to the treaty: while some of the decisions and awards supporting this view correctly reject the inclusion of the legality requirement in the '*Salini* test', they go on to say, on the one hand, that there is no jurisdiction because there is no consent (no *ratione voluntatis*), and on the other hand, that there is no investment as a result of illegality, and thus no jurisdiction *ratione materiae*.

191. One can obviously say that non-compliance with the laws of the host state militates against jurisdiction *ratione materiae*. This issue could be considered from two different lenses: (i) the contracting parties to the treaty have expressly or impliedly limited the scope of the term 'investment' to 'legal' investments. Therefore, the subject-matter of the tribunal's jurisdiction is limited to legal investments.[323] (ii) since an investment procured by illegal acts (like fraudulent behaviour, misrepresentation, or bribery) does not comport with the condition of 'legality' which is, in many legal systems, a condition for the validity of a contract,[324] then there is no contract, and, therefore, no contractual or property rights to protect. Since there is no right, then there is no investment, and since there is no investment, there is no jurisdiction *ratione materiae* for the investment treaty tribunal.

192. On the other hand, one could say that the issue could exclusively be looked at from a 'consent' or *ratione voluntatis* angle. In this sense, one should merely focus on the scope of the consent given by the contracting parties in the relevant investment treaty. This has been clarified by very straightforward terms by the *Inceysa* tribunal. In *Inceysa,* the tribunal

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[322] *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* (n 34) [46]. See also *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction, 14 November 2005 [109]-[110]; *L.E.S.I. S.p.A. and ASTALDI S.p.A. v. République Algérienne Démocratique et Populaire* (n 75) [83]; *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures, 21 March 2007 [79] fn 11; and *Desert Line Projects LLC v. The Republic of Yemen* (n 75) [102]-[105].

[323] The *Fraport* tribunal considers the legality requirement as a "jurisdictional limitation *ratione materiae*". See *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [334].

[324] For instance, under Article 215 of the Iranian Civil Code, "the object of the contract should have financial value and embody reasonable and legitimate interest."

determined that the consent granted by El Salvador in the BIT "is limited to investments made in accordance with the laws of the host State of the investment", and that "disputes that arise from an investment made illegally are outside the consent granted by the parties and, consequently, are not subject to the jurisdiction of the Centre ..."[325] The tribunal found that Inceysa's investment was not made in accordance with Salvadoran law, because Inceysa had obtained its concession contract through misrepresentations during the public bidding process, including with respect to the identity of its strategic partner which was considered as "a deceit on one of the central aspects of the bid".[326] The tribunal, thus, concluded that, "because Inceysa's investment was made in a manner that was clearly illegal, it is not included within the scope of consent expressed by Spain and the Republic of El Salvador in the BIT and, consequently, the disputes arising from it are not subject to the jurisdiction of the Centre."[327]

193. In reconciling these two apparently overlapping views, one has to understand the meaning and effect of the term 'consent'. This term seems to have two meanings: (i) the first meaning of consent is equivalent to the term *ratione voluntatis*, which concerns the general expression of will regarding submission of disputes to arbitration. (ii) the second meaning is more specific, that is the submission of specific types of disputes to arbitration, like disputes concerning investments. In the second sense, if one bears in mind the general idea that when entering into investment treaties, states can limit the scope of their consent, one comes to the conclusion that when there is a legality clause inserted in the investment treaty by the parties, in case of an illegality, the logical consequence can only be the dismissal of a claim at the jurisdictional stage for lack of one of the requirements set out either in Article 25(1) of the ICSID Convention or other instruments governing the arbitration of the investment dispute, which requirement is consent to arbitration.[328] Therefore, the legality requirement circumscribes the types of the investments that the treaty applies to, i.e. legal investments, and, thereby, determines the types of disputes with respect to which the parties have consented to be referred to arbitration, i.e. disputes with respect to legal investments. In addition, by conditioning the term investment to 'legality', states would effectively limit the subject-matter scope of application of the treaty and, thus, the tribunal's jurisdiction. This twofold function of the legality requirement has been well-explained by the *Quiborax* tribunal: "… under the Bolivia-Chile BIT, the legality requirement is relevant to determine both the Treaty's scope of application and the scope of Bolivia's consent to arbitration."[329] In summation, it appears that lack of legality taints both 'consent', in its narrower sense, and subject-matter jurisdiction.

b. Possible Defences by Investors

194. Faced with the defence of illegality by the host state, an investor might allege that dismissing the case on this ground would defeat the treaty's object and purpose. More frequently, however, are cases in which the investor tries to bring the host state in by making

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[325] *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (n 7) [207].

[326] ibid [123]. The tribunal found that Inceysa violated, among other things, the principle of good faith, the principle that no one should be permitted to profit from their own fraud, international public policy, and the prohibition against unlawful enrichment, all of which, according to the tribunal, were incorporated into Salvadoran law. See ibid [239], [242]–[243], [252]–[253].

[327] ibid [207], [257].

[328] A Carlevaris (n 7) 42.

[329] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia* (n 2) [255].

accusations against the recipient state, triggering the so-called idiom of "misery loves company". The investor would do so under the following kinds of allegations: (i) the host state knew about the illegality but did not object at the time; (ii) the officials of the host state were involved in the corrupt process leading to the establishment of the investment. Furthermore, an investor might allege that it had no ill-intention when committing the illegality (iii). Whether these defences would take the investor anywhere will be subject to in-depth analysis in the following sequence in the upcoming pages: (i) object and purpose of the treaty; (ii) the involvement of the host state; and (iii) the good faith of the investor.

i. Object and Purpose of the Underlying Investment Treaty

195. The general and overbroad statements in preamble of investment treaties regarding the protection of investments may tempt investors to use them in investment treaty arbitrations in various guises. In particular, faced with an illegality defence, an investor might seek to invoke the sweeping preambular investment protection language in the treaty. There seems to be little merit in invoking the vague and general sentences regarding the object and purpose of the treaty in countering the allegations of illegality when the explicit terms of the treaty or mandatory rules of international law call for dismissing the case. Thus, the *Fraport* tribunal articulated in its Award that:

> It is also clear that the parties were anxious to encourage investment, which was the *raison d'etre* of the treaty. But while a treaty should be interpreted in the light of its object and purposes, it would be a violation of all the canons of interpretation to pretend to use its objects and purposes, which are, by their nature, a deduction on the part of the interpreter, to nullify four explicit provisions.[330]

196. Moreover, when considering the preamble for the purpose of interpreting the legality requirement, the preambular paragraphs should be seen holistically. In *Quiborax v. Bolivia*, the tribunal recalled that the objectives of the BIT as set out in its preamble are twofold. While such objectives seek to preserve the investor's interests, at the same time, they also ensure the safeguarding of the interests of the state: "the Preamble of [the BIT] states that the Parties "recogniz[e] the need to promote and protect foreign investments in order to support the economic prosperity of both States" and "wish[] to strengthen the economic cooperation to benefit both States." Accordingly, within the limits set by the applicable treaty interpretation rules, the Tribunal favours a balanced interpretation that takes account of the need to protect foreign investments, on the one hand, and of the State's other responsibilities, on the other."[331]

197. Therefore, depending on the circumstances, a defence against the illegality argument, solely based on the object and purpose of an investment treaty as reflected in the preamble of the investment treaty in question would most probably be unavailing.

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[330] See *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [340]. By 'four explicit provisions', the tribunal was referring to Article 1(1), Article 2(1), Ad Article 2, and the Philippine Instrument of Ratification of the Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments (n 3). For the proposition that preambular languages in investment treaties are not particularly handy in resolving technical questions of jurisdiction, see Chapter 2, Section Two, A.b.ii *supra*.

[331] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia* (n 2) [264].

ii. The Involvement of the Host State

198. In certain circumstances, prominently in corruption and bribery cases, the host state, or persons representing it, contribute to illegality by, for instance, asking for and accepting bribes and inducements. In other situations, the illegal obtaining of the investment occurs despite the fact that the state is kept in the picture and is mindful of the illegal conduct. For example, assume that the investor procures the investment by violating a material provision of the foreign investment law of the host state. The host state takes cognizance of this fact but for some reasons does not contemporaneously object. Therefore, the question at issue here is whether one should take into account the knowledge and/or the contribution of the host state, or its representatives, in the equation of illegality. In other words, if the host state is aware of a breach of its laws in the period of making the investment or if it has contributed to the corruptive course of conduct, shall the illegality still act against the investor by simply denying jurisdiction? In effect, this question seeks to verify whether, as alleged by some, the only victim of the illegality should be the investor and whether the state, so involved in illegality, could benefit from its wrongdoing or negligence. These issues will be considered below.

1st. *Knowledge of the State*

199. Under this sub-heading, I am going to analyse a situation under which the recipient state is aware of a breach of its laws but nevertheless does not object to the disclosed illegality contemporaneously. It was suggested by the tribunal in *Fraport v. Philippines* that had Philippines known of the investor's illegal conduct, it might have been 'estopped' from invoking the illegality in arbitration. The tribunal explained, on the basis of the doctrine of *estoppel*, that the state could not have invoked breaches of the domestic law by the investor as a bar to jurisdiction if it had known them, or might have known them, and had knowingly overlooked them upon the admission of the investment.[332] In the same vein, other tribunals have stressed the need to protect the investor's reliance on the apparent validity of the investment transaction as practically acknowledged by the state.[333]

200. In a dissent to the Judgment in the *Case Concerning the Temple of Preah Vihear*, Judge Spender described the test for *estoppel* in international law in the following terms:

> [T]he principle [of estoppel] operates to prevent a State contesting before the Court a situation contrary to a clear and unequivocal representation previously made by it to another State, either expressly or impliedly, on which representation the other State was, in the circumstances, entitled to

[332] See *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [346]-[347]. However, the arbitrators found no evidence of the state's awareness of the investor's unlawful behaviour, and, therefore, concluded by majority decision that they lacked jurisdiction.

[333] *Ioannis Kardassopoulos v. The Republic of Georgia* (n 11) [191]-[192]:

> The assurances given to Claimant regarding the validity of the JVA and the Concession were endorsed by the Government itself ... The Tribunal also notes that the Concession was signed and 'ratified' by the Ministry of Fuel and Energy, an organ of the Republic of Georgia. The Tribunal further observes that in the years following the execution of the Jvn and the Concession ... Georgia never protested nor claimed that these agreements were illegal under Georgian law. In light of all of the above circumstances, the Tribunal is of the view that Respondent created a legitimate expectation for Claimant that his investment was, indeed, made in accordance with Georgian law and, in the event of breach, would be entitled to treaty protection.

> rely and in fact did rely, and as a result the other State has been prejudiced or the State making it has secured some benefit or advantage for itself.[334]

201. Accordingly, the representation upon which the principle of *estoppel* is based has to be 'clear and unequivocal' and there must be actual and justified reliance by the other party.[335] It is clear from the adjectives 'clear' and 'unequivocal' that the satisfaction of *estoppel* requirements should be given a high evidentiary threshold. Therefore, a simple inaction on the part of the host state to prosecute a breach of its laws cannot discharge the investor's onus of establishing 'clear and unequivocal' representation by the state. Similarly, engaging in settlement negotiations with the investor does not mean that the state has acquiesced to the illegality.[336]

202. On the other hand, under the same principles discussed above, one could say that if pursuant to a formal inquiry from the investor, providing a correct state of the facts, the host state explicitly acknowledges the validity of the investment despite the non-compliance with the host state law, on the very same points which the state later objects to in the course of an investment treaty arbitration, the state cannot later claim the illegality of the investor's actions or inactions as a jurisdictional bar.

203. Be that as it may, one should still be mindful that the issue in question, i.e., the legality of investments, is one of jurisdiction. An arbitral tribunal has the duty to ensure that it has jurisdiction under the relevant treaty. The tribunal in *Eureko v. Slovakia* correctly indicated that:

> … jurisdiction is fixed by laws […] and that such jurisdiction cannot here be created, continued or extended by arguments based on the possible operation of doctrines of acquiescence, waiver or estoppel in respect of acts or omissions of Respondent (or Claimant)…[337]

204. In other words, the principle of *estoppel* or waiver cannot extend the scope of an investment treaty tribunal's jurisdiction. In effect, the only venue for the tribunal to ascertain jurisdiction under such circumstances, i.e., an admitted illegality on the part of the investor known to but actively ignored by the host state, seems to be making certain that the host state has indeed consented, under the applicable standards of the specific treaty, to extend the treaty protection to the specific investment at bar.

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[334] *Temple of Preah Vihear* (*Cambodia v. Thailand*) (Merits) Judgment, I.C.J. Rep. 1962 (15 June 1962) p 6, Dissenting Opinion of Judge Spender, pp 143-44.

[335] This formulation of the elements necessary for the application of *estoppel* have been reiterated in the subsequent jurisprudence of the ICJ: See *Land, Island and Maritime Frontier Dispute* (*El Salvador v. Honduras: Nicaragua intervening*) Application to Intervene, Judgment, I.C.J. Rep. (1990) (13 September 1990) p 92, p 118 ("essential elements required by estoppel: a statement or representation made by one party to another and reliance upon it by that other party to his detriment or to the advantage of the party making it."); *North Sea Continental Shelf* (*Federal Republic of Germany v. Denmark; Federal Republic of Germany v. Netherlands*), Judgment, I.C.J. Rep. 1969 (20 February 1969) p 3, p 26; accord *Delimitation of the Maritime Boundary in the Gulf of Maine Area* (*Canada v. United States of America*), Judgment, I.C.J. Rep. 1984 (12 October 1984) p 246, p 309.

[336] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia* (n 2) [257].

[337] *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (formerly *Eureko B.V. v. The Slovak Republic*), Award on Jurisdiction, Arbitrability and Suspension, 26 October 2010 [219].

205. As it appears from these discussions, analysis of this nuanced issue is very fact-specific and should be decided on a case-by-case basis. In any event, in my opinion, for a tribunal to decide this issue, it needs to analyse, at least, the following factors: (i) the good faith of the investor and the amount of due diligence it had in familiarising itself and complying with the law of host state; (ii) the timespan in which the investor performed the relevant investment contract or acted under the investment authorisation from the time the state knew of the alleged illegality until it raised its objection to the alleged illegality (which mostly occurs in the wake of a dispute between the parties); (iii) the level of the state's knowledge of the illegality and the circumstances under which the state accepted the contract or issued the investment permit; (iv) the contemporaneous reaction of the two other organs of the state (usually the legislative and the judiciary) to the illegality of the investment (at the time of the establishment of the investment or immediately before or after the making of the investment); and (v) the contributions the state made to the investment despite the knowledge of illegality (like providing land, raw materials, etc.), and the benefits reaped by the host state during the operation of the illegal investment, if any.[338]

2nd. *Involvement of the Host State in the Corruption*

206. A state or persons representing the state could, in theory, contribute to the illegal acquisition of an investment by, for instance, accepting bribes. One important preliminary observation is that, technically speaking, in cases of bribery, it is not the host state *qua* the host state which benefits from the illicit payment. Rather, the individuals acting on behalf of the state reap such illegal benefits. In fact, if the recipient state is the beneficiary of the payment, it would not be a bribe anymore, rather, it would be better characterised as part of the consideration of the investment contract, irrespective of whether it is labelled as royalty fee, tax etc. Put differently, whereas, in the former situation, individuals take personal advantage of the payments, in the latter situation, the money remitted would go to the national fund and would constitute part of the budget of the state.[339]

207. It is also important to bear in mind that despite the involvement of certain representatives of the host state in the illegality, the interests of an investor with no clean hands shall not prevail over the public interests. The distinction between the public interests on the one hand and the interests of the respondent in an investment treaty arbitration on the other hand is important. The investor should be sanctioned not in order to benefit the respondent but rather to preserve the public interests. Furthermore, such an investor shall not be assisted by an arbitral tribunal in his/her illegal conduct by allowing him/her to use the apparatus of investment treaty arbitration. In this respect, the *World Duty Free* award refers to a statement from "Chitty on Contracts" which is illustrative of the above-mentioned point, although primarily from the perspective of English jurisprudence:

[338] As support for some of these propositions, see *Ioannis Kardassopoulos v. The Republic of Georgia* (n 11) [191]-[192]; *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [346]; *Desert Line Projects LLC v. The Republic of Yemen* (n 75) [105]; *Inmaris Perestroika Sailing Maritime Services GmbH and Others v. Ukraine* (n 221) [140].

[339] *World Duty Free Company v Republic of Kenya* (n 50) [169], [178]. It should also be noted that those officials who are involved in taking bribes usually face civil, administrative, and criminal sanctions when the corruption issue is divulged. This is while, the foreign investor, because of his being foreign, usually escapes the adverse municipal legal consequences and sanctions of the host state.

> "Illegality may affect a contract in a number of ways but it is traditional to distinguish between (1) illegality as to formation and (2) illegality as to performance ..." "Where a contract is illegal as formed, ..., the courts will not enforce the contract, or provide any other remedies arising out of the contract. The benefit of the public, and not the advantage of the defendant, being the principle upon which a contract may be impeached on account of such illegality, the objection may be taken by either of the parties to the contract. 'The principle of public policy', said Lord Mansfield, 'is this: *ex dolo malo non oritur actio*. No court will lend its aid to a man who founds his cause of action upon an immoral or illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the court says he has no right to be assisted. It is upon that ground the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and the defendant were to change sides, and the defendant were to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally at fault, *potior est conditio defendentis*.' The rules on illegality have been criticised as being unprincipled but a better way of viewing them, as the previous dictum from *Holman v. Johnson* illustrates [...], is as 'being indiscriminate in their effect and are capable therefore of producing injustice.' The 'effect of illegality is not substantive but procedural', it prevents the plaintiff from enforcing the illegal transaction. The '*ex turpi causa* defence', as was stated by Kerr L.J. in *EuroDiam Ltd v. Bathurst* [1990] QB 1, 'rests on a principle of public policy that the courts will not assist a plaintiff who has been guilty of illegal (or immoral) conduct of which the courts should take notice. It applies if in all the circumstances it would be an affront to public conscience to grant the plaintiff the relief which he seeks because the court would thereby appear to assist or encourage the plaintiff in his illegal conduct or to encourage others in similar acts'. ..... illegal contracts are not devoid of legal effect, but the *ex turpi causa* maxim entails that no action on the contract can be maintained."[340]

208. Having said that, the tribunal in *World Duty Free* indicated that "it would be "an affront to public conscience" to grant to the claimant the relief which it seeks because this tribunal "would thereby appear to assist and encourage the plaintiff in his illegal conduct."[341] Another relevant point put forward by *World Duty Free* tribunal is that "the law protects not the litigating parties but the public; or in this case, the mass of tax-payers and other citizens making up one of the poorest countries in the world."[342]

209. The tribunal in *Metal-Tech* also dealt with this issue. Although the tribunal was "sensitive to the ongoing debate that findings on corruption often come down heavily on claimants, while

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[340] ibid [161] (referring to HG Beale (ed), *Chitty on Contracts* (Vol. 1, 28th edition, Sweet & Maxwell 1999) [17-007]).

[341] ibid [178].

[342] ibid [181].

possibly exonerating defendants that may have themselves been involved in the corrupt acts", and noted 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", it explained that "the idea . . . 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."[343]

210. All in all, the involvement of certain representatives of the government of the host state in the illegality is not a viable defence for an investor to sustain in order to protect itself against the illegality that it committed while establishing its investment.

3rd. *Investor's Good Faith*

211. As alluded to above, in certain situations, the investor may allege that although there is illegality, i.e. breach of the laws of the host state at the time of making the investment, it had no ill-intention to violate such laws. This could be due to two distinct reasons: (i) it did not know that it was breaching the laws of the host state; or (ii) it was forced into the corruption by the authorities of the host state.

212. To begin with the first reason, i.e., that the investor did not know that it was breaching the laws of the host state, it is noteworthy to recall an old maxim: "ignorance of the law is no defence". This same rule applies to an investor venturing its capital, equipment or technical knowledge abroad. In fact, an investor must take the host state law as he finds it and should familiarise himself with the law of the place where he is going to invest in, including at the time when he is establishing his/her investment.[344] According to the tribunal in *Alasdair Ross Anderson v Republic of Costa Rica*, each investor "must meet [the legality] requirement, regardless of his or her knowledge of the law or his or her intention to follow the law".[345] Pursuant to the above observation, the intention of the investor and his knowledge of the laws and regulations of the host state at the time of making the investment have no role to play in the compliance with the legality requirement equation.

213. As an aside, in most of the corruption situations (obviously not always), it is hard to consider genuine an investor saying that it did not know about the law of the host state. As quite correctly suggested by Llmazon, investors acting in this way always know the illegality of their actions yet decide to engage in corruption anyway, either overtly or tacitly.[346] In addition, as has been pointed out by one commentator, absolving investments violating the laws of the host state by an allegedly genuine investor from the jurisdictional scrutiny seems problematic since it will probably be difficult in many instances to determine, from a factual

[343] *Metal-Tech Ltd. v. Republic of Uzbekistan* (n 2) [389].

[344] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004 [197]-[206]; *Gami Investments, Inc. v. The Government of the United Mexican States*, UNCITRA, Final Award, 15 November 2004 [91]; *International Thunderbird Gaming Corporation v. The United Mexican States* (n 230) [164]; *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [58] (observing that "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."); C McLachlan, L Shore & Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (OUP 2017) 309-310.

[345] *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [52]. See also C Knahr (n 7) 17.

[346] AP Llamzon (n 8) 5.

point of view, whether an investor had actually acted in good faith or whether he had knowingly committed a violation of the host state's domestic law.[347]

214. Having said that, an exception could be made to this statement and that exception concerns the case of investing in countries whose laws are not clear or easily-accessible, and there is no chance to obtain access or clarity by a good faith effort via inquiring from the governmental authorities of the host state or by soliciting legal advice from a proper professional law firm or reputable freelance lawyers. In this connection, the *Fraport* tribunal said: "in some circumstances, the law in question of the host state may not be entirely clear and mistakes may be made in good faith …"[348] This situation of unclear laws was unsurprising in the early days of the real burgeoning of arbitration, which to me is the period after the end of World War II. At the time, and in the early 1960s, many countries had recently been decolonised and had premature and underdeveloped legal systems. Therefore, when engaged in international arbitrations, even when their law was chosen as the governing law to the contract by the parties themselves, the law was found to be inapplicable by the arbitral tribunal due to being vague and unsophisticated.[349] However, this trouble is not as prevalent around the world nowadays, although one cannot argue with certainty that it does not exist at all any longer. In fact, despite the numerous initiatives both at the national and international level to promote the transparency of investment legislation,[350] the investor is often not in a position to obtain sufficient knowledge of all relevant pieces of legislation. In my opinion, if in such circumstances, the badly advised investor, who means well and has done its best to acquaint itself with the laws of the host state,[351] acts timely in curing or rectifying a non-compliance, good faith

[347] On this point, Carlevaris aptly points out that it "is in fact more difficult to determine the investor's good faith and knowledge of the causes of the illegality than the identity of the norms allegedly violated and the seriousness of the breach." See A Carlevaris (n 7) 47. In the same vein, Knahr commentates that a subjective assessment "seems problematic since it will probably be difficult in many instances to determine whether an investor had actually acted in good faith or whether he had knowingly committed a violation of a host state's domestic law. Hence, an objective assessment of the severity of the violation … seems preferable." See C Knahr (n 7) 17.

[348] *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [396]-[398].

[349] For instance, in *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, Lord Asquith of Bishopstone, the umpire, stated that since no body of settled legal principles for the construction of modern commercial instruments existed in the Sheikhdom, and since justice was discretionary "in this very primitive" country, its laws could not be applied to the contract. *Petroleum Development Ltd v. Sheikh of Abu Dhabi* (*Abu Dhabi Case*) (1951) 18 ILR 144.

[350] See, for instance, the World Bank Guidelines:

> Each State is encouraged to publish, in the form of a handbook or other medium easily accessible to other States and their investors, adequate and regularly updated information about its legislation, regulations and procedures relevant to foreign investment and other information relating to its investment policies.

Guidelines on the Treatment of Foreign Direct Investment (1992) 7 ICSID Rev-FILJ 297. See also Articles 10 and 11 of the 2012 United States Model BIT, especially Article 10(1) which reads:

> Each Party shall ensure that its: (a) laws, regulations, procedures, and administrative rulings of general application; and (b) adjudicatory decisions respecting any matter covered by this Treaty are promptly published or otherwise made publicly available.

[351] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (n 344) [197]-[206]; *Gami Investments, Inc. v. The Government of the United Mexican States* (n 344) [91]; *International Thunderbird Gaming Corporation v. The United Mexican States* (n 230) [164]; *Alasdair Ross Anderson et al v. Republic of Costa Rica* (n 9) [58] (observing that "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."); C McLachlan, L Shore & Matthew Weiniger (n 344) 309-310.

interpretation of the treaty requires that the investment be deemed lawful. Such rectifying action could be deemed as ‘timely’ when it occurs as soon as the investor becomes aware of the illegality, which should more preferably be before arising of a dispute, or, at the latest, the filing of a claim. Furthermore, the investor should present evidence that the advice it received misled it and confused its understanding of the host state law. It goes without saying that the investor must also show that it was reasonable for it at the time of making the investment to rely on the advice, which later proves to be wrong. Additionally, an investor cannot be heard to argue that it violated a mandatory rule of international law since it did not know whether the host state law included this norm or not. Therefore, these conditions must be satisfied cumulatively for an investor to be able to get away with the illegality: (i) the investor must show that it had good faith, for instance, by showing that it has not been condemned in the host state or any other state for commission of crimes or other sorts of illegalities of the kind at stake; (ii) it should show that it acted reasonably and did its best efforts to acquaint itself with the laws of the host state, for example, by hiring a reputable local lawyer or law firm; (iii) it should prove that the legal regime of the host state was nevertheless far away from transparent and clear; (iv) it should also establish that before a dispute arose, and upon being notified of the illegality it acted immediately to rectify the illegality to the extent possible; and (v) the investor cannot be heard to say that it violated a mandatory rule of international law, like prevention of bribery, under the impression that the laws of the host state did not entertain this rule.

215. As to the other reason for committing an illegality despite having good faith, i.e., having to pay bribes to get the investment project, one must observe that it is no legal excuse for the investor to avow that corruption is a common practice in the recipient country without which the award of a contract is difficult or even impossible.[352]

216. To conclude on this point, unless very special circumstances exist, the investor’s good faith or lack of knowledge as to the laws of the host state do not nullify illegality or its consequences.[353]

217. That being said, it should be noted that jurisdiction would be dismissed if the illegality is the result of the investor’s action or inaction. In other words, it is the investor’s conduct which should be checked against the legal provisions of the host state. Therefore, if the alleged illegality is something which is the exclusive result of the violation of the host state law by the authorities of the host state in the course of the admission or establishment of the investment, then the legality requirement cannot be evoked to bar the tribunal from exercising jurisdiction. For instance, if according to the laws of country “A”, investments in the public transportation

[352] See *World Duty Free Company v Republic of Kenya* (n 50) [156] (reviewing ICC practice on this issue). That being said, in case the bribe is obtained by use of force, coercion, or oppression, then the scenario would probably be different. See ibid [181].

[353] On the other hand, a finding of bad faith or intentional violation of the host state law would buttress the tribunal’s finding on illegality and, consequently, would lead to a decision of lack of jurisdiction. In *Fraport v. Philippines*, the investor had concluded certain secret and concealed shareholding agreements, which were in violation of Philippine’s Anti-Dummy Laws. This action on the part of the investor had a twofold meaning to the arbitral panel: first that the host state had no way of knowing the illegality of the claimant’s illegal arrangements; second, and more importantly, the investor did not act in good faith in non-compliance with the laws of the recipient state. *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines* (n 2) [323], [326]-[327], [332], [346]-[347], [355], [387], [398]. This latter finding arguably played an important role in the tribunal’s persuasion for dismissing jurisdiction. ibid [323], [327], [398].

section should be procured through a bidding process, but the ministry of transportation of that country, with no legal justification, concludes a contract for urban track-building directly with an innocent and clean-handed foreign investor without holding a bidding process, then the host state cannot in later arbitration proceedings invoke the violation committed by itself to have the case dismissed. In fact, in such a situation, the illegality is beyond the investor's control. As stated in *Kardassopoulos v Georgia*, a state cannot avail itself of its own wrongdoing in order to deny protection of the investment under an investment treaty (*nemo auditur propriam turpitudinem allegans*):

> 183. […] the Tribunal observes that Respondent does not allege that Claimant committed any act in violation of Georgian law. Quite the contrary, it is the Respondent which argues that its State-owned enterprises violated Georgian law by exceeding their authority, thus rendering void *ab initio* the JVA and the Concession.
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> 184. Accordingly, Article 12 of the BIT cannot be invoked by Respondent to exclude Claimant's investment from protection under the BIT. It follows that notwithstanding the fact that the JVA and the Concession may be void *ab initio* under Georgian law, Claimant's investment nonetheless remains entitled to protection under the BIT and the Tribunal so finds.[354]

Conclusion

218. One of the prime areas in investment treaty arbitrations in which the municipal laws of the host state apply as 'law' is the jurisdictional issue of the legality requirement. Domestic laws of the host state determine whether the investment in question was established in a lawful manner or not. The application of the laws of the host state to the question of the determination of the legality of the investment is principally because of the express or implied agreement of the investment treaty contracting parties to the application of the laws of the host state to this matter. In any event, it was demonstrated in this Chapter that even if no reference has been made to the laws of the host state for the purpose of determining the legality of the investment, general principles of law require the application of the internal laws of the host state since unlawful investments, i.e., investments made in contravention of the host state law, do not deserve protection under international investment agreements. It was submitted that in this latter situation, i.e., lack of any legality requirement in the investment treaty at stake, the tribunal may dismiss the case on the ground of inadmissibility rather than lack of jurisdiction.

219. Like any other condition, the legality requirement has a limited scope. Although due to the use of open-textured terms of 'laws', 'regulations, and 'legislation' in the legality requirement, the 'formal' scope of the requirement is usually broad and mostly uncontroversial, the 'substantive' scope of the legality requirement is quite vague, which vagueness has created

[354] *Ioannis Kardassopoulos v. The Republic of Georgia* (n 11) [183]-[184]. In that case, the tribunal found further support for its reasoning from the 'representations and warranties' given by the Georgian public authorities in the relevant instruments concerning the investment, in the frequent assurances and confirmations given by authorities of the host state as to the investment's legality, and in the lack of objections or complains during the period following the conclusion of the investment. ibid [185]-[194]. According to the tribunal, the overall conduct of the respondent had given rise to the investor's 'legitimate expectations' that the investment complied with the Georgian law. See ibid [192]-[194].

much controversy and ambiguity in practice and scholarship. It was submitted in this Chapter that a ‘balanced’ and ‘holistic’ interpretation of the legality requirement would include in the ‘substantive’ realm of the condition the fundamental laws of the host state (its constitution, its organic laws (if any), and its mandatory laws) as well as the ordinary laws of the host state, to the extent that the latter laws are violated at the time of the initiation of the investment in order to guarantee the establishment or the success of the investment. Finally, as the ‘ordinary meaning of the terms’ used in a typical legality requirement indicates, the ‘temporal’ scope of the legality requirement is confined to breaches of the internal laws of the host state at the time of making the investment not the subsequent violation of such laws.

220. As was shown in this Chapter, subject to the wording of the legality requirement in question, the violation of the laws of the host state at the time of the establishment of the investment leads to the negation of a legal attribute to the subject-matter of the dispute, i.e., investment. In this sense, the investment treaty would not apply to an investment which is not made in accordance with the laws of the host state. As a result, the investment treaty arbitral tribunal which derives its jurisdiction from the treaty in question will not have the competence to decide the case due to lack of jurisdiction *ratione materiae*.

221. Finally, unless absolutely manifest circumstances exist, the investor’s good faith or its lack of knowledge would not absolve it from the legal consequences of non-compliance with host state law in the course of making its investment. Furthermore, the involvement of the host state authorities in a corruptive act leading to the establishment of the investment will not excuse the investor’s illegal conduct at the time and will not bar the legal consequences of the legality requirement from being implemented in case of violation of the laws of the host state.