# Chapter 3.2
# Illegality and Corruption Defenses in Investor-State Arbitration

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## A. INTRODUCTION

In investment arbitration, corruption and illegality represent two distinct but occasionally overlapping defenses. The defense of illegality generally entails that the investment at issue was illegal under applicable domestic law or international law. It can involve a range of issues, from breaches of domestic regulatory frameworks to violations of international legal obligations committed by the investor. The defense of corruption is predicated on the principle that investment treaty protections should not extend to investments acquired or maintained through corrupt practices. This defense generally asserts that an investment tainted by corruption is not deserving of protection under international law. The basis for this defense lies in the notion that corruption undermines the rule of law and contravenes international norms against unethical behavior. Corruption can manifest in various forms, such as bribery of government officials, fraudulent misrepresentation, or kickbacks.

In this Chapter, we address how investment arbitration tribunals have approached the illegality and corruption defenses. In **Section B**, we introduce the legality requirement for investments, the sources of this requirement, the temporal scope of application of this requirement, and the law applicable to assess the legality of an investment. **Section C** addresses how corruption allegations have been raised as a defense or an attack in investment arbitration. **Section D** analyses the consequences of illegality and corruption on jurisdiction, admissibility, or the merits of the dispute. **Section E** examines the burden and standard of proof to demonstrate the illegality of the investment, as applied by arbitral tribunals. Finally, **Section F** outlines the conclusions of this Chapter.

## B. LEGALITY OF AN INVESTMENT

### I. The Source of the Legality Requirement

Many investment treaties include provisions stating that investments protected by them must be made, accepted, or established "in accordance with the [host State's] laws" or include clauses requiring investments to comply with the host State's laws and regulations.[1] These provisions are

[1] *See, e.g.*, Bilateral Investment Treaty Between The Government of The Kyrgyz Republic and The Government of the Republic of India, signed 14 June 2009, Article 1(4) ("'[I]nvestment' 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, taken together with the assets of the enterprise, has the characteristics of an investment such as the commitment of capital or other resources, certain duration, the expectation of gain or profit the assumption of risk and a significance for the development of the Party in whose territory the investment is made. An enterprise may possess the following assets:…"); Agreement between the Swiss Confederation and the Islamic Republic of Pakistan on the Promotion and Reciprocal Protection of Investments, signed 11 July 1995, Article 2(1) ("The present Agreement shall apply to any investments in the territory of one Contracting Party by investors of the other Contracting Party, that have been made later than first September 1954 in accordance with the laws and regulations of the former Contracting Party.")

designed to limit the scope of protection under the relevant investment treaty and, in particular, to limit the State parties' consent to resolve disputes through arbitration.

Some tribunals have found, however, that legality is a prerequisite for protection under investment treaties even without an explicit requirement, finding that an implied legality requirement still applies as a general principle of international law.[2] Yet, some tribunals have held that, at least in the context of the Energy Charter Treaty, there is no implied legality requirement for precluding jurisdiction.[3]

Not all violations of the host State's laws deprive an investment from treaty protection. The legality requirement typically covers non-trivial violations of the host State's legal order, violations of the foreign investment regime, and fraud to secure the investment or profits. Minor violations, such as registration or notification defects, are less likely to disqualify an investment if they do not render it void or invalid under applicable law. Indeed, tribunals have found that the legality requirement applies only to serious violations of the host State's laws and regulations, such as corruption and fraud,[4] overlapping with the corruption defense discussed below. Furthermore, tribunals have disagreed on whether the inquiry should be limited to violations of laws and regulations governing the investment regime only as opposed to other breaches of domestic laws.[5]

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2 *See, e.g.*, *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010, ¶¶ 123-124; *SAUR International v. Argentine Republic*, ICSID Case No. ARB/04/4, Award on Jurisdiction and Liability, 6 June 2012, ¶ 308; *Phoenix Action Ltd v. Czech Republic*, ICSID Case No. ARB/06/5, Award, 15 April 2009, ¶¶ 100-101; *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines (II)*, ICSID Case No. ARB/11/12, Award, 10 December 2014, ¶ 332; *Ampal-American Israel Corp., EGI-Fund (08-10) Investors LLC, EGI-Series Investments LLC, BSS-EMG Investors LLC and David Fischer v. Arab Republic of Egypt*, ICSID Case No. ARB/12/11, Decision on Jurisdiction, 1 February 2016, ¶ 301; *Spentex Netherlands, B.V. v. Republic of Uzbekistan*, ICSID Case No. ARB/13/26, Award, 27 December 2016, as discussed in Vladislav Djanic, *In Newly Unearthed Uzbekistan Ruling, Exorbitant Fees Promised to Consultants on Eve of Tender Process Are Viewed by Tribunal as Evidence of Corruption, Leading to Dismissal of All Claims Under Dutch BIT*, INVESTMENT ARBITRATION REPORTER (22 June 2017), https://www.iareporter.com/articles/in-newly-unearthed-uzbekistan-ruling-exorbitant-fees-promised-to-consultants-on-eve-of-tender-process-are-viewed-by-tribunal-as-evidence-of-corruption-leading-to-dismissal-of-all-claims-under-dutch/.

3 *See, e.g.*, *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, ICSID Case No. ARB/07/14, Award (excerpts), 22 June 2010, ¶ 187; *Ascom Group S.A., Anatolie Stati, Gabriel Stati and Terra Raf Trans Traiding Ltd. v. Republic of Kazakhstan*, SCC Case No. 116/2010, Award, 19 December 2013, ¶ 812.

4 *See, e.g.*, *Achmea B.V. (formerly Eureko B.V.) v. The Slovak Republic (I)*, PCA Case No. 2008-13, Final Award, 7 December 2012, ¶¶ 173-176 (implied requirement); *Energoalians SARL v. the Republic of Moldova*, ad hoc, Award, 23 October 2013, ¶ 261 (implied requirement); *HOCHTIEF Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/07/31, Decision on Liability, 29 December 2014, ¶ 199 (express requirement); *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award, 30 March 2015, ¶¶ 483, 494 (express requirement); *ECE Projektmanagement International GmbH and Kommanditgesellschaft PANTA Achtungsechzigste Grundstücksgesellschaft mbH & Co v. The Czech Republic*, PCA Case No. 2010-5, Award, 19 September 2013, ¶ 3.170 (express requirement); *Peter A. Allard v. The Government of Barbados*, PCA Case No. 2012-06, Award on Jurisdiction, 13 June 2014, ¶ 94 (express requirement).

5 *See, e.g.*, *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award, 14 July 2010, ¶ 119

In addition, a few tribunals have applied a *proportionality test* to determine whether the legality requirement applies.[6] One of them was the *Vladislav Kim v. Uzbekistan* tribunal, which involved an express legality requirement in the Uzbekistan-Kazakhstan BIT and where the tribunal proposed three elements that must be examined to determine the applicability of the legality requirement: (1) the significance of the obligation with which the investor is alleged to not comply; (2) the seriousness of the investor's conduct; and (3) whether the combination of the investor's conduct and the law involved 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.[7] Lack of prosecution by the State can create legitimate expectations for investors, preventing the host State from later raising the illegality defense. As discussed below, tribunals also assess the investor's conduct and due diligence.

## II. Temporal Scope of the Legality Requirement

Tribunals generally agree that the legality requirement applies only to the initial making of the investment, not to the holding of an investment over the course of its entire lifetime.[8] This is largely the result of how the BITs formulate the legality requirement: Tribunals generally justify this temporal restriction by referring to the word "*made*" in the applicable legality provision. Post-establishment violations of the host State's laws generally do not disqualify the investment from treaty protection but may impact the merits of the case. For investments made through a series of acts, tribunals require all acts to be legal, not just the final one. Some treaties may require that the investment be

("However, unless specifically stated in the investment treaty under consideration, a host State should not be in a position to rely on its domestic legislation beyond the sphere of investment regime to escape its international undertakings vis-à-vis investments made in its territory.").

6 *Metalpar S.A. and Buen Aire S.A. v. Argentine* Republic, ICSID Case No. ARB/03/5, Decision on Jurisdiction, 27 April 2016, ¶ 84.

7 *Vladislav Kim, Pavel Borissov, Aibar Burkitbayev and others v. Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction, 8 March 2017, ¶¶ 20, 405-409, 541.

8 *See, e.g.*, *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010, ¶ 127; *Vannessa Ventures Ltd v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/04/6, Award, 16 January 2013, ¶ 167; *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic*, ICSID Case No. ARB/07/26, Decision on Jurisdiction, 19 December 2012, ¶ 260; *ECE Projektmanagement International GmbH and Kommanditgesellschaft PANTA Achtungsechzigste Grundstücksgesellschaft mbH & Co v. The Czech Republic*, PCA Case No. 2010-5, Award, 19 September 2013, ¶¶ 3.165-3.168; *Quiborax S.A., Non-Metallic Minerals S.A. v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Award, 16 September 2015, ¶¶ 129-130; *Bernhard von Pezold and others v. Republic of Zimbabwe,* ICSID Case No. ARB/10/15, Award, 28 July 2015, ¶ 420; *Oxus Gold plc v. Republic of Uzbekistan, the State Committee of Uzbekistan for Geology & Mineral Resources, and Navoi Mining & Metallurgical Kombinat*, ad hoc, Final Award, 17 December 2015, ¶¶ 706-707; *Copper Mesa Mining Corporation v. Republic of Ecuador*, PCA Case No. 2012-2, Award, 15 March 2016, ¶ 5.54; *Churchill Mining and Planet Mining Pty Ltd v. Republic of Indonesia*, ICSID Case No. ARB/12/14 and 12/40, Award, 6 December 2016, ¶ 488; *Vladislav Kim, Pavel Borissov, Aibar Burkitbayev and others v. Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction, 8 March 2017, ¶¶ 374-377; *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award, 4 October 2013, ¶ 193.

not only made in accordance with the host State's laws but be also maintained in accordance with those laws, this requiring continued legality.

### III. Applicable Law for Assessment of Legality

The legality of an investment is generally assessed under the host State's domestic law. In cases of trans-border criminal activities, the laws of other jurisdictions, such as the investor's home State, may be relevant. As discussed below, serious violations against international public policy such as corruption and fraud, might be governed by the standards developed under international public policy rules.

## C. Corruption as a Defense or Attack in Investment Arbitration

Corruption plays a significant and multifaceted role in investment arbitration, serving both as a defense for States against investor claims and, in some cases, as a basis for investors to bring claims under investment treaties.

### I. The Source of the Corruption Defense

Corruption in investment arbitration can be established on the basis of the host State's domestic law prohibiting corruption or on the basis of international public policy on corruption. While municipal laws provide concrete definitions of corruption and bribery within each jurisdiction, there are also international instruments that are often relevant.[9] On the international plane, States nearly universally adopted the United Nations Convention against Corruption (UNCAC), which came into force in 2005.[10] It is the only legally binding universal anti-corruption instrument and reflects a commitment by States to fight corruption, with emphasis on international cooperation and asset recovery. While the UNCAC does not offer a broad definition of corruption, it specifies particular acts that member states are required to be criminalized through its legislation and some that are encouraged to be criminalized. The corruption offenses outlined by UNCAC include:

- Bribery in the public and private sectors (Articles 15, 16, and 21)
- Embezzlement in the public and private sectors (Articles 17 and 22)
- Trading in influence (Article 18)
- Abuse of functions (Article 19)
- Illicit enrichment (Article 20)
- Money laundering (Article 23)
- Concealment (Article 24)
- Obstruction of justice (Article 25) related to the aforementioned offenses.

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9 *See, e.g.*, *Vladislav Kim, Pavel Borissov, Aibar Burkitbayev and others v. Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction, 8 March 2017, ¶ 594. *See also* U.N. Office on Drugs and Crime, University Module Series: Anti-Corruption Module 1: What Is Corruption and Why Should We Care?, https://www.unodc.org/e4j/en/anti-corruption/module-1/key-issues/corruption---baseline-definition.html.

10 U.N. Office on Drugs and Crime, Corruption and Economic Crime Branch, *Learn about UNCAC, Factsheet* (Oct. 31, 2003) (191 State parties as of 7 August 2024), https://www.unodc.org/corruption/en/uncac/learn-about-uncac.html.

The case of *Vladislav Kim v. Uzbekistan* illustrates how the corruption defense can be raised on the basis of domestic law as well as under international public policy on corruption. There, the respondent State argued that the investor's claims were inadmissible because of corruption both under a provision of the Uzbek Criminal Code and, separately, also under international public policy on corruption.[11] The tribunal acknowledged the existence of an international public policy against corruption, as recognized in various international instruments, citing the UNCAC as well as the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions dated 17 December 1997. The tribunal affirmed that payments to officials constitute corruption under international public policy. Ultimately, it concluded that international public policy aligned with the provision against corruption in the Uzbek Criminal Code, emphasizing bribery of government officials.[12]

## II. Defense of Corruption Raised by Respondent States

One of the often-cited cases on corruption is *World Duty Free v. Kenya,* in which the respondent States raised the defense of corruption based on the action of its most senior officer, a former president of the country, who was the recipient of the claimant's bribe.[13] While the tribunal found it "highly disturbing" that the president was not prosecuted for these actions, the tribunal was asked to determine the existence of a transnational public policy against bribery and its implications for the proceedings. The tribunal articulated "international public policy" as a consensus regarding universal standards and accepted norms of conduct that must be upheld across all jurisdictions, often referred to as transnational public policy. It concluded that "bribery is inconsistent with the international public policy of most, if not all, States," thereby emphasizing that public policy serves to protect not merely the parties involved, but the public at large.[14] It held that Kenya retained the right to annul the transaction at issue because the corrupt actions of its former president were not attributable to the State.[15] In *Hamester v. Ghana*, the tribunal held that "[a]n investment will not be protected if it has been created in violation of national or international principles of good faith by way of corruption, fraud, or deceitful conduct."[16]

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11 *See, e.g.*, *Vladislav Kim, Pavel Borissov, Aibar Burkitbayev and others v. Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction, 8 March 2017, ¶¶ 592-600.

12 *Id.*

13 *World Duty Free Co. Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award, 4 October 2006.

14 *World Duty Free Co. Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award, 4 October 2006, ¶ 157.

15 *World Duty Free Co. Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award, 4 October 2006, ¶ 188.

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

## D. Acts of Corruption Leading to Investor's Claims of Breach of Investment Treaty Obligations

Corruption can also serve as a basis for an investor to claim that the respondent State has violated their investment treaty obligations. In *EDF v. Romania*, the claimant alleged that a Romanian state entity's request for a bribe constituted a breach of the fair and equitable treatment standard under the bilateral investment treaty at issue. EDF claimed that the refusal to pay a bribe led to the non-extension of a contract for the airport project. The tribunal, however, found that the evidence presented by EDF did not meet the "clear and convincing" standard required to prove the corruption allegations.[17] In *RSM v. Grenada*, the claimants contended that Grenada's decision to expel RSM from a petroleum exploration project was influenced by bribery involving a senator.[18] They argued that this corruption violated the BIT's provisions. However, the tribunal dismissed the claim under Rule 41(5) of the ICSID Arbitration Rules, finding that a previous ICSID tribunal had ruled that Grenada's termination of the agreement in dispute was valid. RSM subsequently requested a successor tribunal to revisit those findings under Article 51 of the ICSID Convention, citing new evidence of corruption. However, the successor Tribunal refused, noting that the facts and circumstances related to the alleged misconduct had been accessible to RSM during the earlier case but were not raised at that time.[19]

In *BSG v. Guinea*, both the investor and the State sought to lean on corruption in support of their claims. The case involved a complex scenario where the claimant, BSG, sought compensation for the expropriation of mining concessions, alleging that the revocation was a result of extortion attempts by the Guinean government.[20] Instead of finding expropriation, the tribunal confirmed the existence of corruption and declared the claimant's case inadmissible, finding that the investment was obtained through influence peddling and corruption. Although the Guinean Criminal Code only penalized passive influence peddling (i.e., the recipient of bribes in dealings with non-public officials), the tribunal applied international treaties ratified by Guinea, such as the African Union Convention and the ECOWAS Anti-Corruption Protocol, which supersede national law.[21] The tribunal also dismissed Guinea's counterclaim, which sought relief for the harm caused to the respondent State by the claimants' corrupt practices.[22] The tribunal first noted that "the inadmissibility of claims does not automatically lead to a finding of inadmissibility of counterclaims."[23] However, it found that the harm caused by the claimants' actions "would not have occurred if the Guinean state

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17 *EDF (Services) Limited v. Republic of Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, ¶ 221.

18 *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Corporation v. Grenada*, ICSID Case No. ARB/10/6, Award, 10 December 2010, ¶ 7.3.6.

19 Id.

20 *BSG Resources Limited (in administration), BSG Resources (Guinea) Limited and BSG Resources (Guinea) SÀRL v. Republic of Guinea (I),* ICSID Case No. ARB/14/22, Award, 18 May 2022, ¶¶ 468-486.

21 Id., at ¶¶ 469-482.

22 Id., at ¶¶ 1103-1110.

23 Id., ¶ 1104.

officials in charge of making the controversial decisions or persons close to them had not been on the receiving end of the corruption scheme."[24] It also found some "aggravating circumstances" such as the respondent State's failure to pursue criminal action against those officials.[25] In this context, the tribunal concluded that the "general principles of international law," such as *ex turpi causa non oritur actio*, [26] rendered the counterclaims inadmissible.

While States have used allegations of corruption to object to investors' claims, investors have also leveraged corruption allegations to argue breaches of treaty obligations. The effectiveness of these arguments depends on the strength of evidence and the ability to demonstrate links between corruption and treaty violations. Corruption can thus be used as a shield and a sword in investment arbitration.

## E. CONSEQUENCES OF ILLEGALITY AND CORRUPTION

Claims of illegality and/or corruption in international investment arbitration are highly complex and contentious, involving multiple layers of legal interpretation and policy considerations. These allegations can impact the jurisdiction of the tribunal, the admissibility of claims, or the merits of the dispute.[27] This section explores the jurisdictional, admissibility, and merits issues related to illegality and corruption allegations, focusing on key cases and principles that have shaped this area of law.

### I. Consequences for Jurisdiction

For an arbitral tribunal to have jurisdiction over a dispute under an international investment treaty or agreement ("IIA"), an investor must meet several basic jurisdictional requirements. One of the gateways questions is whether the alleged investment qualifies as an "investment," under the specific IIA. The consent to jurisdiction granted by the parties to an IIA is limited to disputes arising from investments that meet the treaty's specific definition.

As explained above, many investment treaties include provisions requiring investments to be made in accordance with the law of the host State to be considered an "investment" under the treaty.[28] Therefore, IIAs explicitly stating that only investments made "in accordance with the law" of the host

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[24] Id.

[25] Id., ¶ 1109.

[26] From Latin, "action does not arise from a dishonourable cause." *See* "ex turpi causa non oritur actio. *Oxford Reference.* Available at https://www.oxfordreference.com/view/10.1093/oi/authority.20110803095806471.

[27] *Unión Fenosa Gas, S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/14/4, Award, 31 August 2018, ¶ 7.48 ("[t]he effect of international public policy under the Treaty as a matter of international law and also as a matter of Egyptian law, proven corruption by the Claimant in procuring the SPA would be fatal to the Claimant's claims derived from the SPA in this arbitration, as regards jurisdiction, admissibility and merits.").

[28] *See, e.g.*, Agreement Between the Government of the Republic of Kazakhstan and the Government of Malaysia for the Promotion and Protection of Investments, signed 25 May 1996, Article 1(2); Agreement Between the Republic of Turkey and the Republic of Kazakhstan Concerning the Reciprocal Promotion and Protection of Investments, signed 1 May 1992, Article 1(2). Other relevant provisions also include a legality requirement.

State,[29] or similar provisions,[30] limit the arbitral tribunal's jurisdiction to decide a claim related to such an investment. If an investment was not made according to the host State's laws, the arbitral tribunal lacks jurisdiction *ratione materiae* to resolve the case.[31]

Multiple tribunals have dealt with corruption issues as matters of jurisdiction, more specifically, *ratione materiae* jurisdiction, analyzing whether the investment was illegally established *ab initio.*[32] As noted, the severity of noncompliance with legal requirements can significantly impact the jurisdictional and substantive outcomes of a case. In *Kim v. Uzbekistan* and *Cortec v. Kenya*, the tribunals assessed the severity of noncompliance with domestic law, considering factors such as the extent of the violation and its impact on the investment's legitimacy, the gravity of the breach, and the seriousness of the law being breached. In contrast, tribunals have considered that minor or trivial breaches do not deprive the investment from treaty protection, refusing to decline jurisdiction in such cases on the grounds of illegality.[33]

## II. Investor's Due Diligence

In considering the investment was made in accordance with the host State's laws, some tribunals have focused on the investor's due diligence obligations – namely, that an investor has an obligation to investigate the legislation and regulatory framework of the country in which they invest.

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29 *See, e.g.*, Agreement Between the Government of the Republic of Kazakhstan and the Government of Malaysia for the Promotion and Protection of Investments, signed 25 May 1996, Article 1(2); Agreement Between the Republic of Turkey and the Republic of Kazakhstan Concerning the Reciprocal Promotion and Protection of Investments, signed 1 May 1992, Article 1(2). Other relevant provisions also include a legality requirement.

30 *See, e.g.*, Agreement between the Swiss Confederation and the Government of the Kyrgyz Republic on the Promotion and Reciprocal Protection of Investments, signed 1 June 1999, Article 2.

31 *See, e.g.*, *David Minnotte and Robert Lewis v. Republic of Poland,* ICSID Case No. ARB(AF)/10/1, Award, 16 May 2014, ¶ 131.

32 *See e.g. United Agencies Limited SA v. People's Democratic Republic of Algeria*, ICSID Case No. ARB/20/1, Award (Excerpts), 25 July 2022, ¶ 267, *Fynerdale Holdings BV v. The Czech Republic*, PCA Case No. 2018-18, Award, 29 April 2021, ¶ 526; *David Minnotte and Robert Lewis v. Republic of Poland*, ICSID Case No. ARB(AF)/10/1, Award, 16 May 2014, ¶ 121; *Anglo-Adriatic Group Limited v. Republic of Albania*, ICSID Case No. ARB/17/6, Award, 7 February 2019, ¶ 287; *Infinito Gold Ltd. v. Republic of Costa Rica*, ICSID Case No. ARB/14/5, Decision on Jurisdiction, 4 December 2017, ¶ 137; *Anglo-Adriatic Group Limited v. Republic of Albania*, ICSID Case No. ARB/17/6, Award, 7 February 2019, ¶ 293.

33 *Vladislav Kim, Pavel Borissov, Aibar Burkitbayev and others v. Republic of Uzbekistan,* ICSID Case No. ARB/13/6, Decision on Jurisdiction, 8 March 2017, ¶ 398 ("An investor may violate a law of some import egregiously or it may violate a law of fundamental importance in only a 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 concern with the seriousness of the violation."); *see also Cortec Mining Kenya Ltd, Cortec (Pty) Ltd and Stirling Capital Ltd v. Republic of Kenya,* ICSID Case No. ARB/15/29, Final Award, 22 October 2018, ¶¶ 319-321.

In *Alasdair Ross Anderson and others v. the Republic of Costa Rica*, the arbitral tribunal found that it had no jurisdiction because the investment was not made in accordance with Costa Rican law.[34] This case involved a claim by 137 Canadian citizens against Costa Rica for alleged violations of the Canada-Costa Rica Bilateral Investment Treaty (BIT), related to investments made through third parties (the Villalobos brothers). The BIT between Canada and Costa Rica defines "investment" as "any kind of asset owned or controlled directly, or indirectly through a company or natural person of a third State, by an investor of one of the Contracting Parties in the territory of the other Contracting Party in accordance with the latter's legislation."[35] The tribunal found that the Villalobos brothers had violated Costa Rica's Organic Law of the Central Bank by engaging in unauthorized financial intermediation. It concluded that because the transaction through which the claimants obtained ownership of their assets did not comply with Costa Rican law, the claimants did not have a covered investment under the treaty according to Costa Rican law.[36] Therefore, the tribunal declared itself incompetent to decide the case. In reaching this conclusion, the tribunal noted:

> [P]rudent investment practice requires that any investor exercise due diligence before committing funds to any particular investment proposal. An important element of such due diligence is for investors to assure themselves that their investments comply with the law. Such due diligence obligation is neither overly onerous nor unreasonable. Based on the evidence presented to the Tribunal, it is clear that the Claimants did not exercise the kind of due diligence that reasonable investors would have undertaken to assure themselves that their deposits with the Villalobos scheme were in accordance with the laws of Costa Rica.[37]

## F. ADMISSIBILITY OF THE CLAIM

Arbitral tribunals have also addressed corruption and illegality of the investment as matter of admissibility, for instance when the treaty does not provide a clause requiring compliance of the investment with the law, or if the illegal or deceitful conduct took place after the investment was established. As explained by the tribunal in *Worley International v. Ecuador:*

> The reason why serious violations such as a breach of international public policy may bar the admissibility of claims is that international adjudicatory bodies have a duty not to entertain claims tainted by violations of certain universally accepted norms pursuant to general principles of good faith and *nemo auditur propiam turpitudinem allegans*. [...]

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[34] *Alasdair Ross Anderson and others v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award, 19 May 2010, ¶¶ 51-61.

[35] Agreement Between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments, adopted on 18 March 1998, Article I. g.

[36] *Alasdair Ross Anderson and others v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award, 19 May 2010, ¶¶ 51-61

[37] Id., at ¶ 58.

While in investment arbitration, international public policy has primarily been invoked in the context of illegalities affecting the making of the investment, the underlying rationale also applies to subsequent illegalities, if they are severe and taint the claims in arbitration. According to Douglas, an investor whose claims are tainted by a breach of international public policy must not be "assisted in any way by the arbitral process."[38]

Tribunals have mostly addressed admissibility under the clean hands doctrine. The clean hands principle asserts that a party cannot benefit from its misconduct. In *Littop v. Ukraine*, the tribunal applied this principle, finding that the plaintiffs controlled the company through corruption and bribery, leading to the claim's inadmissibility.[39] The principle of *nemo auditur propriam turpitudinem allegans*, meaning no one can benefit from their own wrongdoing, is also explored in cases like *Inceysa v. El Salvador* and *Plama v. Bulgaria*.[40]

In a similar vein, in *Churchill Mining v. Indonesia*, the tribunal noted that investors must exercise a reasonable level of due diligence when making an investment, especially in a risky business environment.[41] In this specific case, the tribunal decided that the claim was inadmissible because the investment was made in violation of Indonesian domestic law, as the mining licenses had been obtained through fraudulent conduct.

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38 *Worley International Services Inc. v. Republic of Ecuador*, PCA Case No. 2019-15, Final Award, 22 December 2023, ¶ 314; *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, 2 August 2006, ¶ 242 ("Applying the first principle indicated above to the case at hand, we can affirm that the foreign investor cannot seek to benefit from an investment effectuated by means of one or several illegal acts and, consequently, enjoy the protection granted by the host State, such as access to international arbitration to resolve disputes, because it is evident that its act had a fraudulent origin and, as provided by the legal maxim, 'nobody can benefit from his own fraud.'").

39 *Littop Enterprises Limited, Bridgemont Ventures Limited and Bordo Management Limited v. Ukraine*, SCC Case No. V 2015/092, Final Award, 4 February 2021, ¶ 439.

40 *Inceysa Vallisoletana S.L. v. Republic of El Salvador,* ICSID Case No. ARB/03/26, Award, 2 August 2006, ¶ 229; *Plama Consortium Limited v. Republic of Bulgaria,* ICSID Case No. ARB/03/24, Award, 27 August 2008, ¶¶ 140-146.

41 *Churchill Mining and Planet Mining Pty Ltd v. Republic of Indonesia*, ICSID Case No. ARB/12/40 and 12/14, Award, 6 December 2016, ¶ 506 ("[T]he scope of the due diligence depends on the particular circumstances of each case, such as the general business environment, and includes ensuring that a proposed investment complies with local laws, as well as investigating the reliability of a business partner and that partner's representations before deciding to invest.").

## G. CONSEQUENCES ON THE MERITS

Multiple arbitral tribunals have concluded that illegality should be analyzed as part of the merits of the dispute.[42] For instance, arbitral tribunals have considered the investor's illegal conduct to assess the host state's measures against the investor.[43] In *Lao Holdings v. Lao (I)*, the tribunal did not find sufficient "clear and convincing evidence" to confirm the State's bribery allegations against the investor.[44] However, it acknowledged the probable existence of illicit payments to government officials, relevant to demonstrate the investor's bad faith.[45] When reviewing the claimants' overall conduct, including probable corruption in halting an external audit, manipulation of authorities to secure a gambling license, and false commitments, the tribunal concluded that the claimants acted in bad faith. [46]

In the *Plama v. Bulgaria*, decided under the Energy Charter Treaty, the tribunal denied protection for the investment at the merits stage and dismissed all claims due to misrepresentation and illegality of the investment.[47] The claimant had falsely presented itself as a consortium of major companies with substantial assets, while in reality, an individual with limited financial resources acted alone as the sole investor.[48] The tribunal concluded that Bulgaria would not have consented to the investment had it known the truth.[49] It determined that the claimant had obtained the investment through deceitful conduct, violating Bulgarian law, and found that enforcing the contract would contradict international public policy. The tribunal also emphasized that the claimant's actions violated the principle of good faith, an obligation under both Bulgarian and international law.[50]

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42 *Bank Melli Iran and Bank Saderat Iran v. Kingdom of Bahrain*, PCA Case No. 2017-25, Award, 9 November 2021, ¶¶ 503-507; *Hesham Talaat M. Al-Warraq v. The Republic of Indonesia*, ad hoc, Award on Respondent's Preliminary Objections to Jurisdiction and Admissibility of the Claims, 21 June 2012, ¶ 99; *HOCHTIEF Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/0/31, Decision on Liability, 29 December 2014, ¶ 200.

43 *Lao Holdings N.V. v. Lao People's Democratic Republic (I)*, ICSID Case No. ARB(AF)/12/6, Award, 6 August 2019, ¶¶ 278-280.

44 *Lao Holdings N.V. v. Lao People's Democratic Republic (I)*, ICSID Case No. ARB(AF)/12/6, Award, 6 August 2019, ¶¶ 7, 110 ("In the Tribunal's view there need not be "clear and convincing evidence" of every element of every allegation of corruption, but such "clear and convincing evidence" as exists must point clearly to corruption.")

45 Id., ¶¶ 7, 158, 206, 214, 223.

46 Id., ¶¶ 7, 158, 206, 214, 223.

47 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, ¶¶ 112-146.

48 Id., ¶ 133.

49 Id., ¶¶133- 143.

50 Id., ¶ 144.

Tribunals have also considered the illegality of the investment to assess the investor's claims regarding a breach of its purported "legitimate expectations".[51] For example, the tribunal in *Mamidoil v. Albania,* having found that the construction and operation of the claimant's investment did not comply with the domestic legislation of the host state, concluded that the claimant was not "entitled to rely on the perpetuation of its activities in illegal circumstances and [could] not claim a violation of legitimate expectations with respect to the illegal operation."[52]

## H. BURDEN AND STANDARD OF PROOF

### I. Different Approaches

While investors must generally prove their investment was made, the respondent State bears the initial burden of proving allegations of illegality or corruption. The standard of proof for establishing illegality or corruption is a contentious issue in investment arbitration, with tribunals adopting different approaches:

- The standard of proof should be the same as for other allegations in investment arbitration, as the consequences differ from domestic criminal proceedings.
- Tribunals may rely on circumstantial evidence, such as red flags, due to the difficulty of proving illegality and corruption directly.
- Illegality should be proven with clear and convincing evidence, due to the seriousness of the allegation.

The objective in raising an objection based on illegality, including corruption and fraud issues, is to challenge the jurisdiction of the tribunal, the admissibility of the claim, or the merits of the claim. There is no determination of criminal liability of any individual or corporation, and therefore, most tribunals have found that it is not necessary to prove facts of corruption under the "beyond reasonable doubt" standard.

### II. Balance of Probabilities or Preponderance of the Evidence

In *Kardassopolous v. Georgia,* the tribunal concluded that in general international investment tribunals do not impose on the parties a higher or more demanding standard of proof than the balance of probabilities.[53] This same standard should apply to cases involving proof of corruption,[54] especially considering that it is particularly difficult to obtain direct evidence of fraud or corruption.[55]

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51 *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award, 30 March 2015, ¶ 716.

52 Id.

53 *Ioannis Kardassopoulos v. The Republic of Georgia*, ICSID Case Nos. ARB/05/18 and ARB/07/15, Award, 3 March 2010, ¶ 229.

54 *Methanex Corporation v. United States of America*, ad hoc, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV Chapter E Article 1101 NAFTA, ¶ 18.

55 Carolyn B. Lamm, Hansel T. Pham and Rahim Moloo, *Fraud and Corruption in International Arbitration*,

Some commentators have also noted that "'like most crimes and intentional misconduct, and perhaps more so, acts of corruption ... are specifically designed not to be able to be identified or detected.'"[56] The tribunal in *Libananco v. Turkey* expressly rejected the argument that, because of the seriousness of the corruption, the applicable standard of proof should be higher. The tribunal acknowledged the gravity of the matter, but refused to consider that a higher standard should be applied.[57] In *Unión Fenosa Gas v. Egypt*, the tribunal held "[a]s to the standard of proof, although these allegations [of corruption against the claimant] amount to serious criminal *misconduct*.'"[58] Other tribunals have upheld the "preponderance of the evidence" standard.[59] In *Penwell v. Kyrgyz Republic*, the tribunal reasoned that:

> This Arbitral Tribunal does not see any convincing reason why, outside the field of criminal law, a heightened standard of proof should apply to allegations of illegality.

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10(3) TRANSNATIONAL DISPUTE MANAGEMENT (TDM) 699, 703 (May 2013). Other commentators also agree that the standard must not be elevated. Partasides argues that the proper standard is the usual preponderance of the evidence. *See, e.g*., Constantine Partasides, *Proving Corruption in International Arbitration: A Balanced Standard for the Real World,* 25(1) ICSID REVIEW FOREIGN INVESTMENT LAW JOURNAL 47, 50, 56 (2010) ("whilst the standard of proof should not be relaxed for allegations of corruption, by the same token it need not be made more severe"); Vladimir Khavlei, *Using Red Flags to Prevent Arbitration from Becoming a Safe Harbour for Contracts that Disguise Corruption*, Special Supplement 2013: Tackling Corruption in Arbitration, p. 19; *PJSC DTEK Krymenergo v. Russian Federation*, PCA Case No. 2018-41, Award, 1 November 2023, ¶ 570.

56 Carolyn B. Lamm, Hansel T. Pham and Rahim Moloo, *Fraud and Corruption in International Arbitration*, 10(3) TRANSNATIONAL DISPUTE MANAGEMENT (TDM) 699, 703 (May 2013).

57 *Libananco Holdings Co. Limited v. Republic of Turkey*, ICSID Case No. ARB/06/8, Award, 2 September 2011, ¶ 125 ("In relation to the Claimant's contention that there should be a heightened standard of proof for allegations of 'fraud or other serious wrongdoing', the Tribunal accepts that fraud is a serious allegation, but it does not consider that this (without more) requires it to apply a heightened standard of proof. While agreeing with the general proposition that 'the graver the charge, the more confidence there must be in the evidence relied on' [...] this does not necessarily entail a higher standard of proof. It may simply require more persuasive evidence, in the case of a fact that is inherently improbable, in order for the Tribunal to be satisfied that the burden of proof has been discharged.") (emphasis ommitted).

58 *Unión Fenosa Gas, S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/14/4, Award, 31 August 2018, ¶ 7.52 (emphasis added).

59 *See, e.g.*, *The Rompetrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Award, 6 May 2013, ¶¶ 182, 245; *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines (I)*, ICSID Case No. ARB/03/25, Award, 16 August 2007, ¶ 399; *Flughafen Zurich A.G. and Gestión e Ingeniería IDC S.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/19, Award, 18 November 2014, ¶¶ 141-143; *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Award, 26 July 2007, ¶ 124; *Churchill Mining and Planet Mining Pty Ltd v. Republic of Indonesia,* ICSID Case No. ARB/12/40 and 12/14, Award, 6 December 2016, ¶ 244; *JSC DTEK Krymenergo v. The Russian Federation*, PCA Case No. 2018-41, Award, 1 November 2023, ¶ 568 (noting that the relevant standard continues to be "preponderance of the evidence" as explained in *Glencore v. Colombia*, ¶ 669). *See also*Lisa Bohmer, *Uncovered: Tribunal in Grand Express v. Belarus Declares Claims Inadmissible After Finding That Claimant Defrauded Its Belarusian Partner and Sent Falsified Documents to Eurasian Development Bank*, INVESTMENT ARBTRATION REPORTER (15 February 2024) ("the tribunal [in *Grand Express v. Belarus*) notably considered it unnecessary to apply a heightened standard of proof to illegality allegations.") [the Award is not public].

> In the field of criminal law, the standard must be high because what is at stake is the risk of unjustly sanctioning an innocent person. Outside that field, what is at stake is the respective interests of two persons, the claimant and the respondent, and it would be paradoxical to impair the interests of the latter by reason of the seriousness of the alleged misbehavior of the former.[60]

### III. Clear and Convincing Evidence

Some investment tribunals have indicated that a higher standard of proof should be adopted in corruption cases because it is a serious charge, while acknowledging that there is no general consensus among international tribunals and commentators regarding the need for a high standard of proof of corruption. In *Fraport v. Philippines II*, the tribunal held, for example, that "[i]n view of the consequences of corruption on the investor's ability to claim the protection of the BIT, the evidence must be clear and convincing to lead one to reasonably believe that the facts as alleged have occurred,"[61] and dismissed the jurisdictional objection based on the failure of the respondent State to "provide clear and convincing evidence that Fraport was aware of and engaged in corruption and fraud… when it made its Initial Investment."[62]

### IV. Circumstantial Evidence and Red Flags

Circumstantial evidence has become a common way to substantiate corruption claims, with investment tribunals accepting to use the "red flags" method to establish corruption. As Professor Bin Cheng explained in his leading treatise: "In cases where direct evidence of a fact is not available, it is a general principle of law that proof may be administered by means of circumstantial evidence."[63] This principle, often called the "red flags" approach or "connecting the dots," has been applied in regard to the corruption defense, as a "general principle" or "transnational rule."[64]

The rationale for applying the "red flags" approach is commonsensical:

> As has long been recognised, corruption is rarely proven by direct cogent evidence; but, rather, it usually depends upon an accumulation of circumstantial evidence. Circumstantial evidence of corruption is as good as direct evidence in proving corruption. There is no reason in this arbitration, which is not a criminal proceeding, to impose a higher standard of proof: see the *Libananco* award (2011).[65]

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60 *Penwell Business Limited (by MegaCom) v. Kyrgyz Republic*, PCA Case No. 2017-31, Final Award, 8 October 2021, ¶ 334.

61 *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines (II)*, ICSID Case No. ARB/11/12, Award, 10 December 2014, ¶ 479.

62 Id., at ¶ 481.

63 *Cheng, Bin, General Principles Of Law as Applied by International Courts and Tribunals,* reprinted, Cambridge 1987, p. 322.

64 *Penwell Business v. Kyrgyz Republic*, PCA Case No. 2017-31, Award, 8 October 2021, ¶ 331.

65 *Union Fenosa Gas, S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/14/4, Award, ¶ 7.52 (Aug. 31, 2018).

In *Metal-Tech v. Uzbekistan*, the tribunal ruled that "[f]or the application of the prohibition of corruption, the international community has established lists of indicators, sometimes called 'red flags.'"[66] Other tribunals have since followed the suite, notably in the cases of *Penwell Business v. Kyrgyz Republic, Libananco v. Turkey* and *Union Fenosa v. Egypt*, rejecting the idea of a heightened burden of proof.[67] Tribunals approach the evidence of "reg flags" with scrutiny.[68]

## V. Burden Shifting

Once the respondent State puts forward *prima facie* evidence of illegality, the burden shifts to claimants to provide a compelling response.[69] In *Fynerdale v. Czech Republic*, the tribunal observed that "a shift of the burden of proof depends upon the particularity of each case and that the tribunal in question has a certain discretion in assessing the relevant facts" and that "[f]ollowing the Respondent's arguments based on alleged red flags, the Claimant would have been expected to convince the Tribunal of its good standing."[70] The tribunal then found that it lacked jurisdiction because claimant did not establish the legality of the investment.[71] The *Metal-Tech* tribunal similarly found that the claimant's inability to justify the services rendered by its consultants contributed to the tribunal's finding on corruption.[72]

## I. CONCLUSIONS

The current state of jurisprudence concerning corruption and illegality highlights significant challenges and limitations. The persistence of corruption undermines public trust in institutions and hinders effective governance. While legal frameworks exist to combat these issues, enforcement often falters due to systemic weaknesses and a lack of political will. Counsel and tribunals must play a crucial role in exposing corruption and ensuring that it is punished, acting as vital safeguards for justice Sand fostering accountability.

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66 *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award, 4 October 2013, para. 293, ¶ 293.

67 *See, e.g., Penwell Business Limited (by MegaCom) v. Kyrgyz Republic*, PCA Case No. 2017-31, Final Award, 8 October 2021, ¶ 324; *Libananco Holdings Co. Limited v. Republic of Turkey*, ICSID Case No. ARB/06/8, Award, 23 September 2011, ¶ 125; *Unión Fenosa Gas, S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/14/4, Award, 31 August 2018, ¶ 7.52.

68 *Vladislav Kim, Pavel Borissov, Aibar Burkitbayev and others v. Republic of Uzbekistan,* ICSID Case No. ARB/13/6, Decision on Jurisdiction, 8 March 2017, ¶ 548 ("As circumstantial evidence, red flags can play an important supporting role in the assessment of guilt. Whether red flags can directly establish, for example, an element of a crime depends on the legal system applicable. There is not a universal answer.");

69 *Fynerdale Holdings B.V. v. Czech Republic*, PCA Case No. 2018- 18, Award, 29 April 2021, ¶¶ 567-569.

70 Id., ¶¶ 568, 573.

71 Id., ¶¶ 573-574.

72 *Metal-Tech Ltd. v. The Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award, 4 October 2013, ¶ 390.