The Consequences of the “Clean Hands” Concept in International Investment Arbitration

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1. INTRODUCTION

The uncertainty surrounding the scope of application of the Clean Hands doctrine resulted in its exclusion from the 2006 International Law Commission (ILC) Draft Articles on Diplomatic Protection.³ The Clean Hands doctrine was not even considered for inclusion in the ILC Draft Articles on Diplomatic Protection as a matter of the progressive development of international law.⁴ This exclusion, in the view of a minority of members at the ILC, was in part due to a conceptual confusion as to the function of the Clean Hands doctrine in the context of diplomatic protection as distinguished from inter-State claims. In accordance with the aforementioned view, in the context of diplomatic protection, the Clean Hands doctrine operates as a precondition for the admissibility of claims, whereas in the broader context of inter-State claims, the Clean Hands doctrine is equated

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 - 3 *Report of the International Law Commission to the General Assembly*, U.N. GAOR Supp. No. 10, U.N. Doc. A/61/10 (2006).
 - 4 It would seem that the human rights aspect of international claims – the possibility of invoking the Clean Hands doctrine by respondent States to block access to international remedies – was also a relevant consideration. This point will be taken up later.

with the principle of good faith and thus, does not create a procedural bar. However, as other members of the ILC (including the Special Rapporteur, Professor Dugard) have noted, the Clean Hands doctrine was not concerned with diplomatic protection alone, or even primarily.⁵ This latter view had been confirmed by a number of inter-State cases.

The ILC's codification exercise revealed the existence of uncertainty as to the scope of application of the Clean Hands doctrine and crystallized various points of contention. For example, more recently, the *Yukos* tribunal referred to the traditional meaning of the doctrine by referring to the argument advanced by Russia based on the Clean Hands doctrine as a bar to a claim as "the 'unclean hands' doctrine proper".⁶

In the last decade, the jurisprudence of investment treaty arbitration has led to the application of the Clean Hands doctrine outside the context of diplomatic protection; it has been applied both in the context of the *first strand*, the "legality requirement" and in the context of the *second strand*, the "abuse of process" debate. These *two strands* should be considered as a reinvention of the Clean Hands doctrine as applied in international investment law.

In the context of the *first strand*, the illegality of investment has operated in some instances as a jurisdictional bar, rendering the consent of the host State invalid. As will be illustrated by the reviewed cases, in the context of the legality requirement case-law, only a limited version of the Clean Hands doctrine comes into play when the illegality of the investment operates as a jurisdictional bar. As such, the arbitral tribunal's legality analysis will be limited to the establishment stage, i.e., the "making" of an investment, as opposed to the post-establishment conduct of the investor, i.e., the alleged wrongdoing at the performance stage. In this limited sense, it has been well-established that the Clean Hands doctrine does not need treaty stipulation. Thus, investment arbitration tribunals

5 Report of the International Law Commission to the General Assembly, *supra* note 3, at 14.

6 *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, Final Award of July 18, 2014 (hereinafter, "*Yukos Award*"), para. 1361. Of course, in *Yukos*, the claim against Russia was an investor-State claim. In an investor-State claim, the investor has an international remedy of its own and for this reason, for the purposes of the clean hands doctrine analysis, an investor-State claim should be equated with an inter-State claim as distinguished from a diplomatic protection claim.

have found that, “a clean hands principle or legality requirement [may] be read into the [Energy Charter Treaty (ECT)]”;⁷ it “is implicit even when not expressly stated in the relevant [Bilateral Investment Treaty] (BIT)”⁸; and is “inherent in every BIT.”⁹

At the same time, beyond the initial stage of the making of an investment, non-compliance with the host State’s law is captured by the Clean Hands concept in its broad sense to be considered at the merits stage. Thus, the *Yukos* Tribunal, relied on Article 39 (Contribution to the injury) of the ILC Draft Articles on State Responsibility and accordingly reduced the damages owed to the Claimants by 25% due to their violation of Russian tax law.¹⁰ More recently, the *Mamidoil* Tribunal, after rejecting the jurisdictional consequences of the legality requirement on the facts of the case, took the non-compliance with the domestic law of the host State into account at the merits stage to reject Claimants’ claim regarding the violation of the fair and equitable treatment (FET) standard.¹¹

The *second strand* of the “unclean hands” case-law concerns the issue of “abuse of process,” which deals with the consequences of abusing the system of investment protection.¹² This strand was initiated by *Phoenix*, where the tribunal highlighted the issue of abusing the system of investment protection and found that the tribunal lacked jurisdiction *ratione materiae*¹³ as a result of the abuse.¹⁴ Whereas the (first) legality requirement strand of the case-law is based on the domestic legality of the investment, the (second) “abuse of process” strand is based on international legality of the investment. In fact, the *Phoenix* Tribunal acknowledged that the investment had been made lawfully, such as, in accordance with the Czech

7 *Id.* at 429.

8 *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, Award, ¶ 101 (Apr. 15, 2009) [hereinafter *Phoenix* Award].

9 *SAUR Int’l S.A. v. Argentine Republic*, ICSID Case No. ARB/04/4, Decision on Jurisdiction and Liability, ¶ 306 (June 6, 2012) [hereinafter *SAUR* Award].

10 *Yukos* Award, *supra* note 6, at ¶ 1637.

11 *Mamidoil Jetoil Greek Petroleum Prod. Societe S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award (Mar. 30, 2015) [hereinafter *Mamidoil* Award].

12 *See Phoenix* Award, *supra* note 8, at ¶ 113.

13 *Id.* ¶ 54.

14 *Id.* ¶ 68.

legal order.¹⁵ However, it considered the question whether “assets invested bona fide” as part of its jurisdiction *ratione materiae* inquiry.¹⁶ Thus, the Tribunal held that if the investor had “unclean hands” and the investment had been made in bad faith – solely to bring a pre-existing dispute under the International Centre for Settlement of Investment Disputes (ICSID)/Bilateral Investment Treaties (BITs) dispute settlement mechanism – then the arbitral tribunal lacked jurisdiction *ratione materiae*.¹⁷ Nevertheless, it would seem that going beyond the “*Salini* test” to accommodate abuse of process concerns has not been the only way to address the jurisdiction issue.¹⁸ For example, as evidenced by the *Levy* case, the tribunals have established by case-law that they are precluded from exercising jurisdiction.¹⁹

This article examines the uncertainty surrounding the meaning and function of the Clean Hands doctrine as well as its legal status as part of general international law. Furthermore, it discusses various manifestations of the application of the Clean Hands concept in investment treaty arbitration.

After a brief review of the treatment of the Clean Hands doctrine by the ILC in Section II, we will consider the application of the Clean Hands doctrine in investment treaty arbitration in Section III. Part A examines the *first strand*, the legality requirement and relevant case law. Part B will address the *second strand*, abuse of process. Two representative cases from the abuse of process case-law will be examined to illustrate the evolution of case-law within this strand.

This article does not purport to try to bring coherence to a fast moving subject, rather, it seeks to examine different aspects of the application of the Clean Hands doctrine in international investment law.

15 *Id.* ¶ 134.

16 *Id.* ¶ 114.

17 *Id.* ¶ 144.

18 *Id.* ¶ 39.

19 See, e.g., *Renée Rose Levy v. Republic of Peru*, ICSID Case No. ARB/11/17, Award (Jan. 9, 2015).

2. THE TREATMENT OF THE CLEAN HANDS DOCTRINE BY THE ILC

Generally, the Clean Hands doctrine is a positive defence based on equity and it is also recognized in the Common Law tradition. In accordance with the Clean Hands doctrine, one seeking equitable relief cannot take advantage of one's own wrong.²⁰ In the words of the ILC, "[a]ccording to the clean hands doctrine no action arises from willful [sic] wrongdoing: *ex dolo malo non oritur actio*."²¹ In public international law, and in the context of diplomatic protection, the Clean Hands doctrine "is invoked to preclude a State from exercising diplomatic protection if the national it seeks to protect has suffered an injury in consequence of his or her own wrongful conduct."²²

20 *Clean Hands Doctrine*, BLACK'S LAW DICTIONARY (5th ed. 1979) (Black's Law Dictionary defines the Clean Hands doctrine as follows: "Under 'clean hands' doctrine, equity will not grant relief to a party, who, as actor, seeks to set judicial machinery in motion and obtain some remedy, if such party in his prior conduct has violated conscience or good faith or other equitable principle."). In his discussion of the possible consequences of the U.S. rescue mission in the context of the United States Diplomatic and Consular Staff in Tehran (U.S. v. Republic of Iran), Judgment (May 24, 1980), <http://www.icj-cij.org/docket/files/64/6293.pdf>, Oscar Schachter referred to the Clean Hands doctrine in the following terms:

The equitable doctrine of "clean hands" applied in domestic law provides an analogy. A plaintiff seeking relief from a Court may reasonably be denied such relief because of conduct that is contumacious or that interferes with the judicial process or anticipates its outcome. International tribunals have the same kind of authority and should exercise it whenever appropriate. Would it have been appropriate to do so in the hostage case because of the U.S. rescue mission (as in fact two dissenting judges proposed)? The decision of the majority of the Court to do no more than rebuke the United States was a more reasonable way of dealing with the problem.

Oscar Schachter, *International Law in the Hostage Crisis: Implications for Future Cases*, in AMERICAN HOSTAGES IN IRAN: THE CONDUCT OF A CRISIS 344 (Paul H. Kreisberg ed., 1985).

21 John R. Dugard (Special Rapporteur on Diplomatic Protection), *Sixth Rep. on Diplomatic Protection*, ¶ 2, International Law Commission, U.N. Doc. A/CN.4/546 (Aug. 11, 2004).

22 *Id.*

There is, however, uncertainty as to the scope of application of the Clean Hands doctrine. In this regard, Ian Brownlie has pointed out that the Clean Hands doctrine may also have substantive aspects:

[T]here will be a residue of instances in which questions of inadmissibility and 'substantive' issues are difficult to distinguish. This is the case with the doctrine of 'clean hands,' according to which a claimant's involvement in activity illegal under either municipal or international law may bar the claim.²³

On two specific occasions the ILC declined the opportunity to regulate the Clean Hands doctrine, namely, during preparation of the Draft Articles on State Responsibility (2001) and the Draft Articles on Diplomatic Protection (2006).²⁴

First, the Commission had the opportunity to elaborate on the Clean Hands doctrine during the course of preparing the Articles on State Responsibility but it did not do so. For instance, in Special Rapporteur, which is Professor Crawford's Second Report, he noted that when dealing with the provisions on the "circumstances precluding wrongfulness":

The doctrine has hardly been referred to in the Commission's previous work on State responsibility. Special Rapporteur Garcia Amador dealt with it only in relation to 'Fault on the part of the alien', which is now subsumed in Part Two, article 42 (2), as a basis for limiting the amount of reparation due. To the extent that 'clean hands' may sometimes be a basis for rejecting a claim of diplomatic protection, the doctrine appears to operate as a ground of inadmissibility rather than as a circumstance precluding wrongfulness or responsibility, and it can be left to be dealt with under the topic of diplomatic protection.²⁵

23 IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 503 (7th ed. 2008).

24 International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, Supp. No. 10 (A/56/10) (Nov. 2001), <http://www.refworld.org/docid/3ddb8f804.html>; United Nations, *Draft Articles on Diplomatic Protection* (2006), <http://www.refworld.org/docid/525417fc4.html>.

25 James Crawford (Special Rapporteur on State Responsibility), *Second Rep. on State Responsibility*, ¶ 333, International Law Commission, U.N. Doc. A/CN.4/498 (Apr. 30, 1999). Referring to J. Salmon, the Second Report noted that even within the context of diplomatic protection, the authority supporting the existence of a doctrine of Clean Hands is "fairly long-standing and divided," dealing largely with

While acknowledging that legal principles based on the underlying notion of good faith can play a role in international law, the Special Rapporteur was not convinced that new and vague maxims such as the Clean Hands doctrine should be included within the category of “circumstances precluding wrongfulness.”²⁶ He also noted that the passage taken from Sir Gerald Fitzmaurice’s Hague Academy Lecture quoted in Judge Schwebel’s dissenting opinion in the *Nicaragua* case was only concerned with questions such as *locus standi* or the admissibility of claims.²⁷ In that passage – which Judge Schwebel relied on to conclude that Nicaragua’s claim should fail because Nicaragua had not come to Court with “clean hands” – Fitzmaurice opines that:

“[A] State which is guilty of illegal conduct may be deprived of the necessary *locus standi in judicio* for complaining of corresponding illegalities on the part of other States, especially if these were consequential on or were embarked upon in order to counter its own illegality – in short, were provoked by it.”²⁸

For these reasons, the Special Rapporteur concluded that there was no basis for including the Clean Hands doctrine as a new “circumstance precluding wrongfulness.”²⁹ At the same time, during the Commission’s discussions of the issue, “the view was expressed that the clean hands doctrine was a principle of positive international law. That principle came under the determination of responsibility because it had an impact on the scope of compensation.”³⁰ Thus, in the Special Rapporteur’s view, the Clean Hands

individuals involved in slave-trading and breach of neutrality. *Id.* ¶ 334. The Special Rapporteur further stated that the conclusion reached by Charles Rousseau that “it is not possible to consider the ‘clean hands’ theory as an institution of general customary law” still seemed to be valid. *Id.* ¶ 336.

26 *Id.*

27 Dugard, *supra* note 21, at ¶ 5.

28 *Id.* ¶ 2.

29 Crawford, *supra* note 25, at ¶ 336.

30 *Report of the Commission to the General Assembly on the Work of its Fifty-First Session*, [1999] 2 Yearbook of the International Law Commission 85, ¶ 414, U.N. Doc. A/CN.4/SER.A/1999/Add.1.

doctrine could be analysed subsequently in connection with the loss of the right to invoke State responsibility.³¹

Nevertheless, when dealing with the provisions concerning determination of the form and amount of reparation (Articles 34-39 of the ILC Draft Articles on State Responsibility), no specific provision was allocated to the Clean Hands doctrine, although the terms of Article 39³² are drafted broadly so as not to exclude consideration of conduct falling under the Clean Hands doctrine with regards to reparation sought.³³ Moreover, no place was given to the Clean Hands doctrine when drafting the provisions on "Admissibility of claims" and "Loss of the right to invoke responsibility" (Articles 44 and 45).³⁴

Likewise, in the course of the ILC's preparation of the Draft Articles on Diplomatic Protection, the Special Rapporteur, Professor Dugard, did not include an article specifically addressing the Clean Hands doctrine. After the submission of the Fifth report, a suggestion was made to include the Clean Hands doctrine as a condition for admissibility of diplomatic

31 *Id.* ¶ 415.

32 Crawford, *supra* note 25, at 109.

Article 39 - *Contribution to the injury* – In the determination of reparation, account shall be taken of the contribution to the injury by willful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought.

33 As will be discussed below, the *Yukos* Tribunal in its recent award confirmed this point.

34 Crawford, *supra* note 25, at 120-21.

Article 44 - *Admissibility of claims* – The responsibility of a State may not be invoked if:

- (a) the claim is not brought in accordance with any applicable rule relating to the nationality of claims;
- (b) the claim is one to which the rule of exhaustion of local remedies applies and any available and effective local remedy has not been exhausted.

Article 45 - *Loss of the right to invoke responsibility* – The responsibility of a State may not be invoked if:

- (a) the injured State has validly waived the claim;
- (b) the injured State is to be considered as having, by reason of its conduct, validly acquiesced in the lapse of the claim.

protection.³⁵ This would mean that if an internationally wrongful act of a State that caused an injury to an alien resulted from this alien's initial wrongful conduct, the alien's State of nationality should be precluded from exercising diplomatic protection. As articulated by Alain Pellet during the ILC's work on diplomatic protection, if the Clean Hands doctrine had any separate existence or real consequences at a procedural level, it could only be in connection with diplomatic protection.³⁶ In this regard, Pellet drew the Commission's attention to the pleadings submitted in the *Oil Platforms*³⁷ case.

It is worth mentioning that in *Oil Platforms*, the United States in its Counter-Memorial had argued that the Court should deny the relief sought by Iran because of Iran's own allegedly illegal conduct.³⁸ Iran observed that "the United States seems to invoke the 'plaintiff's own wrongful conduct"

35 It should be noted that after the submission of the Third Report, the Commission considered suggestions for issues, including the Clean Hands doctrine, which could be included within the scope of its work. There was a division of opinion as to how to deal with the Clean Hands doctrine issue. Some members suggested that it would be better for the Commission not to take any position on the "clean hands" rule. The Special Rapporteur in his concluding remarks noted that the "clean hands" principle could arise in connection with the conduct of the injured person, the claimant-State or the respondent-State, so that it would be difficult to formulate a rule applicable to all cases. *Report of the Commission to the General Assembly on the Work of its Fifty-Fourth Session*, [2002] 2 Yearbook of the International Law Commission 52-53, U.N. Doc. A/CN.4/SER.A/2002/Add.1.

36 *Summary Records of the 2791st Meeting*, [2004] 1 Yearbook of the International Law Commission 4, U.N. Doc. A/CN.4/SR.2791.

37 *Oil Platforms (Islamic Republic of Iran v. U.S.)*, Judgment, 2003 I.C.J. 177, ¶ 29 (Nov. 6).

38 *Oil Platforms (Islamic Republic of Iran v. U.S.)*, Counter-Memorial and Counter-Claim Submitted by the U.S. (June 23, 1997), <http://www.icj-cij.org/docket/files/90/8632.pdf>. The United States contended that, "[n]otwithstanding its own manifestly illegal armed attacks against neutral shipping and neutral trade, Iran seeks in this case to invoke a treaty designed to regulate friendly relations between States." *Id.* at 156.

defence in Part V of its Counter-Memorial as both: a) a ground for *inadmissibility* of the Iranian claim and b) a defence on the merits.”³⁹

On the question of inadmissibility, Iran countered by arguing that the Clean Hands argument only operates as a procedural defence in the context of a diplomatic protection claim, as distinguished from an inter-State claim:

It is true that in another field of State responsibility, the clean hands concept appears as one of the prerequisites for the admissibility of State claims, namely those arising in the context of diplomatic protection. But, it must be stressed, the prerequisite is exclusively confined to that context, and hence it deals only with a foreign individual's clean hands and not his own State's. Therefore, one can only agree with the United States' contention, supported by extensive jurisprudential and doctrinal quotations, according to which a citizen requesting diplomatic protection from his own State must present himself with clean hands. Yet this falls far short of demonstrating that such a principle is required in direct State-to-State claims.⁴⁰

As already noted, Iran acknowledged that issues broadly relating to the Clean Hands doctrine may, outside the specific context of diplomatic protection, be considered by an international judicial body at the merits stage.⁴¹ However, Iran argued that even under such a scenario, “the “clean hands” concept does not operate independently”⁴² and that “at most, the clean hands defence could have an effect in relation to the quantification of damages.”⁴³

The Court characterized the U.S.'s arguments in the nature of a defence on the merits. It noted that the U.S.'s arguments on this issue were first raised in its Counter-Memorial after the Court's Judgment of December 12, 1996 confirmed its jurisdiction.⁴⁴ Despite detecting a degree of inconsistency in the arguments advanced by the U.S. on this issue as further

39 Oil Platforms (Republic of Iran v. U.S.), Reply and Defence to Counter-Claim Submitted by the Islamic Republic of Iran, at 178 (Mar. 10, 1999), <http://www.icj-cij.org/docket/files/90/8630.pdf>.

40 *Id.* at 179.

41 *Id.* at 181-82.

42 *Id.* at 182.

43 *Id.*

44 Oil Platforms (Islamic Republic of Iran v. U.S.), Judgment, 1996 I.C.J. 1 (Dec. 12).

developed throughout subsequent pleadings and in oral argument – where the United States had presented its argument as having a preliminary character – the Court noted that:

The United States does not ask the Court to find Iran's claim inadmissible; it asks the Court to dismiss that claim. It does not argue that the Court should be debarred from examining the merits of the Iranian claim on the grounds of Iran's conduct; rather it argues that Iran's conduct is such that it "precludes it from any right to the relief it seeks from this Court", or that it "should not be permitted to recover on its claim". The United States invites the Court to make a finding "that the United States measures against the platforms were the consequence of Iran's own unlawful uses of force" and submits that the "appropriate legal consequences should be attached to that finding". The Court notes that in order to make that finding it would have to examine Iranian and United States actions in the Persian Gulf during the relevant period — which it has also to do in order to rule on the Iranian claim and the United States counter-claim.⁴⁵

In the course of the Commission's discussions, Pellet went on to argue that "[t]he 'clean hands' doctrine was a specific legal institution inseparable from the question of diplomatic protection, and was only of relevance if the protected individual's hands were 'not clean'."⁴⁶ He further noted that:

The vague concept of "clean hands" was not very different from the general principle of good faith in the context of relations between States, and had no autonomous consequences and little practical effect on the general rules of international responsibility. However, in the context of diplomatic protection, which involved relations between States and individuals, the concept took on new significance: it became functional, for in the absence of "clean hands" the exercise of diplomatic protection was paralysed.⁴⁷

Professor Dugard, however, while agreeing with Pellet on the importance of the Clean Hands doctrine, was not sure that it concerned diplomatic

45 Oil Platforms, 2003 I.C.J., ¶ 29. The Court, thus, did not find it necessary to deal with the request of the United States to dismiss Iran's claim. *Id.*

46 *Summary Records of the 2791st Meeting*, *supra* note 36, at ¶ 24.

47 *Summary Records of the 2793rd Meeting*, [2004] 1 Yearbook of the International Law Commission, ¶ 5.

protection alone, or even primarily.⁴⁸ Professor Dugard further explained that the Clean Hands doctrine “had not arisen in connection with diplomatic protection in the *Oil Platforms* case, or in the more recent *Arrest Warrant* case.”⁴⁹ Accordingly, in view of Professor Dugard, “[i]t was the type of topic that might well be considered separately, and should not be included under diplomatic protection, because it extended well beyond it.”⁵⁰

Furthermore, Brownlie’s position as reflected in the Commission’s Report was that “[t]here was little or no evidence of the existence of a doctrine in general international law called the “clean hands” doctrine, and even if there were, he agreed with the Special Rapporteur[, Professor Dugard,] that it had nothing to do with the exercise of diplomatic protection.”⁵¹ While acknowledging that there are instances such as the *Oil Platforms* case where references to this doctrine may be found in international litigation, he pointed out that:

ICJ had shown no tendency to adopt or encourage references to the “clean hands” doctrine. Mr. Pellet had referred to a number of perfectly respectable principles of treaty law, and elements analogous to the “clean hands” doctrine were indeed present in the law. The principle of “good faith” was related, but it was not the same thing: it had considerable authority behind it, whereas the “clean hands” doctrine did not. It would make life unnecessarily difficult for the Special Rapporteur if the Commission asked him to study the non-subject of “clean hands.”⁵²

Pellet, highlighting once again the distinction between the particular meaning of the Clean Hands doctrine in the context of diplomatic protection (as an admissibility consideration) and its broader meaning in inter-State claims, noted that the cases referred to by Brownlie were related to inter-State claims and thus, Pellet did not find Brownlie’s argument persuasive.⁵³ Pellet explained that the inter-State cases may not be cited for the proposition that the Clean Hands doctrine does not apply to

48 *Summary Records of the 2791st Meeting*, *supra* note 36, at ¶ 32.

49 *Id.*

50 *Id.*

51 *Summary Records of the 2793rd Meeting*, *supra* note 47, at ¶ 42.

52 *Id.*

53 *Id.* ¶ 43.

diplomatic protection.⁵⁴ In fact, Pellet “agreed with Mr. Brownlie that in proceedings between States[,] the doctrine was inapplicable[,]” noting that “where a case involved an individual and a State via diplomatic protection, the doctrine was relevant.”⁵⁵

Human rights considerations relating to international claims were also referred to during the debate on this issue. Attention was drawn to the fact that commentators, based on the ruling of the European Court of Human Rights in the *Slivenko* case, had spoken of banishing the Clean Hands doctrine from international cases involving the protection of human rights, arguing that the applicability of the doctrine would be highly controversial in this context.⁵⁶

As a result, “the Commission requested the Special Rapporteur to consider whether the Clean Hands doctrine [was] relevant to the topic of Diplomatic protection and[,] if so[,] whether it should be reflected in the form of an article” in the Draft Articles.⁵⁷ Ultimately, the ILC did not include the Clean Hands doctrine in its Draft Articles on Diplomatic Protection adopted in 2006. In the Special Rapporteur’s view, the evidence in favour of the Clean Hands doctrine was inconclusive. He concluded that:

In these circumstances the Special Rapporteur sees no reason to include a provision in the draft articles dealing with the clean hands doctrine. Such a provision would clearly not be an exercise in codification and is unwarranted as an exercise in progressive development in the light of the uncertainty relating to the very existence of the doctrine and its applicability to diplomatic protection.⁵⁸

54 *Id.*

55 *Id.* Pellet also pointed out that, “[i]n the context of inter-State relations, the fact that two States were in violation of international law did not preclude the responsibility of both States being invoked.” *Id.* ¶ 2.

56 *Id.* ¶ 48. See Aleksandr Shapovalov, *Should a Requirement of “Clean Hands” be a Prerequisite to the Exercise of Diplomatic Protection? Human Rights Implications of the International Law Commission’s Debate*, 20 AMERICAN UNIVERSITY INTERNATIONAL LAW REVIEW 829 (2005).

57 Int’l Law Comm’n, Rep. on the Work of Its Fifty-Sixth Session, U.N. Doc. A/59/10, ¶ 54 (2004).

58 Dugard, *supra* note 21, at ¶ 18.

It has been remarked that the decision of the ILC not to include the Clean Hands doctrine in the Draft Articles “is not to say that the principle is not part of international law; rather, this decision clarifies that the only conduct relevant to assessing the admissibility of claims under international law is that of the claimant itself.”⁵⁹

It is worth noting in this regard that more recently, the *Yukos* Tribunal held that the Clean Hands doctrine as a bar to a claim does not exist as a principle of international law.⁶⁰ In the *Yukos* case, Russia argued that the Claimants' engagement in tax evasion arrangements in violation of Russian tax laws would trigger the Clean Hands doctrine, thus barring their claim.⁶¹ Consistent with the well-settled practice of investment arbitration tribunals, the Tribunal did not read into the ECT any legality requirement with respect to the performance of the investment (as opposed to the “making” of the investment) as a jurisdictional bar.⁶² As such, the Tribunal had to pronounce upon Russia's proposition to the effect that the Clean Hands doctrine as a general principle of law would operate as a bar to the Claimants' claim. In this regard, the Tribunal held that:

[A]s Claimants point out, despite what appears to have been an extensive review of jurisprudence, Respondent has been unable to cite a single majority decision where an international court or arbitral tribunal has applied the principle of “unclean hands” in an inter-State or investor-State dispute and concluded that, as a principle of international law, it operated as a bar to a claim.⁶³

The Tribunal thus concluded that “‘unclean hands’ does not exist as a general principle of international law which would bar a claim by an investor.”⁶⁴ However, as will be discussed below, the Tribunal acknowledged that the

59 Rahim Moloo, *A Comment on the Clean Hands Doctrine in International Law*, 8 TRANSNATIONAL DISPUTE MANAGEMENT 4 (SPECIAL ISSUE) 1 (2011).

60 *Yukos Award*, *supra* note 6, at ¶ 1373.

61 *Id.* ¶¶ 1281-1310.

62 *Id.* ¶¶ 1349-1356.

63 *Id.* ¶ 1362. Due to the fact that Judge Schwebel was a member of the *Yukos* Tribunal, Russia relied on his dissenting opinion in the Nicaragua case, as well as referred to “other dissenting ICJ and PCIJ opinions where the principle of ‘unclean hands’ was invoked (albeit often without referring to it by name).” *Id.* ¶ 1361.

64 *Id.* ¶ 1363.

Claimants' illegal conduct during the performance of the investment could have an impact on the Tribunal's analysis of liability and damages.⁶⁵

3. THE CLEAN HANDS DOCTRINE IN INVESTMENT TREATY ARBITRATION

The idea that when individuals have access to an international remedy of their own the Clean Hands doctrine should be applicable to them directly can be found in the party submissions in private cases before the Iran-United States Claims Tribunal (*hereinafter* "the Iran-U.S. Tribunal"). In its pleading in the *Aryeh* case, Iran invoked the Clean Hands doctrine as follows:

The claim should be dismissed under the universal, equitable doctrine of 'clean hands.' The doctrine, which is supported by a vast and diverse body of international legal literature, State practice and international case-law, states that anybody wishing to bring a claim before an international court, must have acted properly and correctly prior to the claim⁶⁶

In *Aryeh*, Iran's "clean hands" argument was based on an assertion regarding the making and use of forged corporate documents by the Claimants to substantiate their claim for the expropriation of their shareholdings in a number of Iranian corporations.⁶⁷ The Iran-U.S. Tribunal, however, held that the allegations of forgery required an enhanced standard of proof and should be proved by clear and convincing evidence.⁶⁸ In light of this standard, the Iran-U.S. Tribunal found that no forgery was proven.⁶⁹

65 *Id.* ¶ 1374.

66 *Aryeh v. Republic of Iran*, Respondent's Hearing Memorial and Written Evidence, Case No. 842, 843, 844, 44 exhibit C (Iran U.S. Claims Trib., Mar. 23, 1993).

67 *Id.*

68 *Id.*

69 *Vera-Jo Miller Aryeh v. Republic of Iran*, Award No. 581-842/843/844-1, 33 Iran-U.S. C.T.R., at 317-18 (May 22, 1997). A discussion of other cases before the Tribunal involving the allegation of claimant-induced fraud, and raising the possibility of applying the Clean Hands doctrine. See W. MICHAEL REISMAN & CHRISTINA PARAJON SKINNER, *FRAUDULENT EVIDENCE BEFORE PUBLIC INTERNATIONAL TRIBUNALS: THE DIRTY STORIES OF INTERNATIONAL LAW* 101 (2014).

Professor Crawford has remarked that the ICJ has never applied the Clean Hands doctrine, even in cases such as *Oil Platforms* where it might have done so.⁷⁰ However, in the context of investment treaty arbitration and referring to *Inceysa*,⁷¹ he points out that “[t]he only investment tribunal award to apply the clean hands doctrine did so on the basis of applicable national law.”⁷² In this context, and referring to the *Hamester* award as an example,⁷³ Professor Crawford goes on to observe that “[g]eneric claims of wrongdoing have not succeeded.”⁷⁴

At the same time, two investment treaty awards rendered in 2014 specifically referred to or discussed the Clean Hands doctrine. The *Fraport* Tribunal referred to the Clean Hands doctrine in *obiter dictum* in the context of its discussion of the legality requirement as applicable when the relevant BIT does not contain a legality clause.⁷⁵ Moreover, the *Yukos* Tribunal did not apply the Clean Hands doctrine to the post-establishment illegalities and thus refused to treat Claimants’ “unclean hands” as a procedural hurdle.⁷⁶ Yet, the *Yukos* Tribunal took the Claimants’ illegal conduct (“unclean hands”) into account in the assessment of damages.⁷⁷ Furthermore, in a recently rendered award, the *Mamidoil* Tribunal after

70 JAMES CRAWFORD, BROWNLIE’S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 701 (8th ed. 2012).

71 *Inceysa Vallisoletana, S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award (Aug. 2, 2006).

72 CRAWFORD, *supra* note 70.

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

74 CRAWFORD, *supra* note 70. It should be noted, however, that the *Hamester* Tribunal rejected the Respondent’s objection to its jurisdiction based on the distinction between legality at the initiation of the investment, and legality during the performance of the investment. *Hamester*, ICSID Case No. ARB/07/24. The Tribunal reasoned that the legality of the investor’s conduct during the performance of the investment is a merits issue, as opposed to a jurisdictional bar. *Id.* This will be discussed further below.

75 *Fraport AG Frankfurt Airport Serv. Worldwide v. Republic of the Phil.*, ICSID Case No. ARB/03/25, Award, (Aug. 16, 2007) [hereinafter *Fraport 2007 Award*].

76 *Yukos Award*, *supra* note 6.

77 *Id.* ¶ 1374.

rejecting the jurisdictional consequences of the legality requirement on the facts of the case, took the Claimant's non-compliance with the domestic law of the host State into account at the merits stage to reject its claim regarding the violation of the FET standard.⁷⁸

It should be noted that the "legality requirement" strand of the case-law is only one avenue for considering the consequences of the Clean Hands doctrine by investment arbitration tribunals. The *second strand* of the "unclean hands" case-law concerns the issue of abuse of process, which deals with the consequences of abusing the system of investment protection. These *two strands* will be addressed respectively in subsections A and B below.

a. The Legality Requirement: Illegal Investments Are Not Covered by BIT Protection

Cases representative of the "legality requirement" case-law include *Inceysa v. El Salvador*, *Fraport v. Philippines*, and *Mamidoil v. Republic of Albania*.⁷⁹ They respectively include a jurisdictional decision based on a finding as to the illegality of the investment at the preliminary objections stage, a finding of lack of jurisdiction with the benefit of full briefing, and a holding rejecting the jurisdictional objection based on the illegality of the investment while dismissing the Claimant's claim for the violation of the FET standard on the merits for its failure to comply with Albanian law.⁸⁰

I. INCEYSA V. EL SALVADOR⁸¹

Inceysa was an arbitration case under the ICSID Convention with the main consent instrument being the BIT concluded between Spain and El Salvador. At issue in this case were the Claimant's allegations of contractual breach and expropriation on the part of El Salvador.⁸²

⁷⁸ *Mamidoil Award*, *supra* note 11.

⁷⁹ *Inceysa Vallisoletana, S.L.*, ICSID Case No. ARB/03/26; *Fraport 2007 Award*, *supra* note 73; *Mamidoil Award*, *supra* note 11.

⁸⁰ *Inceysa Vallisoletana, S.L.*, ICSID Case No. ARB/03/26; *Fraport 2007 Award*, *supra* note 73; *Mamidoil Award*, *supra* note 11.

⁸¹ *Inceysa Vallisoletana, S.L.*, ICSID Case No. ARB/03/26.

⁸² *Id.* ¶ 3.

The dispute in *Inceysa* concerned a service contract for installation, management and operation of mechanical inspection stations for vehicles and for the provision of emission control services.⁸³ In June 2000, the Ministry of the Environment and Natural Resources (MARN) of El Salvador organized a bidding process for providing the aforementioned services.⁸⁴ Inceysa, a company incorporated under the laws of Spain, was the winning bidder.⁸⁵ In November 2000, the contract between Inceysa and MARN (*hereinafter* "the Contract") was signed⁸⁶ and in December 2000, Inceysa acquired the land on which to perform the Contract.⁸⁷ In February 2001, it bought additional parcels of land for this purpose.⁸⁸ However, several problems arose between the parties in 2001, with reference to which Inceysa sent a letter to the Minister at MARN referring to the BIT concluded between Spain and El Salvador.⁸⁹

In July and August 2002, Inceysa complained to MARN about contractual breaches caused by the fact that MARN hired other companies to provide the services which Inceysa had been hired to provide, thus denying the exclusivity given to it under the Contract.⁹⁰ Having not been provided with a satisfactory reaction from MARN, Inceysa ultimately filed its Request for Arbitration with the Centre on July 21, 2003, alleging contractual breach and expropriation.⁹¹

For its part, El Salvador filed a civil lawsuit in a domestic court asking for the termination of the Contract.⁹² More importantly, and in the context of the ICSID arbitration, El Salvador, among other jurisdictional objections, countered that Inceysa had acted in the process of obtaining

83 *Id.*

84 *Id.* ¶ 23.

85 *Id.* ¶ 27.

86 *Id.* ¶ 30.

87 *Id.* ¶ 32.

88 *Id.*

89 *Id.* ¶ 33.

90 *Id.* ¶ 34.

91 *Id.* ¶¶ 1-3.

92 *Id.* ¶ 43.

the Contract and thus could not claim the protection of the BIT.⁹³ In its Memorial on Objections to Jurisdiction, the Respondent argued that the BIT was only intended to extend its protection to the investments made legally in El Salvador, i.e., “in accordance with its laws.”⁹⁴

El Salvador asserted that it had clear evidence that the concession contract had been procured by fraud, including on the grounds of (1) the submission of false financial statements; (2) the submission of forged documents to misrepresent the experience of Mr. Lavado, Inceysa’s sole administrator at the time; (3) misrepresentations and deceit surrounding evidence submitted regarding Inceysa’s prior experience in the field of vehicle inspections; (4) violation of bidding provisions by obfuscating the true association between Inceysa and another participant (ICASUR).⁹⁵ It further argued that the BIT protects only legitimate investments and that the necessary condition for an investment to benefit from the BIT is that the investment should be made in accordance with the domestic legislation of the host State.⁹⁶ It concluded that:

The Investment Treaty was meant to protect only investments made in accordance with the host State’s laws, and the parties consented to ICSID jurisdiction only over disputes arising from such legal investments.⁹⁷

Given the objections to jurisdiction by the Respondent, the tribunal declared the proceeding on the merits suspended.⁹⁸ Inceysa denied that it fabricated its financial statements to secure the Contract.⁹⁹ It also denied other grounds relied on by El Salvador to establish fraud and illegality, such as its failure to disclose its connection with ICASUR.¹⁰⁰ The Tribunal,

93 *Id.* ¶ 3.

94 *Id.* ¶ 45.

95 *Id.* ¶ 53.

96 *Id.* ¶¶ 46–48.

97 *Id.* ¶ 48.

98 *Id.* ¶ 13.

99 *Id.* ¶ 68.

100 *Id.* ¶¶ 68–71.

however, found that based on the evidence on the record, the Respondent's allegations of fraud were established to the satisfaction of the Tribunal.¹⁰¹

In determining whether El Salvador's consent to submit disputes to the jurisdiction of ICSID through the BIT covers illegal investments, the Tribunal characterized this issue as a question of jurisdiction *ratione voluntatis*.¹⁰² Inceysa argued that resolving this issue would involve the resolution of substantive issues on the merits of the matter.¹⁰³ In rejecting the argument advanced by Inceysa, the Tribunal noted that:

Article 41 of the ICSID Convention is clear when it indicates that '*The Tribunal shall be the judge of its own competence.*' Consequently, the ICSID Convention recognizes the 'Kompetenz-Kompetenz' principle and imperatively obligates the Arbitral Tribunal to decide the issues formulated on this subject.

It is obvious that because the ICSID Convention obligates the Arbitral Tribunal to decide on its own competence, it implicitly gives the Tribunal the right to analyze all factual and legal matters that may be relevant in order to fulfill this obligation.¹⁰⁴

The Tribunal noted that in this context, the reference to the "merits issues" was imprecise.¹⁰⁵ It observed that if in the process of determining its own competence, "the Arbitral Tribunal is obligated to analyse facts and substantive normative provisions that constitute premises for the definition of the scope of the Tribunal's competence . . . it has no alternative but to deal with them."¹⁰⁶ It further explained that:

even though it might be considered that the analysis the Arbitral Tribunal is obligated to make involves the determination of issues of a substantive nature, such as the conformity of Inceysa's investment with the laws of El Salvador, it is obvious that these issues constitute a premise that must necessarily be examined in order to decide the issue of the competence of the Arbitral Tribunal.¹⁰⁷

101 *Id.* ¶ 97.

102 *Id.* ¶ 144.

103 *Id.* ¶ 146.

104 *Id.* ¶¶ 148-149.

105 *Id.* ¶ 154.

106 *Id.* ¶ 155.

107 *Id.* ¶ 157.

In turning to the legality requirement, the Tribunal noted that as evidenced by the negotiating history of the BIT, El Salvador consistently expressed its intention that the scope of investment protection of the BIT be limited to investments made in accordance with its laws.¹⁰⁸ In fact, one of the additions suggested by El Salvador to the draft text days before the entry into force of the BIT, was to qualify the word “investment” in Article 1(2) of the draft – which dealt with the definition of “investment” – by adding the phrase “... in accordance with the laws in force in each of the Contracting Parties.”¹⁰⁹ Spain, however, took the position that the proposed addition to Article 1 was not necessary due to the fact that the legality requirement was more closely related to the process of admission of the investment and that another article already contained such limitation.¹¹⁰ Spain admitted in its communication that compliance with the laws of the host State was a “necessary condition for an investment to benefit.”¹¹¹

Accordingly, the Tribunal determined that the evident intent of the Contracting Parties was to include a limitation based on the legality requirement despite the apparent absence of such a condition in Article 1(2) of the BIT.¹¹² Accordingly, basing this limitation on the consent granted by Spain and El Salvador, the Tribunal concluded that:

[T]he 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, and that this Tribunal is not competent to resolve them, for failure to meet the requirements of Article 25 of the Convention and those of the BIT.¹¹³

The Tribunal then turned to Article XI, paragraph 3, of the BIT, which provided that the arbitration will be based, among other sources, on: “generally recognized rules and principles of International Law.”¹¹⁴ The Tribunal thus found it useful to consider Article 38, paragraph 1(c) of the

108 *Id.* ¶ 207.

109 *Id.* ¶ 192.

110 *Id.* ¶ 194.

111 *Id.*

112 *Id.* ¶¶ 194-197.

113 *Id.* ¶ 207.

114 *Id.* ¶ 222.

Statute of the ICJ, according to which “the general principles of law are an autonomous or direct source of International Law, along with international conventions and custom.”¹¹⁵ The Tribunal went on to analyze Inceysa’s investment in light of the general principles of law which it considered to be applicable to the case.¹¹⁶ First and foremost, the Tribunal found that Inceysa’s conduct during the public bidding process violated the principle of good faith, which was described by the Tribunal as a “supreme principle.”¹¹⁷ The Tribunal concluded that:

By falsifying the facts, Inceysa violated the principle of good faith from the time it made its investment and, therefore, it did not make it in accordance with Salvadoran law. Faced with this situation, this Tribunal can only declare its incompetence to hear Inceysa’s complaint, since its investment cannot benefit from the protection of the BIT, as established by the parties during the negotiations and the execution of the agreement.¹¹⁸

In addition, applying a number of good-faith-related legal maxims, including “*Ex dolo malo non oritur actio*” to the case at hand, the Tribunal held 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.¹¹⁹ The Tribunal also found that Inceysa’s conduct violated international public policy, the “essential function” of which “is to preserve the values of the international legal system against actions contrary to it.”¹²⁰ In the Tribunal’s view, sanctioning illegal acts, as contemplated by the inclusion of the “in accordance with law” clause in the BITs, was a clear manifestation of such a policy.¹²¹ Extending its legality requirement analysis to another consent instrument, i.e., the consent contained in the Investment Law of El Salvador, the Tribunal found that

115 *Id.* ¶ 226.

116 *Id.* ¶ 229.

117 *Id.* ¶ 230.

118 *Id.* ¶ 239.

119 *Id.* ¶¶ 240-242.

120 *Id.* ¶ 245 (footnote omitted).

121 *Id.* ¶ 246.

the legality requirement as contained in Article 96 of the Constitutional of El Salvador and the Foreigners Law, would produce the same result.¹²²

II. FRAPORT V. PHILIPPINES¹²³

This ICSID arbitration arose under the Germany-Philippines BIT.¹²⁴ The dispute concerned a concession contract for the construction and operation of a new international passenger airport terminal in Manila.¹²⁵ The Claimant's investment was made in a Philippine company, later known as PIATCO in 1999.¹²⁶ Fraport's investment in PIATCO, both as a shareholder and lender, was influenced by the fact that the Respondent had, prior to the investment at issue, conferred upon PIATCO the concession rights for the construction and operation of a new international passenger airport terminal in Manila (*hereinafter* "the Terminal").¹²⁷ Following the collapse of Fraport's investment in PIATCO, the taking over by the Philippine authorities of the Terminal prior to its completion, and the May 1993 decision of the Philippine Supreme Court rendering the investment "null and void" on the basis of a "serious violation of Philippine law and public policy,"¹²⁸ Fraport filed its request for arbitration claiming violations of the BIT on September 17, 2003.¹²⁹

For its part, the Respondent challenged the jurisdiction of the Tribunal and denied any liability under the Germany-Philippines BIT.¹³⁰ In essence, the Respondent argued that the Claimant made its investment in PIATCO

122 *Id.* ¶¶ 258-264.

123 *Fraport 2007 Award*, *supra* note 73; *Fraport AG Frankfurt Airport Serv. Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, Decision on Annulment (Dec. 23, 2010); Resubmitted Case: *Fraport AG Frankfurt Airport Serv. Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/11/12, Award (Dec. 10, 2014) [*hereinafter Fraport 2014 Award*].

124 *Fraport 2014 Award*, *supra* note 123.

125 *Id.* ¶ 2.

126 *Id.*

127 *Id.*

128 *Id.* ¶ 217.

129 *Id.* ¶ 6.

130 *Id.* ¶ 4.

in violation of the laws of the Philippines, in particular foreign ownership and control legislation laws, known as the Anti-Dummy Law (ADL).¹³¹ In this connection, the Respondent contended that the concession contract for the Terminal was a public utility project and thus, subject to the nationality restrictions of the Philippine Constitution and the ADL (in particular, a 40% foreign ownership limitation, as well as foreign management and control restrictions).¹³²

The Philippines contended that Fraport had knowingly made secret arrangements (secret Shareholders' Agreements) to sidestep these restrictions.¹³³ As a result, the Philippines argued that Fraport's investment would fall outside the scope of the protection afforded by the Germany-Philippines BIT because "it was not made in compliance with Philippine law."¹³⁴ At the request and insistence of the Tribunal's President, some of these secret Shareholders' Agreements were made available to the Tribunal in January 2006 during the hearing on jurisdiction and liability.¹³⁵

On the basis of the evidence on the record, including the Claimant's own internal documents (the secret Shareholders' Agreements), the Tribunal found that the limitation on foreign management and control had been knowingly breached, in the sense that:

Fraport was consciously, intentionally and covertly structuring its investment in a way which it knew to be a violation of the ADL. Fraport's equity investment in terms the statutorily limited percentage in [the Terminal] project was lawful under Philippine law. Fraport's controlling and managing the investment was not. Despite having been advised and plainly understanding this, Fraport secretly designed its investment in the project so as to have that prohibited management and control, in particular by reserving to itself the ultimate authority as a shareholder in PIATCO to decide those matters set out in [. . .] Article 2.02 (2) (a) of the . . . Shareholders' Agreement of 6 July 1999.¹³⁶

131 *Id.*; An Act to Punish Acts of Evasion of the Laws on the Nationalization of Certain Rights, Franchises or Privileges, Comm. Act No. 108 (Oct. 30, 1936) (Phil.).

132 *Fraport 2014 Award*, *supra* note 123, at ¶ 287.

133 *Id.* ¶ 401.

134 *Id.* ¶ 285.

135 *Id.* ¶ 322.

136 *Id.* ¶ 323.

In assessing the impact of the illegality of the investment, the Tribunal recalled that Article 25 of the ICSID Convention, which provides, *inter alia*, the parameters of jurisdiction *ratione materiae*, does not define “investment.”¹³⁷ The Tribunal’s rejection of Fraport’s contention that “the parties’ dispute in this arbitration [was] indeed about an ‘investment’ made pursuant to the BIT”¹³⁸ was as follows:

With respect to a bilateral investment treaty that defines ‘investment’, it is possible that an economic transaction that might qualify *factually and financially* as an investment (*i.e.* be comprised of capital imported by a foreign entity into the economy of another state which is party to a BIT), falls, nonetheless, outside the jurisdiction of the tribunal established under the pertinent BIT, because *legally* it is not an “investment” within the meaning of the BIT. This will occur when the transaction that might otherwise qualify as an “investment” fails *ratione temporis*, as occurred in [*Lucchetti v. Peru*], or fails *ratione personae*, as occurred in *Soufraki v. The United Arab Emirates*. It will also occur when the transaction fails to qualify *ratione materiae*, as occurred in *Inceysa Vallisoletana, S.L. v. Republic of El Salvador*.¹³⁹

The Tribunal noted that the Germany-Philippines BIT had a jurisdictional limitation *ratione materiae*.¹⁴⁰ Article 1(1) of the Germany-Philippines BIT contained a legality requirement, providing that “[t]he term ‘investment’ shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State”¹⁴¹ Additionally, the Tribunal noted that Article 2, paragraph 1 of the Germany-Philippines BIT, an accompanying Protocol, as well as the Instrument of Ratification of the Republic of the Philippines (which was exchanged with Germany) contained references to the legality requirement.¹⁴² This, combined with the Tribunal’s factual finding regarding the breach of the ADL, resulted in a finding of lack of jurisdiction *ratione materiae* by the Tribunal:

137 *Id.* ¶ 305.

138 *Id.* ¶ 298.

139 *Id.* ¶ 306 (footnotes omitted).

140 *Id.* ¶ 334.

141 *Id.* ¶ 335.

142 *Id.* ¶¶ 335-337.

Compliance with the host state's law is an explicit and hardly unreasonable requirement in the Treaty and its accompanying Protocol. Fraport's ostensible purchase of shares in [the Terminal] project, which concealed a different type of unlawful investment, is not an 'investment' which is covered by the BIT. As the BIT is the basis of jurisdiction of this Tribunal, Fraport's claim must be rejected for lack of jurisdiction *ratione materiae*.¹⁴³

In his Dissenting Opinion, Bernardo Cremades relied on the fact that Fraport was a shareholder in PIATCO in 1999 and argued that the fact that the Claimant's asset may have engaged in illegal conduct in the Philippines "does not change the fact that its shareholdings are an asset accepted in accordance with Philippine law."¹⁴⁴

After an *ad hoc* Committee rendered a decision annulling the Fraport Award on December 23, 2010 on due process grounds, the resubmitted case was decided on December 10, 2014. The new panel in an *obiter* referred to the Clean Hands doctrine in its analysis of the legality requirement, explaining that:

Investment treaty cases confirm that such treaties do not afford protection to illegal investments either based on clauses of the treaties, as in the present case [. . .], or, absent an express provision in the treaty, based on rules of international law, such as the 'clean hands' doctrine or doctrines to the same effect. One of the first cases having ruled on this issue, *Inceysa v. El Salvador*, has held that 'because Inceysa's investment was made in a manner that was clearly illegal, it is not included in 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.'¹⁴⁵

The new tribunal noted that at the jurisdictional stage, its analysis would be limited to examining whether there was a violation of the ADL at the time of Fraport's initial investment.¹⁴⁶ The assessments of the new Tribunal were consistent with the original Tribunal's assessments. Thus, a finding of the ADL violation by Fraport resulting from the secret Shareholders Agree-

143 *Id.* ¶ 404.

144 *Id.* ¶ 13 (Dissenting Opinion of Arbitrator Cremades).

145 *Fraport 2014 Award*, *supra* note 123, at ¶ 328 (footnotes omitted).

146 *Id.* ¶ 388.

ments to secure control over the Terminal's operations was confirmed; this finding reaffirmed that the "Pooling Agreement" entered into by Fraport with the Philippine shareholders in July 1999 established a block voting arrangement in favour of Fraport, allowing it to make binding recommendations.¹⁴⁷ In part replying to the point made in the Dissenting Opinion appended to the original Award, the Tribunal held that:

Fraport violated the ADL when making its Initial Investment, the latter being consequently excluded as investment protected by the BIT because of its illegality. The illegality of the investment at the time it is made goes to the root of the host State's offer of arbitration under the treaty. [. . .] Lack of jurisdiction is founded in this case on the absence of consent to arbitration by the State for failure to satisfy an essential condition of its offer of this method of dispute settlement.¹⁴⁸

Accordingly, the Tribunal found that there was "no legal dispute arising out of" an "investment" in the language of Article 25(1) of the ICSID Convention, and that the Respondent had not consented to the arbitration of Claimant's claims with respect to its (factual) investment.¹⁴⁹

III. MAMIDOIL V. REPUBLIC OF ALBANIA AND THE IMPACT OF THE LEGALITY REQUIREMENT AT THE MERITS STAGE¹⁵⁰

Greek investors, Mamidoil Jetoil Greek Petroleum Products Societe S.A. (*hereinafter* "Mamidoil"), submitted to the ICSID an application for arbitration against the Republic of Albania in connection with an alleged breach of the 1991 Greek-Albanian BIT.¹⁵¹ *Mamidoil* – whose main field of activity in Albania involved the construction and operation of an oil container terminal on a land plot in the *Durres Port* area (*hereinafter* "*Durres Port* project")¹⁵² – claimed that by constructing and operating a "tank farm" in the port of Durres, it had made an investment in Albania.¹⁵³

147 *Id.* ¶ 395.

148 *Id.* ¶ 467.

149 *Id.* ¶ 468.

150 *Mamidoil Award*, *supra* note 11.

151 *Id.* ¶ 7.

152 *Id.*

153 *Id.* ¶ 279.

It asserted that the measures taken by Albania to re-zone the site of the investor's operations, and subsequent interruptions to and relocation of petroleum-related activities from the *Durres Port* area to other locations violated the terms of the Greek-Albanian BIT arrangements.¹⁵⁴

Mamidoil alleged that by rejecting any claim for compensation, Albania violated its own expressed commitments in relation to the relocation of *Durres Port* project.¹⁵⁵ It claimed that its decision to go through with the construction of the *Durres Port* project in October 1999 was based on the substantive approval of the project by high-level Albanian governmental authorities, as expressed in the lease contract dated June 1999, as well as their consistent, oral endorsements of the *Durres Port* project; their assurances as to the regulatory requirements relating thereto, and their encouragement for the project to go ahead.¹⁵⁶

Mamidoil contended that its investment was made legally and in compliance with all necessary permits and Governmental authorizations.¹⁵⁷ Mamidoil insisted that it applied for all, and received some, of the necessary governmental permits; those that it did not receive, or received belatedly, were due to failures by Albania.¹⁵⁸ Relying on the award in *Tokios Tokelés v. Ukraine* (where the tribunal noted that "minor errors" and "a failure to observe the bureaucratic formalities of domestic law" would not amount to illegality), the Claimant asserted that mere formal failures, such as the failure to obtain a permit which would have been granted, are not sufficient to constitute illegality of an investment under international law.¹⁵⁹ Rather, Claimant argued that only a serious violation of domestic law can lead to illegality of the investment.¹⁶⁰

Albania did not contest the fact that the tank farm formed the basis of Mamidoil's investment.¹⁶¹ However, Albania contested the legality of

154 *Id.* ¶ 303.

155 *Id.* ¶ 159.

156 *Id.* ¶ 541.

157 *Id.* ¶ 295.

158 *Id.* ¶ 297.

159 *Id.* ¶ 304.

160 *Id.* ¶ 306.

161 *Id.* ¶ 282.

the Mamidoil's operations in Albania.¹⁶² Albania argued that, in spite of numerous notifications regarding the need to obtain necessary permits, Mamidoil failed to address in any way the receipt of government approvals, authorizations or permits that were necessary to conduct its investment (*Durres Port* project) pursuant to Albanian Law.¹⁶³ As such, it asserted that the illegality of the investment constitutes a bar to jurisdiction because neither the BIT nor the ECT protects investments that are illegal or made in bad faith.¹⁶⁴

Moreover, Albania claimed that Mamidoil had been informed of the decision regarding the re-zoning of the *Durres Port* area through a letter from the Durres Sea Port Authority dated November 17, 1999 (less than a year after the approval of the agreement to lease the land to the investor for the *Durres Port* project).¹⁶⁵

Albania argued that Mamidoil failed to exercise the necessary due diligence required for an investment of such scale, particularly in light of the publicized infrastructural developments scheduled in Albania and Albania's cooperation with international development agencies such as the World Bank and other European institutions.¹⁶⁶ Instead, Albania alleged that Mamidoil relied on undocumented, vague, oral assurances of support by certain government officials (*Durres Port* authority) as proof of a "general non-objection" to its investment.¹⁶⁷

The Tribunal identified the issue of the legality of the investment as a central issue in the dispute between Mamidoil and Albania, which was determinative for both jurisdiction over, and the merits of, the dispute.¹⁶⁸ The Tribunal also noted that the significance of legality at the jurisdictional level depended on the fact that States' consent to investment arbitration largely due to the expectation that arbitral tribunals extend investment protection only to investments that have been made lawfully.¹⁶⁹ Neverthe-

162 *Id.*

163 *Id.* ¶ 337.

164 *Id.* ¶ 324.

165 *Id.* ¶ 197.

166 *Id.* ¶ 196.

167 *Id.* ¶ 193.

168 *Id.* ¶ 289.

169 *Id.* ¶ 291.

less, the Tribunal distinguished between the substantive and procedural dimensions of illegality of the investment as alleged by Albania.¹⁷⁰

With respect to substantive illegality, the Tribunal noted that the decisive moment for the appreciation of the investment's substantive legality is when the investment is planned and made.¹⁷¹ It further noted that "not every type of non-compliance with national legislation bars the protection of an investment."¹⁷² Reviewing the illegality jurisprudence, the Tribunal observed that investment arbitration tribunals "have stated that the illegality must be "serious" or "manifest," and that "minor errors" and "a failure to observe the bureaucratic formalities of the domestic law" will not justify the denial of jurisdiction."¹⁷³

At the same time, the Tribunal found that the Claimant's failure to apply for all the necessary permits, and thus Albania's non-issuance of the permits, was not just a minor issue.¹⁷⁴ This finding was based on the significance on the domestic laws on Urban Planning, which actually required such permits.¹⁷⁵ However, the Tribunal noted that, as established by the record, Albanian authorities consistently tried to cooperate with Claimant by repeatedly requesting and inviting it to submit the necessary applications accompanied by the necessary documentation.¹⁷⁶ As a result, the Tribunal found that the Respondent, by its conduct, conveyed to the Claimant that these illegalities were curable.¹⁷⁷ Based on this finding, the Tribunal observed that

It is true that a State cannot be expected to have consented to an arbitral dispute settlement mechanism for investments made in violation of its legislation. However, it can be expected to accept the jurisdiction of an arbitral tribunal when, in that State's own appreciation, the illegality of the investment was susceptible of being cured, as that State's own legalization offers show. In such

170 *Id.* ¶ 371.

171 *Id.* ¶ 375.

172 *Id.* ¶ 481.

173 *Id.* ¶ 482 (footnotes omitted).

174 *Id.* ¶ 489.

175 *Id.* ¶ 407.

176 *Id.* ¶ 490.

177 *Id.* ¶ 493.

circumstances, the legal significance of the absence of permits is to be determined as a question of merits – namely whether Respondent’s international responsibility is engaged in the face of Claimant’s violation of Albanian law – rather than this Tribunal’s jurisdiction.¹⁷⁸

At the merits stage, the Tribunal took into account the violation of Albanian law in dealing with the Claimant’s claim for the violation of the FET standard, as formulated in Article 10.1 of the ECT, and Claimant’s legitimate expectations of the investment.¹⁷⁹ In this regard, as a preliminary matter, the Tribunal held that legitimate expectations can only arise at the time the investment is made.¹⁸⁰

Although the Tribunal confirmed its jurisdiction despite the absence of permits (i.e. illegality of the investment), it noted that, as previously explained, the complete absence of applications for the relevant permits had no bearing on jurisdiction.¹⁸¹ However this issue could not be overlooked at the merits stage.¹⁸² The incomplete applications for the relevant permits, rendered the Claimant’s operations illegal under Albanian law, including the Law on Urban Planning.¹⁸³ The fact that Albania subsequently offered to help with the legalization of the situation was found by the Tribunal as not having a bearing on its legitimate expectations analysis.¹⁸⁴

The Tribunal reasoned that the conduct post-dated the totality of the investment process.¹⁸⁵ As a result, the Tribunal ultimately dismissed the claim for the FET violation and found that the “Claimant [was] not entitled to rely on the perpetuation of its activities in illegal circumstances and cannot claim a violation of legitimate expectations with respect to the illegal operation of the tank farm.”¹⁸⁶

178 *Id.* ¶ 494.

179 *Id.* ¶ 496.

180 *Id.* ¶ 695.

181 *Id.* ¶ 712.

182 *Id.*

183 *Id.*

184 *Id.* ¶¶ 713-714.

185 *Id.* ¶¶ 712-714.

186 *Id.* ¶ 716.

The dissenting arbitrator Hammond disagreed with the Majority's approach to the issue of illegality. His core disagreement with the Majority's approach was on the question of permits and licenses, and his view of the fact that the "Claimant's alleged failings with respect to permits and licenses had no relationship to Respondent's laws on foreign investment."¹⁸⁷ In this regard, Hammond noted the legality requirement analysis of the tribunal in the *Saba Fakes* case, wherein it was found that a violation of the regulations in the telecommunications sector or domestic competition law did not implicate a violation of the legality requirement.¹⁸⁸ Hammond argued that the same logic should be applied to the FET violation analysis.¹⁸⁹ While he agreed with the Majority that the Claimant failed to comply with the Respondent's domestic permit laws, in his view, the fact that Respondent failed to enforce the licensing norms throughout the entire period of Claimant's operations, should have been taken into account in the Tribunal's FET analysis.¹⁹⁰

IV. CONCLUDING OBSERVATIONS WITH RESPECT TO THE LEGALITY REQUIREMENT

The previous subsections have highlighted the developments with regard to the applications of the requirement of legality of investments in investment disputes and their implications for the Clean Hands doctrine. In this regard, two additional observations may be made.

First, it must be noted that the legality requirement does not necessarily need to be stipulated in the relevant treaty. This point has been made by a number of tribunals. For example, in *Plama Consortium Ltd. v. Bulgaria*,¹⁹¹ the tribunal noted that the ECT does not include a provision calling for the investment's conformity with a given law. The tribunal articulated its approach regarding this issue as follows:

Unlike a number of Bilateral Investment Treaties, the ECT does not contain a provision requiring the conformity of the Investment with

187 *Id.* ¶ 126 (Dissenting Opinion of Arbitrator Hammond).

188 *Id.* ¶ 128 (footnote omitted).

189 *Id.*

190 *Id.* ¶ 131.

191 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award (Aug. 27, 2008).

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. [. . .] In accordance with the introductory note to the ECT “[t]he fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues” Consequently, the ECT should be interpreted in a manner consistent with the aim of encouraging respect for the rule of law. The Arbitral Tribunal concludes that the substantive protections of the ECT cannot apply to investments that are made contrary to law.¹⁹²

Thus, Claimant’s misrepresentation in obtaining approval for the purchase of a Bulgarian entity was “contrary to the principle of good faith which is part not only of Bulgarian law” but also “of international law – as noted by the tribunal in the *Inceysa* case” and resulted in depriving Claimant’s investment in Bulgaria from the protections provided by the ECT.¹⁹³

It should be noted, however, that the *Plama* tribunal, confronted with a case of first impression – where for the first time a jurisdictional objection based on an allegation of misrepresentation and illegality in the context of the ECT was at issue – in its Decision on Jurisdiction in February 2005, held that “the Respondent’s allegation of misrepresentation by the Claimant does not deprive the Tribunal of jurisdiction in this case.”¹⁹⁴ Accordingly, the tribunal’s analysis in its 2008 Award in the passage quoted above was effectively a finding that *Plama*’s claim was inadmissible. This was reflected in paragraph 3 of the *dispositif* of the 2008 Award as follows: “Claimant is not entitled to any of the substantive protections afforded by the ECT”.¹⁹⁵

192 *Id.* ¶¶ 138-139 (footnotes omitted).

193 *Id.* ¶ 144.

194 *Id.* ¶ 229.

195 *Id.* ¶ 325.

In *SAUR International v. Argentine Republic*,¹⁹⁶ the tribunal held that the legality requirement is "inherent in every BIT".¹⁹⁷ With regard to the interpretation of the BIT, the tribunal held that:

The requirement of not having engaged in a serious violation of the legal regime is a tacit condition, inherent in every BIT, since it cannot be understood under any circumstance that a State is offering the benefit of protection through investment arbitration when the investor, to reach that protection, has committed an unlawful action.¹⁹⁸

On the facts, however, the tribunal found in favour of SAUR, holding that there was no evidence in the record that the investor had breached Argentine law.¹⁹⁹ Relying on the findings of a domestic judicial process commenced against the investor in relation to the payments, the tribunal found that the money was indeed intended to pay salaries and that the payments were correctly recorded in the company's accounts.²⁰⁰

The *Yukos Award* further confirmed the *Plama* Tribunal's approach regarding the issue of legality under the ECT.²⁰¹ The *Yukos Award*, rendered

196 *SAUR Award*, *supra* note 9. This case concerned an Argentine water concession awarded to the French company, SAUR International. SAUR claimed that the measures taken by the host State constituted indirect expropriation, as well as a violation of the fair and equitable treatment standard. Among other things, Argentina objected to the jurisdiction of the tribunal alleging that the investor had acted illegally in making a series of secret payments to certain parties. Countering this objection, SAUR pointed out that the France-Argentina BIT did not contain a legality requirement. It also factually denied engaging in any illegal activity. *Id.*

197 *Id.*

198 *Id.*

199 *Id.*

200 *Id.*

201 As is well-known, three cases were brought by two Cypriot companies (Hulley Enterprises and Veteran Petroleum) and Yukos Universal, a company organized under the laws of the Isle of Man, which collectively held just over 70% of the shares of the former Yukos Oil Company. The three arbitrations were held in parallel as a single set of proceedings, but due to the fact that the three Claimants maintained separate claims, three separate awards were rendered. In the following discussion reference is made to the most recent *Yukos Award*. See *Yukos Award*, *supra* note 6.

on July 18, 2014, did not characterize the legality-based objection in the context of the ECT. The *Yukos* Tribunal found that, under the circumstances of the case, it did not need to decide whether the legality requirement it read into the ECT operated as a bar to jurisdiction or, as suggested in *Plama*, as a deprivation of Claimants' substantive protections under the ECT.²⁰²

In answering the question of whether a Clear Hands doctrine or a legality requirement could be read into the ECT, the Tribunal agreed with the *Plama* Tribunal and held that:

In imposing obligations on States to treat investors in a fair and transparent fashion, investment treaties seek to encourage legal and *bona fide* investments. An investor who has obtained an investment in the host State only by acting in bad faith or in violation of the laws of the host State, has brought itself within the scope of application of the ECT through wrongful acts. Such an investor should not be allowed to benefit from the Treaty.²⁰³

Turning to the second concluding observation, it must be noted there is supporting case law to the effect that the illegality of the investment may operate as a jurisdictional objection only if the alleged illegality is related to the initial stage of making an investment.

The important distinction between “the making of the investment” in the host State, as opposed to the post-establishment “performance of the investment,” and limiting the operation of the legality requirement as a jurisdictional bar to the former, was first articulated by the *Hamester* Tribunal as follows:

The Tribunal considers that a distinction has to be drawn between (1) legality as at the *initiation* of the investment . . . and (2) legality *during the performance* of the investment. [. . .] Thus, on the wording of this BIT, the legality of the creation of the investment is a jurisdictional issue; the legality of the investor's conduct during the life of the investment is a merits issue.²⁰⁴

More recently, the *Yukos* Tribunal further confirmed this approach as applied to the ECT by rejecting Russia's contention “that the right to invoke the ECT must be denied to an investor not only in the case of illegality in

202 *Yukos* Award, *supra* note 6, at ¶ 1353.

203 *Id.* ¶ 1352.

204 *Hamester* Award, *supra* note 73, at ¶ 127.

the *making* of the investment but also in its *performance*.”²⁰⁵ The Tribunal observed that there was no compelling reason to deny altogether the right to invoke the ECT in such circumstance.²⁰⁶ In the Tribunal’s view, the appropriateness of the imposed domestic sanctions by the host State should remain under the scrutiny of investment tribunals:

[I]f the investor believes these sanctions to be unjustified (as Claimants do in the present case), it must have the possibility of challenging their validity in accordance with the applicable investment treaty. It would undermine the purpose and object of the ECT to deny the investor the right to make its case before an arbitral tribunal based on the same alleged violations the existence of which the investor seeks to dispute on the merits.²⁰⁷

On the facts, the Tribunal did not find that the investment had been made in bad faith or in violation of the laws of the host State. However, it held that instances of Claimants’ illegal conduct during the performance of the investment could be considered at the merits stage:

The Tribunal concludes that Respondent’s ‘unclean hands’ argument fails as a preliminary objection. It does not operate to deprive the Tribunal of its jurisdiction in this arbitration, render inadmissible any of the Claimant’s claims or otherwise bar Claimants from invoking the substantive protections of the ECT.

However, [. . .] some of the instances of Claimants’ ‘illegal and bad faith’ conduct complained of by Respondent in the context of this preliminary objection, could have an impact on the Tribunal’s assessment of liability and damages.²⁰⁸

Addressing the issue of liability, the Tribunal found that the primary objective of the Russian Federation was not to collect taxes, but rather to bankrupt Yukos and appropriate its valuable assets.²⁰⁹ In particular, the Tribunal noted that:

Among the many incidents in this train of mistreatment that are within the remit of this Tribunal, two stand out: finding Yukos

205 *Yukos Award*, *supra* note 6, at ¶ 1354.

206 *Id.* ¶ 1355.

207 *Id.*

208 *Id.* ¶¶ 1373-1374.

209 *Id.* ¶ 1579.

liable for the payment of more than 13 billion dollars in VAT in respect of oil that had been exported by the trading companies and should have been free of VAT and free of fines in respect of VAT; and the auction of YNG at a price that was far less than its value. But for these actions, for which the Russian Federation [. . .] was responsible, Yukos would have been able to pay the tax claims of the Russian Federation justified or not; it would not have been bankrupted and liquidated[.].²¹⁰

The Tribunal concluded that the Russian Federation violated its obligation under Article 13 (the expropriation provision) of the ECT.²¹¹ It held that although the Russian Federation did not explicitly expropriate Yukos or the holdings of its shareholders, the measures that it took in respect of Yukos had an effect “equivalent to nationalization or expropriation.”²¹² In light of the Tribunal’s assessments on expropriation, the Tribunal did not deem it necessary to consider whether Respondent’s actions were also in breach of the FET standard as contained in Article 10 of the ECT.²¹³

At the same time, relying particularly on Article 39 of the ILC Draft Articles on State Responsibility (Contribution to the injury), and based on its apportionment of responsibility, the Tribunal reduced the damages owed to the Claimants by 25% due to a finding of their contributory fault as a result of, *inter alia*, Yukos’ “tax optimization” misconduct in the Russian low-tax regions.²¹⁴

b. Abuse of Process: Abusing the System of Investment Protection Under the ICSID Convention

Whereas the legality requirement strand of case-law is based on the domestic legality of the investment, the abuse of process strand is based on international legality of the investment. In fact, as will be discussed below, the abuse of process inquiry is only triggered when the domestic legality hurdle is surmounted and the tribunal is satisfied that the investment has been made in compliance with the domestic law of the host State. This

210 *Id.*

211 *Id.* ¶ 1888.

212 *Id.* ¶ 1580.

213 *Id.* ¶ 1585.

214 *Id.* ¶ 1637.

second strand was initiated in *Phoenix*, where the Tribunal first dealt with the issue of abusing the system of investment protection, and found that as a result, it lacked jurisdiction *ratione materiae*.

The *Levy* case represents a recent example of a departure from the *Phoenix* Tribunal's approach. It would seem that going beyond the "*Salini* test" to accommodate abuse of process concerns has not been the only way to address the issue.

I. PHOENIX ACTION, LTD V. THE CZECH REPUBLIC²¹⁵

Phoenix was an ICSID arbitration arising under the Israeli-Czech Republic BIT.²¹⁶ The Claimant, an Israeli company registered under the laws of the State of Israel on October 14, 2001, was entirely owned by Mr. Vladimir Beno, a former Czech national.²¹⁷ *Phoenix* complained about the treatment of its investment by the Czech Republic, its investment being two Czech companies, Benet Praha (*hereinafter* "BP") and Benet Group (*hereinafter* "BG").²¹⁸ BP, and its subsidiary, BG, were involved in trading of ferroalloys.²¹⁹ The Tribunal noted that in December 26, 2002, at the time when *Phoenix* purchased the two Czech companies, BP and BG were involved in ongoing legal disputes, BG with a Private party, BP with the Czech fiscal authorities.²²⁰ In fact, a criminal investigation related to a series of tax and custom duty evasion was commenced in April 2001 against Mr. Beno, who was at the time BP's Executive Officer.²²¹ The criminal investigation against Mr. Beno also involved the freezing of BP's funds and the seizure of accounting business documents.²²² The investigation resulted in an arrest warrant being issued against Mr. Beno.²²³ However, Mr. Beno escaped the Czech police and fled to Israel, where he thereafter, on October 14, 2001,

215 *Phoenix Award*, *supra* note 8.

216 *Id.* ¶ 6.

217 *Id.* ¶ 22.

218 *Id.*

219 *Id.* ¶ 25.

220 *Id.* ¶ 28.

221 *Id.* ¶ 32.

222 *Id.* ¶ 33.

223 *Id.* ¶ 32.

registered a new company, Phoenix Action Ltd.²²⁴ The Tribunal noted that Mr. Beno created an Israeli company to buy the two Czech companies he owned as a Czech citizen living in the Czech Republic, after the actions taken by the Czech Republic against these companies.²²⁵

In its jurisdictional decision after the Tribunal decided to bifurcate the proceedings to deal with the jurisdictional objections raised by the Czech Republic, the Tribunal held that it was limited *ratione temporis* to judging only those acts and omissions occurring after the date of the investor's purported investment.²²⁶ As a result, the Tribunal found that it lacked jurisdiction with respect to the acts directed against BP and BG that occurred before December 26, 2002.²²⁷

The Tribunal next turned to the question whether it had jurisdiction *ratione materiae*, namely, whether there is a legal dispute arising directly out of an investment.²²⁸ In its analysis, the Tribunal added more elements to the traditional elements mentioned in the "*Salini* test."²²⁹ Accordingly, the Tribunal held that in order for it to have jurisdiction *ratione materiae*, the following six elements had to be taken into account: "1 – a contribution in money or other assets; 2 – a certain duration; 3 – an element of risk; 4 – an operation made in order to develop an economic activity in the host State; 5 – assets invested in accordance with the laws of the host State; 6 – assets invested *bona fide*."²³⁰

As far as the fifth element (the domestic legality) was concerned, the Tribunal found that there was no violation of a rule of the Czech Republic legal order, and not even the principle of good faith as embodied in the national legal order.²³¹ In this regard the Tribunal noted that Phoenix

224 *Id.*

225 *Id.* ¶ 137.

226 *Id.* ¶ 68.

227 *Id.* ¶ 71 (footnote omitted).

228 *Id.* ¶ 73.

229 *Salini Construttori S.p.A v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶ 52 (July 23, 2001).

230 *Phoenix Award*, *supra* note 8, at ¶ 114.

231 *Id.* ¶ 134.

duly registered its ownership of the two Czech companies in the Czech Republic.²³²

However, with respect to the sixth element, namely, whether or not the investment was a *bona fide* investment, the Tribunal found that based on the totality of evidence, it was clear that the main aim of Phoenix was to bring the pre-existing dispute involving BP and BG before this Tribunal.²³³ In fact, on December 26, 2002, Phoenix acquired an investment that was already burdened with the civil litigation as well as problems with the tax and customs authorities.²³⁴ In addition, the Tribunal noted that apparently all transfers were merely done inside the family of Mr. Beno.²³⁵ The shares of BP were purchased from Mr. Beno's wife, a Czech citizen; while the shares of BG, belonging to Yougo Alloys, were bought from Mr. Beno's daughter.²³⁶ The Tribunal thus found that the Claimant made an investment for "the sole purpose of bringing international litigation against the Czech Republic."²³⁷ Consequently, the Tribunal held that:

The conclusion of the Tribunal is therefore that the Claimant's initiation and pursuit of this arbitration is an abuse of the system of international ICSID investment arbitration. If it were accepted that the Tribunal has jurisdiction to decide Phoenix's claim, then any pre-existing national dispute could be brought to an ICSID tribunal by a transfer of the national economic interests to a foreign company in an attempt to seek protections under a BIT. Such transfer from the domestic arena to the international scene would *ipso facto* constitute a "protected investment" – and the jurisdiction of BIT and ICSID tribunals would be virtually unlimited. It is the duty of the Tribunal not to protect such an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs. It is indeed the Tribunal's view that to accept jurisdiction in this case would go against the basic objectives underlying the ICSID Convention as well as those of bilateral investment treaties. The Tribunal has to ensure that the ICSID mechanism does not protect investments that it was not designed

232 *Id.*

233 *Id.* ¶ 144.

234 *Id.* ¶ 136.

235 *Id.* ¶ 139.

236 *Id.*

237 *Id.* ¶ 142.

for to protect, because they are in essence domestic investments disguised as international investments for the sole purpose of access to this mechanism.²³⁸

The Tribunal thus ultimately concluded that it did not have jurisdiction *ratione materiae* over the claim because the Claimant's purported investment did not qualify as a protected investment under the ICSID Convention and the Israeli/Czech BIT.²³⁹ In the course of its reasoning, the Tribunal noted that the situation in the instant case does not involve the violation of the national legal order of the host State and thus is distinguishable from *Inceysa* and *Fraport*.²⁴⁰ Rather, in its abuse of process analysis, the *Phoenix* Tribunal was merely concerned with the international principle of good faith.²⁴¹ It noted that, "in most cases, but not in all, a violation of the international principle of good faith and a violation of the national principle of good faith go hand in hand."²⁴²

II. RENEE ROSE LEVY AND GREMCITEL S.A. V. REPUBLIC OF PERU²⁴³

Renee Rose Levy and Gremcitel S.A. (hereinafter "Levy") was an ICSID arbitration arising under the France-Peru BIT.²⁴⁴ The Claimants were Ms. Levy, a French national, and Gremcitel, a company organized under the laws of Peru, with its offices in Lima.²⁴⁵ The dispute concerned three parcels of land, located along Peru's Pacific coast near Lima, within the Municipality of Chorrillos.²⁴⁶ The three parcels of land were adjacent to the so-called "Morro Sollar," an area which is claimed to be the site of one of the most important battles in Peruvian history, the Battle of San Juan

238 *Id.* ¶ 144.

239 *Id.* ¶ 145.

240 *Id.* ¶ 113.

241 *Id.*

242 *Id.* ¶ 109.

243 *Renee Rose Levy v. Republic of Peru*, ICSID Case No. ARB/11/17, Award (Jan. 9, 2015).

244 *Id.* ¶ 1 (footnote omitted).

245 *Id.* ¶ 2.

246 *Id.* ¶ 7.

and Chorrillos, which occurred in 1881 between Peru and Chile.²⁴⁷ In 1995, the Municipality of Chorrillos held a public bidding process to sell the three parcels of land to private individuals on the basis of the projects proposed by the bidders for the development of the land.²⁴⁸ By December 1995, Gremco, a Peruvian company (and part of the Levy Group),²⁴⁹ was the owner of the three projects, which were later consolidated into the "Costazul Project," a tourism and real estate project.²⁵⁰ In July 2001, Gremco submitted a proposal for the historical delimitation of the Moro Solar to Peru's National Institute of Culture (INC).²⁵¹

Between 2003 and 2004 the Peruvian company, Gremcitel (part of the Levy Group), acquired the land and the rights relating to the development project.²⁵² On March 22, 2006, Gremcitel applied for the Urban Development Permit.²⁵³ On October 10, 2007, the INC issued a Resolution (*hereinafter* the "2007 Resolution"), which provided a precise delimitation of the boundaries of the Morro Sollar.²⁵⁴ There were also previous Resolutions related to Morro Sollar issued by the Peruvian authorities in 1977 and 1986.²⁵⁵ However, the scope and importance of these earlier Resolutions, in particular, their impact on the crystallization of the controversy, were disputed between the Parties.²⁵⁶ More importantly for the purpose of the abuse of process analysis, in 2005, a Historical Commission was created entrusted with proposing the delimitation of the intangible historical area of Morro Solar.²⁵⁷ The findings of the Historical Commission contained in its 2005 Report was the basis for the 2007 Resolution.²⁵⁸

247 *Id.*

248 *Id.* ¶ 11 (footnotes omitted).

249 *Id.* ¶ 14 (footnote omitted).

250 *Id.* ¶ 18 (footnote omitted).

251 *Id.* ¶ 26 (footnote omitted).

252 *Id.* ¶ 20.

253 *Id.* ¶ 36.

254 *Id.* ¶ 37 (footnote omitted).

255 *Id.* ¶ 112.

256 *Id.*

257 *Id.* ¶ 35 (footnotes omitted).

258 *Id.*

The Claimants claimed that the 2007 Resolution imposed on the land an intangibility status which did not exist until then and thus rendered the Costazul Project meaningless.²⁵⁹ For the Claimants, the 2007 Resolution was the measure that gave rise to the dispute.²⁶⁰ More specifically, the Claimants in the context of their FET argument contended that the Respondent frustrated their legitimate expectations that they would be able to develop the Costazul Project.²⁶¹ As for the Tribunal's jurisdiction under the France-Peru BIT, the Claimants argued that they met the nationality requirement due to the fact that Ms. Levy was a French national and that she owned and controlled Gremcitel, a Peruvian company, indirectly since 2005 (through the company Hart Industries Ltd.) and directly since 2007.²⁶²

For its part, Peru contested the fact that prior to the 2007 Resolution, there was no limitations on the development of the subject parcels of land.²⁶³ The Respondent insisted that the Claimants could have no legitimate expectations that they could develop their land free from restrictions and that the 2007 Resolution should be seen as a mere confirmation of the legal framework established by the previous Resolutions dating back from 1986 to 1977.²⁶⁴ Regarding the Tribunal's jurisdiction, the Respondent argued, among other things, that the hurried transfer of shares which made Ms. Levy the controlling shareholder of Gremcitel constituted an abuse of process," having been carried out for the sole purpose of attracting the France-Peru BIT protection at a time when the dispute had either already arisen or was at least entirely foreseeable.²⁶⁵

The Tribunal identified the central issue as one relating to the chronological crystallization of the dispute, which was determinative for both the Tribunal's jurisdiction *ratione temporis*, and its abuse of process analysis.²⁶⁶ The Tribunal noted that according to the Claimants, Ms. Levy had acquired indirect control over Gremcitel in 2005 (when she acquired just over 33% of

259 *Id.* ¶ 37 (footnote omitted).

260 *Id.*

261 *Id.* ¶ 65.

262 *Id.* ¶ 63.

263 *Id.* ¶ 71.

264 *Id.*

265 *Id.* ¶ 69.

266 *Id.* ¶ 135.

the shares in Hart Industries, which was the main shareholder in Gremcitel) and direct control over Gremcitel in 2007 (when she acquired 58.82% of shares in Gremcitel), which also would turn Gremcitel into a French company for the purposes of Article 25(2)(b) of the ICSID Convention.²⁶⁷

Aside from its abuse of process argument, Peru alleged that Ms. Levy had not put forward reliable evidence as to her shareholding.²⁶⁸ Based on evidence in the record, including the evidence addressed at the Hearing establishing instances of backdating with regard to the relevant corporate resolutions, the Tribunal found that the Claimants had not discharged their burden to prove their assertion as to Ms. Levy's shareholding and indirect control in 2005.²⁶⁹ The Tribunal, however, found that the Claimants met their burden of proof as to the 2007 shareholding.²⁷⁰ As to the exact timing of the transfer, the Tribunal noted that it had already found that the dispute between the Parties ultimately crystallized by the 2007 Resolution of the INC, and more precisely, by the date of its publication in the Official Journal, i.e., October 18, 2007.²⁷¹ Accordingly, the Tribunal found that it was satisfied that the second transfer (the 2007 transfer) had occurred on October 9, 2007, which was before the critical date, i.e., before October 18, 2007, which would be enough for a finding that The Tribunal had jurisdiction *ratione temporis*.²⁷² This finding, in turn, satisfied the requirement of "foreign control" under Article 25(2)(b) of the ICSID and Article 8(3) of the France-Peru BIT, resulting in a finding that Gremcitel also satisfied the requirement of *ratione temporis*.²⁷³

The Tribunal next dealt with the issue of abuse of process. As a preliminary matter, it noted that the Parties had not expressly discussed the characterization of this objection.²⁷⁴ The Tribunal asked the question: "Is

267 *Id.* ¶ 124.

268 *Id.* ¶ 69.

269 *Id.* ¶¶ 154-155.

270 *Id.* ¶ 161.

271 *Id.* ¶¶ 149-150.

272 *Id.* ¶ 161.

273 *Id.* ¶¶ 170-173.

274 *Id.* ¶ 180.

it a matter of jurisdiction, admissibility, or something else?”²⁷⁵ However, the Tribunal did not think it was necessary to resolve the issue:

The Tribunal considers that the characterization of the abuse of process objection as a jurisdictional or as an admissibility issue can be left open in the present case. Under the circumstances of this dispute, such differentiation is, to use the words of the *Pac Rim* tribunal, ‘a distinction without a difference’, in the sense that it would have no impact on the outcome of the case.²⁷⁶

Turning to the substance of the objection, the Tribunal noted, as in particular articulated by the *Phoenix* Tribunal, that the doctrine of abuse of process or abuse of rights may be applicable in cases involving disputed corporate restructuring.²⁷⁷ Reviewing the relevant case-law, the Tribunal further explained that it had been well-established that an organization, or reorganization of a corporate structure designed to obtain investment treaty benefits (sometimes referred to as “treaty shopping”), was not illegitimate *per se*, including where this is done with a view to shielding the investment from possible future disputes with the host State.²⁷⁸ This, however, was not the case when a specific future dispute was about to crystalize:

In this respect, the Tribunal agrees with the test suggested in *Pac Rim* whereby ‘a specific future dispute’ must be ‘forsee[able] [. . .] as a very high probability and not merely as a possible controversy’. In the Tribunal’s view, this test strikes a fair balance between the need to safeguard an investor’s right to invoke a BIT’s protection in the context of a legitimate corporate restructuring and the need to deny protection to abusive conduct.²⁷⁹

The Tribunal acknowledged that the threshold for a finding of abuse of process was high.²⁸⁰ However, based on the facts, it determined that the test was satisfied in the instant Case.²⁸¹ This was due to the established fact that Gremcitel and Mr. Levy had learned about the content of the

275 *Id.*

276 *Id.* ¶ 181 (footnote omitted).

277 *Id.* ¶ 183.

278 *Id.* ¶ 184.

279 *Id.* ¶ 185 (footnote omitted).

280 *Id.* ¶ 186.

281 *Id.* ¶ 195.

2005 Report of the Historical Commission, on which the delimitation implemented through the 2007 Resolution was largely based, around the time of its issuance.²⁸² This knowledge enabled them to come up with a family decision to transfer the majority of the shares to Ms. Levy, in order to secure protection under the BIT.²⁸³ Addressing Mr. Levy's explanation that the transfer was motivated by the intention to internationalize the project, the Tribunal noted:

The Tribunal does not see how transferring shares to a family member with a foreign nationality would internationalize *the project*. What was sought to be internationalized was the soon-to-be-crystallized *domestic dispute*. In other words, the only purpose of the transfer was to obtain access to ICSID/BIT arbitration, which was otherwise precluded.²⁸⁴

The Tribunal therefore concluded that the corporate restructuring by which Ms. Levy became the main shareholder of Gremcitel on October 9, 2007 constituted an abuse of process and thus, the Tribunal was precluded from exercising jurisdiction over the dispute.²⁸⁵

III. CONCLUDING OBSERVATIONS WITH RESPECT TO ABUSE OF PROCESS

This *second strand* was initiated by *Phoenix*, where the Tribunal highlighted the issue of abusing the system of investment protection and found that as a result, it lacked jurisdiction *ratione materiae*.²⁸⁶ Nevertheless, it would seem that going beyond the "Salini test" to accommodate the abuse of process concerns has not been the only way to address the issue. For example, in *Alapli*²⁸⁷, the Majority of the Tribunal followed two lines of reasoning to reach the conclusion that the Tribunal lacked jurisdiction.²⁸⁸ Subsequently, the Claimant based its application for annulment on this

282 *Id.* ¶ 190.

283 *Id.* ¶ 191.

284 *Id.* ¶ 191.

285 *Id.* ¶ 195.

286 See *Phoenix Award*, *supra* note 8.

287 *Alapli Elektrik B.V. v. Republic of Turkey*, ICSID Case No. ARB/08/13, Award (July 16, 2012).

288 *Id.* ¶ 313.

very issue, claiming that there was a lack of a true majority. The Annulment Committee quoted paragraph 315 of the original Award to illustrate these lines of reasoning as follows:

The Majority has found Claimant not entitled to protection under either the Energy Charter Treaty or the Netherlands-Turkey BIT. For Arbitrator Stern this conclusion derives from notions of timing and *bona fides*, considering that Claimant did not make an investment until after the root of the controversy was evident and dispute itself had become a high probability. For Arbitrator Park, the Claimant simply lacks the status of an investor, for want of any contribution to the Alapli Project.²⁸⁹

The Annulment Committee, however, observed that these lines of reasoning were not contradictory, but complementary, and that in any case, this situation would not affect the validity of the Award.²⁹⁰ As far as our discussion of the abuse of process strand is concerned, the central point is that while Arbitrator Stern, following the *Phoenix* line of reasoning, relied on the abusive nature of the corporate restructuring to deny jurisdiction, Arbitrator Park's way of dealing with the situation was to rely on a traditional *Salini* element, *i.e.*, the investor's failure to make any personal contribution to the Alapli Project. In any event, as evidenced by the *Levy* case, the case-law has also evolved into a holding by the tribunals that they are precluded from exercising jurisdiction, without necessarily characterizing this issue as jurisdictional bar.

4. CONCLUSION

Despite the fact that the Clean Hands doctrine in its traditional sense was not included in the ILC Draft Articles on Diplomatic Protection, subsequent developments in international investment law illustrate the extent to which this doctrine has gained popularity. Indeed, the jurisprudence of investment treaty arbitration over the last decade has led to the application of the Clean Hands doctrine in its broad sense, both in the context of the legality requirement and in the context of the abuse of process debate. Whereas the legality requirement strand is based on the domestic legality

289 *Id.* ¶ 315.

290 *Alapli Elektrik B.V. v. Republic of Turkey*, ICSID Case No. ARB/08/13, Decision on Annulment, ¶ 165 (July 10, 2014).

of the investment, the abuse of process strand is based on international legality of the investment.

These *two strands* should be considered as a reinvention of the Clean Hands doctrine as applied in international investment law.²⁹¹ In the context of the legality requirement, the illegality of the investment has operated in some instances as a jurisdictional bar, rendering the consent of the

291 It is worth pointing out that in *Hesham Talaat Al-Warraq v. Indonesia* (*Hesham Talaat M. Al-Warraq v. The Republic of Indonesia*, Final Award, 15 December 2014), the Tribunal read into Article 9 of the OIC Agreement the Clean Hands doctrine in its traditional sense. This Claim was brought by a national of Saudi Arabia against Indonesia under the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference (the "OIC Agreement"). Article 9 of the OIC Agreement reads as follows:

The investor shall be bound by the laws and regulations in force in the host state and shall refrain from all acts that may disturb public order or morals or that may be prejudicial to the public interest. He is also to refrain from exercising restrictive practices and from trying to achieve gains through unlawful means.

Referring to Article 9 of the OIC Agreement, the Tribunal noted at the outset that unlike most BITs, "the OIC Agreement contains an explicit provision that binds an investor to observe certain norms of conduct." (Final Award, para. 631). The Tribunal further noted that the record establishes the Claimant's involvement in six types of fraud, including uneconomical swap with his own entity and replacing valuable assets for trash. At the same time, the Claimant's actions had occurred "after" the making of the investment. Equating the language of Article 9 of the OIC with the Clean Hands doctrine in its traditional sense, the Tribunal held that:

[I]t is established the Claimant has breached Article 9 of the OIC Agreement by failing to uphold the Indonesian laws and regulations and in acting in a manner prejudicial to the public interest. The Claimant's actions were also prejudicial to the public interest. The Tribunal finds that the Claimant's conduct falls within the scope of application of the "clean hands" doctrine, and therefore cannot benefit from the protection afforded by the OIC Agreement. (Final Award, Para. 647)

The Tribunal thus found that the Claimant was not entitled to any damages in respect of the Respondent's breaches of the FET standard due to his post-establishment conduct. (Final Award, para. 683).

host State invalid. In some other instances, the Clean Hands doctrine has operated at the merits stage, where it has either (i) led to rejection of the claimant's claim regarding the violation of the fair and equitable treatment standard or (ii) has resulted in a proportionate reduction of the reparation awarded due to claimant's conduct. In addition, the abuse of process strand, which began by the *Phoenix* Tribunal's holding that it lacked jurisdiction *ratione materiae*, has evolved into a holding by tribunals that they are precluded from exercising jurisdiction, which leaves the characterization of the abuse of process objection open.