INVESTOR CORRUPTION AS A DEFENSE STRATEGY OF HOST STATES IN INTERNATIONAL INVESTMENT ARBITRATION: INVESTORS’ CORRUPT ACTS GIVE AN UNFAIR ADVANTAGE TO HOST STATES IN INVESTMENT ARBITRATION

Margareta Habazin*

I. INTRODUCTION

Corruption is a dominant and growing challenge for international business and investments. 1 Many investment transactions take place in developing countries that have weak or corrupt legal systems. 2 Until very recently, the issue of corruption did not play a significant role in international investment law. 3 Bribing public officials to procure or retain investment contracts was considered to be an inevitable and acceptable cost of doing business in developing countries. 4 However, corruption has become an enormous obstacle for investments and a real problem for countries that depend on foreign investments to help their people and economies grow.

Bribery of public officials and the corruption of national legal systems has turned into a significant issue for international investment law. 5 Corruption has not been possible to control effectively on a national level 6 and numerous international conventions 7 have

---

1 TRANSPARENCY INTERNATIONAL, GLOBAL CORRUPTION REPORT 2009: Corruption and the Private Sector xxv (2009) [hereinafter Executive Summary].
2 ALOYSIUS P. LLAMZON, CORRUPTION IN INTERNATIONAL INVESTMENT ARBITRATION (2014).
3 ANDREAS KULICK, GLOBAL PUBLIC INTEREST IN INTERNATIONAL INVESTMENT LAW (2012).
5 LLAMZON, supra note 2.
6 Id. at 44.
been enacted over the past decade. By signing the anti-corruption conventions, countries recognized that corruption is a widespread phenomenon in international business and investments and that it is morally and legally unacceptable.8

An increasing awareness about the adverse effects of corruption9 made the issue of corruption a focal point in international investment arbitrations in recent years.10 International Centre for Settlement of Investment Disputes (“ICSID”) tribunals have permitted host states to invoke a corruption defense whenever an investor commits bribery to win a government contract. In addition, a few ICSID tribunals accepted the asserted corruption defense of host states and stated in their decisions that it is impossible to ignore the negative impact of corrupt acts.11 The tribunals have accepted the principle that corrupt acts are contrary to international public policy12 and that they cannot enforce contracts or provide treaty protection where an investment is contaminated by corruption.13 Additionally, ICSID tribunals have been willing to punish those that participate in corrupt activities through the denial of a favorable award.14 In a situation of a successfully established corruption defense, investors have been deprived of the appropriate protection of their rights.15 Further, host states have been able to evade any potential liability for investment violations and obligation of compensation and in fact profit from the violation of international investment law.16

The aim of this paper is to demonstrate that ICSID tribunals should not follow previous case law in denying recovery to corrupt

---

9 Id. at 324.
15 Lamm et al., supra note 10.
investors because doing that will grant an unjust and superior position to host states. Investor wrongdoings should be followed by adequate legal consequences, but an investor should not be the only party bearing the consequences of corruption during arbitration.\textsuperscript{17} Host states are willing to use the argument of corruption to avoid an arbitration proceeding and its consequences. The ICSID tribunals should not allow the host states to avoid potential liability, especially because both a government of a host state and an investor are generally engaged and involved in corrupt activities.\textsuperscript{18}

First, the paper will analyze the issue of corruption in international investment arbitration. Second, the paper will examine the deployment of corruption as a defense strategy by host states in international investment arbitration. Next, it will address the jurisdictional consequences of proving corruption in the making of the investment. Further, it will describe the distinctive features of relevant ICSID awards and key issues that led to the dismissal of claims. The paper will also estimate the possible implications of the awards to future ICSID claims affected by bribery and try to predict the outcome of the \textit{MOL v. Republic of Croatia} arbitration. Finally, this paper will discuss whether ICSID tribunals will give unfair advantage to host states if they are going to follow previous case law in denying appropriate protection to corrupt investors. Although it may seem unfair to make states go through an expensive and perhaps politically costly arbitration proceeding, the paper will argue that the state’s involvement in alleged unlawful acts has to be taken into account by the ICSID arbitral tribunals. In that regard, the paper will propose that the ICSID tribunals should allow the host states to invoke corruption as a defense only if the host states demonstrate their commitment to fighting domestic corruption by taking all possible efforts to prosecute and punish their corrupt public officials.

II. Corruption in International Investment Arbitration

An issue of corruption has significant and serious impacts on international business and investments and has a wide range of harmful effects, from inefficiency to decreased investments and


\textsuperscript{18} Morchiladze, \textit{supra} note 11.
growth.\textsuperscript{19} Despite improving and amending national and international laws, more open markets and globalization have actually increased overall levels of corruption.\textsuperscript{20} According to Transparency International’s Global Corruption Barometer 2010, corruption has increased across the world and many foreign investors complained that they lost important business deals and opportunities because their competitors bribed public officials.\textsuperscript{21}

Most countries perceive corruption as a violation of domestic law, international public policy, and customary international law.\textsuperscript{22} However, corruption is still a complex and widespread problem in numerous developing countries.\textsuperscript{23} In many countries, bribery is the way governments are doing international business and states continuously tolerate corrupt activities of their public officials.\textsuperscript{24} Foreign investors are often encouraged to engage in corrupt practices because bribing guarantees a particular result and they frequently agree to bribe public officials to reduce certain risks associated with international investments. By acquiring allies within the current regime, the investors hope to prevent the possibility of expropriation by a host state or the probability that a competitor will walk away with an attractive government contract.\textsuperscript{25}

Many foreign investors choose international arbitration to avoid the unpredictable judicial systems of host states.\textsuperscript{26} The purpose of international investment arbitration is to provide an impartial and reliable mechanism for the resolution of investment disputes between foreign investors and host states arising either from investment treaties or investment contracts.\textsuperscript{27} International investment arbitrations have reduced the concerns of foreign investors and encouraged them to invest while discouraging host governments from violating foreign investors’ rights.\textsuperscript{28}

However, in the landscape of international arbitration allegations of corruption have become more and more common.\textsuperscript{29} Adjudicating disputes where it is alleged that the contract has been

\begin{footnotesize}
\begin{itemize}
  \item[20] LLAMZON, \textit{supra} note 2, at 8.
  \item[21] \textit{Executive Summary, supra} note 1 at XXV.
  \item[22] Meshel, \textit{supra} note 16, at 267.
  \item[23] LLAMZON, \textit{supra} note 2, at 13.
  \item[24] \textit{Id.} at 81.
  \item[25] Summerfield, \textit{supra} note 17, at 5.
  \item[26] \textit{Summerfield, supra} note 17, at 3.
  \item[27] Meshel, \textit{supra} note 16, at 267.
  \item[28] See \textit{id}.
  \item[29] See \textit{id}.
\end{itemize}
\end{footnotesize}
obtained by bribery or where the facts and circumstances suggest that bribery has tainted the contract underlying the dispute has often presented difficult issues for many arbitrators. Judge Lagergren was the first arbitrator to address directly the issue of corruption in international arbitration. He had boldly proclaimed an international public policy against enforcing contracts obtained through corruption. In his award, he looked beyond national laws, declaring a general principle of law that corrupt contracts are void or unenforceable. He emphasized “bribery is an international evil and contrary to good morals and an international public policy common to the community of nations.”

A growing attention to corruption in arbitration increased again after the arbitral award in World Duty Free v. Republic of Kenya in 2006. However, until Metal-Tech Ltd v. the Republic of Uzbekistan, no investment treaty arbitration case had been dismissed due to corruption by an ICSID tribunal. Both World Duty Free and Metal-Tech have underlined the increasing importance of bribery considerations in international investment ventures and reminded the business community, as well as legal practitioners, that bribery is no longer a peripheral issue that can be ignored. As a result, the issue of corruption is increasingly becoming a centerpiece of investor-state disputes and has been invoked as a defense by host states with greater consistency than ever before.

---

34 Losco, supra note 12, at 1217.
36 Lamm et al., supra note 10.
38 Partasides, supra note 4.
III. Corruption as a Defense Strategy of Host States in International Investment Arbitration

The corruption defense of host states has emerged as a powerful weapon for host states to defeat investment claims in circumstances where foreign investors obtained government contracts through corruption.39 As corruption has become a dominant issue in international investment arbitration, arbitral tribunals have started to accept corruption as a defense strategy of host states where both an investor and a host state have participated in corrupt activities.40 The growing acceptance of the corruption defense by the tribunals has led many host states to rely on it as a popular and common practice.41 By invoking the corruption defense the host states hope that the tribunals will dismiss the investor’s claims and impose no penalty on the host state.42 The tribunals have generally permitted the host states to invoke the corruption defense whenever foreign investors have committed bribery to win a government contract. Corruption in a procurement of the government contract has proved to be a successful and effective defense strategy of the host states.43 A few arbitral tribunals have affirmed this perspective in their decisions declaring that contracts obtained through corruption are void as contrary to international public policy and that they cannot enforce the contracts tainted by corruption.

However, arbitral tribunals have hardly addressed finding the proper balance between protecting investment and punishing corruption. To date, arbitrators have provided inadequate guidance on how allegations of corruption should be decided in concrete arbitral cases.44 Moreover, in situations where foreign investors have admitted corruption, the investors have often been deprived of the protection and the host states have avoided any potential liability for breach of investment protection obligations.45

Many cases brought issues relating to corruption to the forefront of international arbitration, but only World Duty Free and Metal-Tech resulted in the tribunals accepting the corruption de-

40 Meshel, supra note 16 at 267, 274.
41 See id.
42 Id. at 267, 274.
43 Losco, supra note 12.
44 LLAMZON, supra note 2, at 8.
45 Lamm et al., supra note 10.
INVESTOR CORRUPTION AS A DEFENSE

fense invoked by the host states against corrupt foreign investors and the allegations of corruption as proven. World Duty Free demonstrated that anti-corruption standards have become incorporated into the international legal framework and that international public policy condemns corruption to the extent of allowing the host state to escape liability for expropriating a contract obtained through corruption.

These ICSID awards highlighted the growing importance of corruption in investment arbitration and showed that evidence of corrupt payments can be crucial for a tribunal decision. ICSID tribunals have embraced the position that foreign investors should not be permitted to obtain protection for violation of contracts procured by corrupt means and usually denied recovery to corrupt investors.

IV. The Relevant ICSID Case Law on Corruption—Cases Where Corruption as a Defense Strategy of the Host State Has Succeeded

Although arbitral tribunals have been dealing with issues relating to corruption for decades, ICSID arbitral tribunals have started to notice that host states are relying on the corruption defense with greater frequency. Most tribunals have permitted host states to invoke the corruption defense whenever an underlying contract was procured by bribery. In addition, many bilateral investment treaties include the obligation of compliance of the investment with domestic laws and protect only investments made “in accordance with the laws” of the host state. This specific obligation is normally considered by arbitral tribunals and the tribunals frequently limit foreign investor’s rights in cases where the investor procured the government contract by bribery.

To preserve the object of investment arbitration and in particular investment treaties, the arbitral tribunals have relied on anti-corruption rules contained in applicable domestic laws and in the relevant investment treaty or agreement, as well as on interna-

---

46 See id.
47 Yackee, supra note 32.
48 Losco, supra note 12, at 1221.
49 Urofsky et al., supra note 35.
50 Losco, supra note 12, at 1221.
51 See id.
52 See id.
tional public policy that prohibits corruption independently of any treaty or contract obligations when they have examined corrupted allegations raised by host states. Although no formal concept of precedent exists in international investment arbitration, future tribunals might consider the ICSID cases analyzed below as concrete guidance in forming their conclusions.

A. World Duty Free Co. Ltd. v. Republic of Kenya

Growing attention to the issue of corruption in international investment arbitration manifested itself in the remarkable case of World Duty Free v. Republic of Kenya (“World Duty Free”)56, in which the ICSID tribunal ruled that the foreign investor could not recover damages for the alleged expropriation because the investor committed bribery to win a government contract. In this case, the investor, World Duty Free, initiated ICSID arbitration against Kenya pursuant to a contract and claimed that the Kenyan government had unlawfully expropriated his investment.58 Unlike most ICSID cases, there was no applicable Bilateral Investment Treaty (“BIT”). The ICSID tribunal’s jurisdiction was based on an arbitration clause in the concession agreement. The investment contract contained a choice-of-law clause that directed the tribunal to apply Kenyan and English law. Further, in the course of arbitral proceedings, the investor admitted and provided the tribunal with proof that he had obtained the government contract by bribing Kenya’s then-President. The investor viewed the money donation as the cost of doing business in Kenya.

53 Meshel, supra note 16 at 267, 272.
54 Morchiladze, supra note 11.
57 Urofsky et al., supra note 35.
58 Yackee, supra note 33, at 723, 730.
59 Yackee, supra note 32.
60 Cecily Rose, Questioning the Role of International Arbitration in the Fight against Corruption, 31 J. INT’L ARB. 183, 204 (2014).
61 Yackee, supra note 33, at 723, 730.
The admission of corruption in this case led the ICSID tribunal to conclude that if it recognized the investor’s rights arising from the investment contract procured by corruption and allowed the claim to go forward, it would violate international public policy. The tribunal relied on Judge Lagergren’s award and various international anti-corruption treaties, as well as other sources when it concluded that bribing Kenya’s public official clearly violated international public policy, as well as Kenyan and English law. The tribunal held “bribery is contrary to the international public policy of most, if not all, States, or to use another formula, to transnational public policy.” The Tribunal also deduced that the fact raised by the claimant that public corruption was culturally tolerated in Kenya and expected as part of its traditional “Harambee” system was legally irrelevant. Additionally, the tribunal stated that the investor was “not legally entitled to maintain any of its pleaded claims . . . on the ground of ex turpi non oritur actio,” as all of the pleaded claims “sound[ed] or depend[ed] upon” the tainted concession agreement.

In *World Duty Free*, the tribunal through the denial of a favorable award to the investor allowed Kenya to benefit from its own corrupt actions and to profit from the expropriation. Further, the willingness of the tribunal to ignore the host state’s own significant involvement in the corrupt activities has attracted remarkable interest in the arbitral community. To many, *World Duty Free* appeared to establish a corruption defense allowing a corrupt host state to escape responsibility even if its senior public officials had been active participants in corrupted activities.

---


64 Yackee, *supra* note 32.

65 See *World Duty Free*, *supra* note 56; Yackee, *supra* note 33, at 723, 731.

66 “*Ex turpi non oritur action*”— from a dishonorable cause an action does not arise.

67 See *World Duty Free*, *supra* note 56.

68 Yackee, *supra* note 33, at 723, 733.

69 See *id.*
B. Metal-Tech Ltd. v. Republic of Uzbekistan

Until the Metal-Tech award in 2013 no investment treaty claim had been dismissed due to corruption by an ICSID tribunal. The only other ICSID case that has been dismissed on corruption grounds is World Duty Free (2006). The Metal-Tech award highlighted the increasing relevance of bribery considerations in international investment arbitration and reminded the business community that bribery is no longer a marginal issue than can be ignored.

In Metal-Tech, the investor initiated ICSID arbitration against Uzbekistan and claimed that Uzbekistan breached its obligations under its domestic laws and the Israel-Uzbekistan BIT by inter alia failing to provide Metal-Tech fair and equitable treatment and expropriating Metal-Tech’s investment without due process of law. The tribunal found that the investor’s payments of approximately four million for different consultancy services to various individuals, including an Uzbek public official and the brother of Uzbekistan’s then prime minister constituted corruption and breached a treaty requirement that investments should be made in accordance with Uzbek law. The tribunal made brief references to “international law and the laws of the vast majority of States”, international anti-corruption conventions, and previous decisions, and relied mostly on the interpretation of the BIT, Uzbek law, and the ICSID Convention.

As a result of the interpretation of the BIT, Uzbek law, and the ICSID Convention and analysis of the evidence, the tribunal found that it lacked jurisdiction over the dispute. In reaching its

70 Lamm et al., supra note 10.
72 Cowley & Bridi, supra note 37.
75 See id.
76 Perry, supra note 71.
78 See id.
conclusion, the tribunal stated that the facts of the case raised a number of “red flags” established by the international community as indicators of corruption.\(^79\) In concluding that the investor’s payments were illegal under Uzbek law, the tribunal considered the size of the investor’s payments, the fact that they were made irrespective of services provided, the lack of professional qualification of the consultants and the lack of transparency of the payment arrangements, the close connections of some of the consultants with Uzbek public officials responsible for the approval of the investor’s investment, and the investor’s failure to provide a clear and logical explanation and to justify the legitimacy of the services for which payments were made.\(^80\) Thus the tribunal held that the payments were made in breach of Uzbek law and dismissed the claim for lack of jurisdiction.\(^81\) It stressed that the rights of the investor against the host state could not be protected in a case where the investment was infected by corruption.\(^82\) The tribunal saw no need to consider alleged breaches of international public policy.\(^83\)

Even though the tribunal dismissed Metal-Tech’s claim due to corruption, it acknowledged that Uzbekistan also participated in the corrupt conduct. Because the investor was deprived of protection under the BIT due to its corrupt acts and the host state avoided any potential liability, the tribunal ordered each party to bear its own costs.\(^84\) The tribunal noted, “the idea . . . is not to punish one party at the cost of the other, but rather to ensure the promotion of the rule of law.”\(^85\) Thus, this award emphasizes the importance of corruption in the context of international investment framework and underlines the possibility that where the contract has been tainted by bribery, either in its procurement or in its performance, recovery may no longer be available to an investor under a BIT in international investment arbitration.\(^86\)

\(^{79}\) Perry, supra note 71.
\(^{80}\) Meshel, supra note 74.
\(^{81}\) de Clapiers, supra note 63.
\(^{82}\) Lamm et al., supra note 10.
\(^{83}\) Hepburn, supra note 39, at 12.
\(^{84}\) Meshel, supra note 74.
\(^{85}\) Metal-Tech Ltd, supra note 73; Meshel, supra note 74.
\(^{86}\) Cowley & Bridi, supra note 37.
C. Siemens A.G. v. Argentine Republic

In Siemens, an investor, a German multinational company, initiated an ICSID arbitration against Argentina. The ICSID tribunal in its award stated that Argentina violated the Argentina-Germany BIT because Argentina’s actions during the crisis constituted an unlawful expropriation. The tribunal ordered Argentina to compensate Siemens in the amount of $200 million.87

Argentina submitted an annulment request that had only the slightest chance of success. While the annulment petition was pending, it came to light that Siemens had systematically encouraged the bribing of public officials worldwide, including in Argentina.88 In response to these disclosures, Argentina took the procedurally rare step of asking ICSID to “revise” the award. Argentina’s request for the revision of the arbitral proceedings persuaded Siemens to settle.89 Siemens agreed to walk away from its $200 million award in response to post-award disclosures that Siemens had procured its investment through the bribery of Argentine public officials.90

The issue of corruption never arose during the arbitral proceedings and the tribunal never had the chance to rule on the legal consequences of the bribery allegations.91 Further, at the time of Siemens case, the issue of corruptly procured investments had never been directly addressed by an arbitral tribunal in a BIT arbitration case. However, it is quite likely that the ICSID tribunal, had it been given the chance, would have applied an international public policy condemning corruption to sanction Siemens for its corrupt conduct.92 Jurisprudential trends indicated that the Siemens tribunal would probably have used the fact that the investment was procured through the bribery of Argentine public officials as a reason to decline its jurisdiction and to deprive the investor of appropriate protection of its rights under the applicable BIT.93 Thus, the outcome of this case demonstrates the potential benefits of a corruption defense to host states94 and that it has become well-settled within the arbitration community that any con-

87 Losco, supra note 12, at 1202.
88 Yackee, supra note 32.
89 See id.
90 Yackee, supra note 33.
91 Losco, supra note 12, at 1202.
92 Yackee, supra note 33, at 739.
93 Yackee, supra note 32.
94 See id.
tract tainted by bribery should be void as contrary to public policy and governing national laws.\textsuperscript{95}

V. MOL v. REPUBLIC OF CROATIA—THE ICSID CASE WHERE CORRUPTION AS A DEFENSE STRATEGY OF THE HOST STATE MIGHT SUCCEED

In \textit{MOL v. Republic of Croatia}, the investor, MOL Hungarian Oil and Gas Plc ("MOL"), initiated an ICSID arbitration against Croatia pursuant to the Energy Charter Treaty ("ECT") claiming that the host state broke its obligations in connection with MOL’s investments in Industrija Nafte dd ("INA").\textsuperscript{96} In 2003 the Croatian authorities decide to privatize INA, Croatia’s most significant enterprise in the field of oil and gas, and MOL acquired a 25\% stake + 1 share in the company, while the Croatian government remained the major shareholder. As part of the arrangement, MOL and the Croatian government entered into a Shareholders’ Agreement dated July 17, 2003. Between 2003 and 2007, the Croatian government continued the process of privatizing INA through reducing its own shareholding, which led in turn, in early 2008, to negotiation of a modification of the Shareholders’ Agreement, as the basis for MOL to increase its stake in INA to 49.08\%. The negotiations culminated in two agreements concluded on January 30, 2009 ("the 2009 Shareholders’ Agreements"). As a result, MOL became INA’s biggest shareholder with just under 50\% stake in INA and management control of the company.\textsuperscript{97}

The circumstances in which negotiations and the conclusion of the 2009 Shareholders’ Agreements occurred lie at the heart of the ICSID arbitration initiated by MOL pursuant to the ECT.\textsuperscript{98} The Croatian government in its response relies on corruption as a defense strategy, and argues that the 2009 Shareholder’s Agreements

\textsuperscript{95} Born, \textit{supra} note 30.

\textsuperscript{96} In 2014, the Croatian government commenced a parallel arbitration against MOL pursuant the UNCITRAL Rules arbitration to invalidate the 2009 Shareholders’ Agreements (PCA Case No. 2014-15). In the UNCITRAL arbitration, Croatia’s main argument was also that MOL procured the 2009 Shareholders’ Agreements by corruption. MOL Hungarian Oil and Gas Company Plc v. Republic of Croatia, ICSID Case No. ARB/13/32, Decision of the Tribunal on Preliminary Objections 4, 6 (Dec., 2014), http://www.italaw.com/sites/default/files/case-documents/italaw4073.pdf.

\textsuperscript{97} Croatia’s government holds 44.8\% of INA.

\textsuperscript{98} In 2014, the Croatian government has commenced a parallel arbitration against MOL pursuant the UNCITRAL Rules arbitration to invalidate the 2009 Shareholders’ Agreements. MOL, \textit{supra} note 96, at 4, 6.
were procured through bribery of Croatia’s then Prime Minister, Ivo Sanader by MOL’s CEO and Chairman Zsolt Hernádi. The host state emphasizes the fact that in November 2012 Mr. Sanader was convicted and sentenced to an eight-year prison term before the Croatian court for taking the bribe in the amount of five million euros from the investor in exchange for facilitating the 2009 Shareholders’ Agreements. However, in July 2015, Croatia’s Constitutional Court annulled the corruption conviction against Mr. Sanader citing procedural errors, and ordered the retrial. In September 2015, the Croatian court started a retrial of former Prime Minister Sanader on a case of a bribe allegedly taken from MOL to allow it to acquire a dominant stake in INA. The Croatian authorities also raised an indictment against Mr. Hernádi for paying bribes in exchange for MOL getting a large stake in INA, but Mr. Hernádi is evading prosecution.

The host state alleges that corruption that underlies the 2009 Shareholders’ Agreements forms a jurisdictional objection based on inter alia lack of consent, lack of “investment,” and violation of public policy. In the host state’s view, the investor never made the valid investment and the tribunal lacks jurisdiction to hear the case. On the other hand, the investor denies any wrongdoing, saying that neither MOL nor Mr. Hernádi has been convicted of any crime in relation to the 2009 Shareholder’s Agreements and that the criminal charges against Mr. Hernádi are being pursued in an effort by the host state to take control of INA. Further, the investor argues that the factual determinations made in Croatian criminal proceedings are not dispositive for the ICSID tribunal.

Generally, it is very difficult to prove bribery as there is usually little or no physical evidence. In MOL v. Republic of Croatia the ICSID tribunal will need to determine how to approach this particular situation because the investor vigorously disputes the allegations of bribery while the facts and circumstances of this case suggest the 2009 Shareholders’ Agreements may have been tainted by corruption. The ICSID tribunal has to decide who has the burden of proof and whether such burden of proof might be discharged in an easier way by evidence of sufficient “red flags”

99 Ivo Sander was Prime Minister between December 2003 and July 2009, when he suddenly resigned from the Prime Minister position.
100 MOL, supra note 96, at 5.
101 Id. at 4.
102 Obersteiner, supra note 55, at 272.
103 MOL, supra note 96, at 5.
established by the international community as indicators of corruption. The tribunal may be ready to use presumptions rather than full-fledged and hard to obtain evidence. In any case, bribery must be sufficiently proven to convince the tribunal that it lacks jurisdiction over the MOL claim.

So far, ICSID tribunals have not dismissed any ECT claim due to allegations of investor’s bribery, although the tribunal in *Plama Consortium Limited v. Bulgaria*\(^{104}\) held that there was an implied requirement of “clean hands”\(^{105}\) in order to bring a claim under the ECT. However, the *Plama* tribunal did not refer to the “clean hands” doctrine in explicit terms. The tribunal relied on the general principle contained in international law that a tribunal will not assist an investor who has engaged in illegal activities.\(^{106}\) Thus, in *MOL v. Republic of Croatia* the tribunal will certainly discuss whether MOL can recover under the ECT because of the alleged illegality of its investment.

By invoking the corruption defense, the Croatian government hopes that the ICSID tribunal will dismiss the investor’s claim and impose no financial liability on Croatia. Thus, the tribunal has to address the issue whether the investor is entitled to the substantive protection offered by the ECT\(^{107}\) and the evidence of bribery generated from the criminal investigation in Croatia may be crucial for the tribunal when it will decide the outcome of this arbitration. The tribunal might hold that the protection under the ECT does not cover investments that are contrary to domestic or international law,\(^{108}\) notwithstanding that the ECT does not expressly pro-


\(^{105}\) The “clean hands” doctrine has been defined as “an important principle of international law that has to be taken into account whenever there is evidence that an investor has not acted in good faith and that it has come to court with unclean hands.” An investment should be made in accordance with the law of a host-state in order to receive the protection of the treaty. This precludes claims made by an investor with unclean hands in relation to that investment. Rahim Moloo, *A Comment on the Clean Hands Doctrine in International Law* (2010), http://ssrn.com/abstract=2358229.

\(^{106}\) See id.


\(^{108}\) Strong attempts at stamping out corruption indicate that the Croatian government is serious in its efforts to fight corruption. Croatia ratified the Council of Europe Criminal Law Convention, the Civil Law Convention on Corruption and the United Nations Convention against Corruption. A new Criminal Code was passed in which corruption-related offences include active and passive bribery, money laundering, illegal mediation, trading in influence, abuse of office and authorities, unfair competition in foreign-trade business operations, bankruptcy abuse,
vide that investments must be made in conformity with a particular law.\footnote{109} In addition, the tribunal should take into consideration that the ECT must be interpreted in accordance with the Vienna Convention on the Law of Treaties and that the introductory note to the ECT provides that the ECT purpose is “to strengthen the rule of law on energy issues.”\footnote{110} As a result, the tribunal may conclude that the substantive protection of the ECT cannot apply to investments that are made contrary to law. The tribunal may find that the investment in this case violated not only Croatian laws, but also applicable rules of international law, pursuant Article 26(6) of the ECT, which provides that disputes need to be decided in accordance with “applicable rules and principles of international law.”\footnote{111} Such applicable rules and principles of international law might include the principle of good faith, the principle of \textit{nemo auditor propriam turpitudinem allegans}, as well as the notion of international public policy. Thus, the tribunal may find that granting the ECT’s protection to the MOL’s investment would be contrary to the basic notion of international public policy,\footnote{112} and accept the host state’s corruption defense that MOL cannot recover under the ECT because the 2009 Shareholders’ Agreements were procured through corruption.

Ideally, findings of corruption should not come down heavily only on MOL, and the tribunal should weigh the illegal actions of the host state and investor and not accept absolutely and unconditionally the corruption defense of the host state.\footnote{113}

\footnote{109} The tribunal in \textit{Plama} noted the fact that the ECT does not contain a provision requiring the conformity of the investment with a particular law. But the tribunal stated, “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.” \textit{See Plama Consortium Limited supra} note 104.

\footnote{110} Smutny & Polášek, \textit{supra} 107, at 292.

\footnote{111} \textit{See id.}

\footnote{112} \textit{See id.}

\footnote{113} In December 2016, the UNCITRAL arbitral tribunal has rejected Croatia’s request to nullify the 2009 Agreements, finding that the evidence was not sufficient to prove corruption. Due to confidentiality rules of the arbitration, the full award has not yet been made public but MOL published excerpts from the award, where “the Arbitral Tribunal finds, declares, rules, orders and awards that Croatia’s claims based on bribery, corporate governance and MOL’s alleged breaches of the 2003 Shareholders Agreement are all dismissed.” The Croatian government will seek for the ruling to be annulled by the Federal Court of Switzerland.

VI. THE JURISDICTIONAL CONSEQUENCES OF FINDING CORRUPTION

Foreign investors must substantively comply with both host state laws and with fundamental principles of law, understood as international public policy. Any violation on either path would lead to the dismissal of a claim. Thus, corruption in investments might lead to the rejection of the jurisdiction of the claim. If an issue of corruption is successfully raised, an arbitral tribunal will lack the jurisdiction and have no competence to deal with an investment dispute.

Therefore, the decision of the arbitral tribunal on corruption in an investment contract bears significant implications and might affect the balance between the rights and obligations of an investor and a host state. If corruption is successfully raised at the jurisdictional stage, the investor might not even obtain restitution of investments already injected into the host state because the tribunal might find that it does not have the jurisdiction. Further, if the tribunal accepts that it has no jurisdiction due to investor’s corrupt acts, the host state will avoid arbitration proceedings and its consequences. Hence, the denial of jurisdiction is a rather harsh punishment for corruption because the host state, which also participated in the illegal act, would, in fact, benefit from it whereas the investor would be deprived of the legal remedy because of it.

A. Jurisdictional Challenges Based on the Treaty Language

A crucial aspect of the investor-state bargain is compliance with host state laws. Many BIT’s require in their definition of investments that the investment be made “in accordance with the


114 Hepburn, supra note 39, at 3.
115 See id.
116 Morchiladze, supra note 11.
117 See id.
119 Morchiladze, supra note 11.
120 See id.
121 Hepburn, supra note 39, at 28.
laws of the host state.” 122 Dolzer and Schreuer note “[w]herever a clause ‘in accordance with the laws of the host state’ may be placed in a treaty, it may be understood to imply that investments made in violation of national laws are not covered by the treaty.” 123 The “in accordance with the laws of the host state” requirement applies whether it is contained explicitly in the treaty or is found implied. The compatibility of the investment with the host state’s laws is relevant to the tribunal’s jurisdiction. 124

There are a number of cases 125 in which the ICSID tribunals have considered challenges to their jurisdiction on the basis that the investment was illegal and therefore, the investment was not made “in accordance with the host state’s laws” as required by the relevant investment treaty. 126 In addition, if the treaties contain an “in accordance with the law” provision, the tribunals have frequently determined that the illegal investments fall outside the scope of the investment treaty and dismissed claims. 127

In many cases, the host states will employ the corruption defense and argue that for ICSID tribunals to have jurisdiction over investor’s claims, the investors must have made their investment “in accordance with the host state’s positive law.” 128 Thus, if the investment treaty requires compliance of the investment with the host state’s laws, the investment might, given corruption is proved, not fall under the definition of investment in the BIT and the tribunal might not have jurisdiction. 129 As a consequence, the investors that have engaged in corruption to secure the government’s con-

122 Haugeneder, supra note 118, at 329.
124 Yackee, supra note 32.
125 In Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, the tribunal determined that the investment was formed in breach of a host state criminal law. In Inceysa Vallisoletana SL v. Republic of El Salvador, the tribunal determined that the claimant had made fraudulent representations to get the government contract and refused jurisdiction over the dispute. Joe Tirado, Matthew Page, & Daniel Meagher, Corruption Investigations by Governmental Authorities and Investment Arbitration: An Uneasy Relationship, 29 ICSID Rev. 493, 496 (2014).
126 See id.
128 Lamm et al., supra note 10, at 342.
129 Haugeneder, supra note 118, at 330.
tracts will probably lose the protection granted by the investment treaty and the chance to recover under the treaty.\footnote{130 Tidarat Sinlapapiromsuk, The Legal Consequences of Investor Corruption in Investor-State Disputes: How Should the System Proceed?, TDM 3 (2013), www.transnational-dispute-management.com/article.asp?key=1959.}

**B. Jurisdictional Challenges Based on General Principles of Law and Public Policy**

Foreign investments in the host state must be made in accordance with certain fundamental principles widely taken to constitute international public policy, including a prohibition on corruption.\footnote{131 Hepburn, \textit{supra} note 39 at 12.} The view that bribery is contrary to international public policy\footnote{132 The concept of international public policy is characterized by ambiguity. The word “international” does not connote that these principles are common to many countries and the content of international public policy might vary from one state to another. By definition, international public policy is a reflection of global consensus on fundamental economic, legal, moral, political, and social values; and, is a collection of universal standards, shared norms, and general principles that are widely accepted by the international community. These rules are developed over time by identifying international consensus on a particular issue. Consensus for the existence of rules of international public policy derives from the convergence of national laws, international conventions, arbitral case law and scholarly commentary. Sinlapapiromsuk, \textit{supra} note 130, at 9.} has developed into an important part of arbitral jurisprudence in the context of international investments.\footnote{133 Losco, \textit{supra} note 12, at 1222.} In the landmark \textit{ICC Case}, Judge Lagergren characterized bribery and corruption as a gross violation of good morals and international public policy.\footnote{134 ICC Case No. 1110 (1963), \textit{supra} note 31; Sinlapapiromsuk, \textit{supra} note 130, at 9.} The ICSID tribunals have frequently relied on the lasting impact of Judge Lagergren’s award in which he proclaimed that corrupt contracts are void or unenforceable as contrary to international public policy.\footnote{135 Losco, \textit{supra} note 12, at 1218.} Further, the \textit{World Duty Free} tribunal, as regards public policy, held that the law protects not the parties, but the citizens of the country.

Thus, it has become relatively well-settled in ICSID jurisprudence that corruption is contrary to international public policy\footnote{136 \textit{Id.} at 1222.} and that compliance with international public policy is relevant for determining whether investment wrongdoings should result in the rejection of jurisdiction. In cases where the issue of corruption had been successfully raised, the tribunals considered investments procured through corruption contrary to international public policy.
and decided that they had no competence to deal with the investment claim because they lacked the jurisdiction and deprive the corrupt investors of the treaty protection.

VII. INVESTORS’ CORRUPT ACTS GIVE AN UNFAIR ADVANTAGE TO HOST STATES

In investment arbitration cases where both parties are engaged in corrupt activities, ICSID tribunals should not accept unconditionally the corruption defense of host state. The reliance of the host states on corruption as a defense strategy to protect themselves from otherwise legitimate obligations to their investors should be a serious concern for the fairness of the system of international investment arbitration.\textsuperscript{137} Corrupt acts of an investor may be a powerful weapon for the host states to defeat investment claims.\textsuperscript{138} By invoking the corruption defense, the host states want to preclude arbitral tribunals to hear the investor’s claims.\textsuperscript{139} Further, ICSID tribunals are willing to overlook the host state’s own substantial involvement in the corrupt scheme.\textsuperscript{140} Often, the liability of the host state based on investor’s allegations of breaches of contract or engaging in actions contrary to treaty protection is not a subject of discussion when the tribunal determines that allegations of the investor’s corrupt acts have been proven.\textsuperscript{141} The ICSID tribunals refuse to participate in enforcing corrupt contracts or providing treaty protection to the investor where the investment is tainted by corruption.\textsuperscript{142} The investor is the only party bearing the consequences of corruption in the investment and the host states usually benefit from their own illegal activities.\textsuperscript{143} Many times, the investor is the hostage of the host state and has no choice but to pay a bribe to public officials to obtain the investment.\textsuperscript{144} Thus, it is unjust to let the host states, which might have otherwise been found to be in breach of its obligations toward the investor, escape their obligations and keep the fruits of their corrupt acts.\textsuperscript{145} Even

\textsuperscript{137} LLAMZON, supra note 2, at 13.  
\textsuperscript{138} Hepburn, supra note 39, at 2.  
\textsuperscript{139} See id.  
\textsuperscript{140} Sinlapapiromsuk, supra 130, at 27.  
\textsuperscript{141} Odumosu, supra note 13, at 118.  
\textsuperscript{142} Id. at 117.  
\textsuperscript{143} Id. at 118.  
\textsuperscript{144} Haugeneder, supra note 118, at 332.  
\textsuperscript{145} Odumosu, supra note 13, at 119.
if an investment was procured by corruption, the states should not be allowed to enrich themselves by expropriating investments without any compensation.\textsuperscript{146} Moreover, one tribunal indicated that “claims founded on illegality have to be dismissed for the benefit of the public and not for the advantage of the defendant.”\textsuperscript{147}

Thus, the tribunals have to address the actions of the host states if such states have participated in the corrupt activities.\textsuperscript{148} The tribunals should not allow the host states to avoid potential liability, especially because both the host state and the investor are usually involved in the corrupt conduct.\textsuperscript{149} Even in the cases where allegations of the investor’s corrupt acts have been proven, it is unfair that the corrupt states keep the entire benefit of the investment without compensation.\textsuperscript{150}

In addition, the fact that the host states can invoke the corruption defense in investment arbitration and thereby escape liability both for potential violations of investment protection obligations and their own corrupt behavior,\textsuperscript{151} is counterproductive in cases where the arbitration involves developing host states in which corruption is widespread.\textsuperscript{152} Such states may knowingly overlook or endorse the corrupt activities of foreign investors and use the corruption defense as a guard against claims of investment protection violations.\textsuperscript{153} The willingness of the ICSID tribunals to accept the corruption defense and to dismiss the investor’s claims as a result might have adverse effects on the level of corruption in the developing states. The undesirable effects should be carefully considered by the tribunals rushing to penalize the investor’s corrupt acts where the developing states, which are themselves corrupt, are concerned.\textsuperscript{154}

Further, dismissing the investor’s claims on grounds of lack of jurisdiction is too strict a remedy, particularly where the host state invoking the defense knew of or participated in the investor’s corrupt act.\textsuperscript{155} To date, the host states have not been required to prosecute the alleged wrongdoers in order to raise successful

\textsuperscript{146} Haugeneder, supra note 118, at 331.
\textsuperscript{147} Born, supra note 30.
\textsuperscript{148} Odumosu, supra note 13, at 118.
\textsuperscript{149} Morchiladze, supra note 11.
\textsuperscript{150} Haugeneder, supra note 118, at 328.
\textsuperscript{151} Meshel, supra note 16, at 267.
\textsuperscript{152} See id.
\textsuperscript{153} See id.
\textsuperscript{154} Id. at 267.
\textsuperscript{155} Id. at 269, 280.
jurisdictional defenses based on corruption. Thus, the tribunals should consider it to be significant whether the host state took no action to thoroughly investigate or punish the corrupt activities, especially where there is an indication that the host state was aware of the corrupt conduct and took no steps to deal with it. Also, in cases where the host states want to rely on the corruption defense, the host states should prove that they undertook all necessary steps and implemented all the necessary measures to prevent involvement of their public officials in corrupt activities. To invoke the corruption defense, the host states should demonstrate that they have implemented required anti-corruption standards in their legal framework, that they have created strong disincentives to discourage corruption crimes, and that they have prosecuted their high ranking public officials involved in corruption.

Consequently, the decision of the tribunal should take into account the actions of both parties. The tribunal should weigh the illegal actions by the states and investors because the corruption defense might be abused by the host states. The situations where the actions of the host states are ignored by the arbitral tribunals do not contribute to the fight against corruption. Also, such decisions might encourage the states to maintain their corrupt systems.

VIII. Conclusion

Confronted with an investor’s claims before an arbitral tribunal, host states will employ all possible legal arguments available to them to avoid liability and subsequent payment of compensation. Corruption has become a central issue in international investment arbitration and decisions in cases such as World Duty Free v. Kenya and Metal-Tech v. Uzbekistan confirm that. Moreover, World Duty Free and Metal-Tech have had a powerful influence on invest-


157 Joe Tirado et al., *supra* 125, at 511.


159 Sinlapapiromsuk, *supra* 130, at 27.

160 Morchiladze, *supra* note 11.

161 Morchiladze, *supra* note 11.

162 Greenwald, *supra* note 156.
ment arbitration jurisprudence and arbitrators have frequently referred to them in investment cases when they have dealt with the issue of corruption.\textsuperscript{163}

No matter how outrageous a host state’s conduct toward an investor might have been,\textsuperscript{164} the fact of an investor’s involvement in corruption related to its investment might be of significant relevance for the investor’s ability to fully access investment protections.\textsuperscript{165} The lawfulness of investments is usually a pre-condition for arbitral tribunals to exercise their jurisdiction in investment cases. Thus, it is not unexpected that investor’s corrupt acts have emerged as a potentially viable state defense in investment arbitration.\textsuperscript{166} The host states have identified the corruption defense as an opportunity to wriggle out of costly investment disputes.\textsuperscript{167}

Even though the tribunals have dismissed the investors’ claims on grounds of corruption, they have acknowledged that the host states have also participated in the corrupt conduct.\textsuperscript{168} Thus, findings of corruption should not come down heavily only on investors while exonerating the corrupt host states.\textsuperscript{169} The international investment law regime should not support illegal acts of the host states and allow the states to profit from their own violation of international law.\textsuperscript{170} The host states should not have an unlimited right to invoke the corruption defense following an investor’s failure to comply with the host state’s laws and international law when such states have been involved in corrupt activities or they knew or should have known about the corrupt conduct, but they did not activate their legal mechanisms to sanction it.

The tribunals should not allow the host states to invoke the investor’s corrupt conduct as an absolute bar to the states own liability because this might not motivate the host states to change their corrupt domestic culture or the corrupt practices of their officials. The host states engaged in the corrupt conduct should be required to demonstrate that they have implemented all necessary anti-corruption standards in their legal framework and prosecuted the allegedly corrupt public officials in order to raise defenses

\textsuperscript{163} LLAMZON, \textit{supra} note 2, at 195.
\textsuperscript{164} See id.
\textsuperscript{165} Yackee, \textit{supra} note 32.
\textsuperscript{166} Yackee, \textit{supra} note 33, at 723, 742.
\textsuperscript{167} Obersteiner, \textit{supra} note 55, at 265.
\textsuperscript{168} Meshel, \textit{supra} note 77.
\textsuperscript{169} Meshel, \textit{supra} note 74.
\textsuperscript{170} Obersteiner, \textit{supra} note 55, at 265.
based on corruption.\textsuperscript{171} Ideally, the failure or unwillingness of the host state to prosecute or punish its corrupt officials should play a significant role in arbitral proceedings and arbitrators should refuse to give effect to the corruption defense of the host state in such situations and not allow the host state to profit from its own violation of international law.

\textsuperscript{171} Sinlapapiromsuk, supra 130 at 27.