



# Chapter V: Investment Arbitration - Illegal Investments

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## I. Introduction

Foreign investment is today regulated by a patchwork of bilateral and regional treaties. The requirement that investments be made in compliance with the laws and regulations of the host State is a common requirement in modern bilateral investment treaties. <sup>(1)</sup> Many investment protection treaties contain “in accordance with host State law” clauses. The wording of these clauses can, however, differ significantly.

The purpose of such provisions is “to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal”, as was explained by the Tribunal in *Salini v. Morocco*. <sup>(2)</sup> Host States have sometimes argued that “in accordance with host State law” clauses would limit the definition of investment under the BIT to the domestic notion of investment instead of referring to the legality of the investment. This however was convincingly rejected by a number of tribunals. <sup>(3)</sup> Furthermore, these clauses also have to be distinguished from specific approval requirements contained in some investment protection treaties. <sup>(4)</sup>

Some BITS contain “in accordance with host State law” clauses in the definition of investment. Examples are the Germany – Philippines BIT (Fraport), the Lithuania – Ukraine BIT (Tokios Tokelos), the Bangladesh – Italy BIT (Saipem), the Spain – Mexico BIT (Tecmed) and the Oman – Yemen BIT (Desert Line). <sup>(5)</sup> To include the clause in the definition of investment of BITS leads to a paradox: On the one hand host State law becomes a point of reference concerning the extent of the jurisdiction of the Tribunal. In that function host State law can limit the scope of legal review by the Tribunal. On the other hand host State law is often the very subject of the legal review by the Tribunal, which has to determine whether host State law and its application led to breaches of the BIT. Therefore, host State law becomes yardstick and object of review at once.

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## Topics

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Investment Arbitration

## Source

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Ursula Kriebaum,  
**Chapter V: Investment Arbitration - Illegal Investments** in  
 Christian Klausegger ,  
 Peter Klein , et al. (eds),  
 Austrian Arbitration  
 Yearbook 2010, (C.H.  
 Beck, Stämpfli & Manz  
 2010) pp. 307 - 335

Other treaties contain an “in accordance with host State law” clause in the provisions on promotion, admission and protection. (6)

Tribunals have found that where they had to apply a BIT that contained an “in accordance with host State law” clause, an investment that was in violation of host State law did not enjoy the protection of the BIT. But it appears that even where tribunals had to apply a BIT without an “in accordance with host State law” clause, they would refuse to afford protection to investments that are contrary to host State law.

The Tribunal in Plama (7) operated under the Energy Charter Treaty which does not contain an “in accordance with host State law clause”. The Tribunal decided, however, that the existence of such a clause is not a prerequisite for a tribunal to be able to deny protection to an illegal investment. The Tribunal in Plama took note of the fact that

the ECT does not contain a provision requiring the conformity of the Investment with a particular law. (8)

But it 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. (9)

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The Tribunal in Phoenix referred to this approach with approval. (10)

The possibility of a denial of investment protection to illegal investment is limited, however, to illegalities committed by the investor. Investment protection treaties allow for the host State to retain a degree of control over foreign investments by denying protection to those investments that do not comply with its laws.

(11) These treaties, however, do

not allow a State to preclude an investor from seeking protection under the BIT on the ground that its own actions are illegal under its own laws. In other words, a host State cannot avoid jurisdiction under the BIT by invoking its own failure to comply with its domestic law. (12)

Therefore, in Kardassopoulos, where Georgian State-owned enterprises violated Georgian law by exceeding their authority and thereby had rendered void *ab initio* the concession under Georgian law, Georgia was unable to invoke an “in accordance with host State law” clause in a BIT to deny investment protection. (13) The same approach had previously been taken by the Tribunal in SPP v. Egypt. (14)

For this reason this article considers only violations of host State law committed by the investor.

Tribunals that declined to protect investments that were not in accordance with host State law have either denied jurisdiction <sup>(15)</sup> or have declined protection at the merits stage. <sup>(16)</sup>

## ***II. Denial of Jurisdiction***

### ***A. No Legal Investment***

One option for a Tribunal is to deny jurisdiction *ratione materiae* for lack of a legal investment. This is what the tribunal in Fraport <sup>(17)</sup> did. It held that the investment [page "310"](#) was not in accordance with law and that the tribunal therefore lacked jurisdiction *ratione materiae*. Article 1 of the Germany – Philippines BIT contains the following definition of investment:

#### Article 1 Definition of Investment

*For the purpose of this Agreement:*

1. the term "investment" shall mean any kind of asset accepted ***in accordance with the respective laws and regulations*** of either Contracting State, ... <sup>(18)</sup>

Fraport invested in a passenger Terminal Project at Manila airport. The Tribunal found that "[i]n the event of a public utility franchise, the proponent and facility operator must, in case of a corporation, be duly registered and owned and controlled up to at least sixty percent (60%) by Filipinos, as further required by the Philippine Constitution". <sup>(19)</sup> The Tribunal found it established that

Fraport concluded that the only plausible way for its equity investment to prove profitable was to arrange secretly for management and control of the project in a way which the investor knew were not in accordance with the law of the Philippines. <sup>(20)</sup>

The Tribunal concluded that management and control of the project were accomplished by illegal secret shareholder agreements. It held that

Fraport knowingly and intentionally circumvented the Anti Dummy Law by means of secret shareholder agreements. As a consequence, it cannot claim to have made an investment "in accordance with law". ... Because there is no "investment in accordance with law", the Tribunal lacks jurisdiction *ratione materiae*. <sup>(21)</sup>

In a number of other cases tribunals examined whether investments

complied with host State law and concluded that they were legal and therefore protected investments. Here are some examples:

In *Saluka* the Respondent alleged that the Claimant had not made its investment in accordance with host State law and therefore should be denied protection under the Treaty. (22) The definition of investment in Article 1 of the Netherlands – Czech BIT does not contain an “in accordance with host State law” clause. (23) Such [page "311"](#) a clause is, however, contained in the provision on admission in Article 2 of the Netherlands – Czech BIT. (24) The Tribunal examined the issue nevertheless as part of the definition of investment since it considered compliance with host State law to be an implicit requirement of an investment:

204. The Tribunal notes in passing that, although not in terms part of the definition of an ‘investment’, it is necessarily implicit in Article 2 of the Treaty that an investment must have been made in accordance with the provisions of the host State's laws. In relevant part, Article 2 stipulates that ‘[e]ach Contracting Party ... shall admit such investments in accordance with its provisions of law’. Accordingly, and as both parties acknowledge, the obligation upon the host State to admit an investment by a foreign investor (*i.e.* in the present context, to allow the purchase of shares in a local company) only arises if the purchase is made in compliance with its laws.

One of the arguments of the Czech Republic was that the business plan submitted to the authorities did not contain a disclosure of the future long-term plans and objectives. The Tribunal did not find this to be in violation of host State law and stated:

While that provision [of an Official Communication of the Czech National Bank] requires the submission of a business plan, the Tribunal has seen nothing to suggest that it imposes a legal obligation upon an investor to disclose its future long-term plans and objectives going far beyond the immediate purposes of its investment in the bank whose shares are being purchased. A ‘business plan’ is inherently a label of considerable generality, and a Tribunal such as this must hesitate before reading into that label such a particular and far-reaching content. (25)

Furthermore the Tribunal found that neither the original purchase of the IBP shares (the investment) by Nomura Europe nor the subsequent ownership of them by Saluka showed any breach of the law. On the contrary, the Czech authorities had explicitly acknowledged Saluka's status as the proper owner of those shares. Therefore the Tribunal considered the holding of the shares by Saluka as an investment as required by Article 1 of the BIT.

In Phoenix <sup>(26)</sup> the applicable BIT contained an “in accordance with host State law” clause in the definition of investment. <sup>(27)</sup> The Tribunal discussed *in abstracto* [page "312"](#) the consequences of violations of host State law by an investor. It stated in an *obiter dictum* that in cases where it is manifest that the investment has been made contrary to law a tribunal may deny its jurisdiction. <sup>(28)</sup> It found, however, that the investment had been performed in accordance with host State law. <sup>(29)</sup>

In OKO Pankki v. Estonia <sup>(30)</sup> a Loan and a Loan Agreement were the original investments. The question arose whether the invalidation of a Payment Agreement for the repayment of the Loan had also invalidated the legality of the Loan and the Loan Agreement. Only investments in accordance with the laws and regulations of the host country were protected by the applicable BITs. <sup>(31)</sup> The Tribunal denied that an invalidation of the Payment Agreement would invalidate the original investment and deprive it of its jurisdiction. It found that

it is not disputed that both [the Loan and the Loan Agreement] were made in accordance with the law and regulations then prevailing in Estonian territory. ...

[T]he fact that the Payment Agreement was eventually declared invalid by the Estonian Supreme Court cannot here decide the Tribunal's jurisdiction. That decision, ..., leaves intact the Bank's investment, *i.e.* the Loan Agreement and the Loan as originally made ... <sup>(32)</sup>

The cases analysed so far have in common that tribunals discussed whether the alleged illegality deprived the investments of their status as protected investments under the BITs.

### **B. No Valid Consent**

Another option for a Tribunal is to deny jurisdiction for lack of consent to arbitration. In Inceysa <sup>(33)</sup> the Claimant had obtained a concession contract for the [page "313"](#) operation of vehicle inspection services. The Ministry of the Environment and Natural Resources of El Salvador decided not to proceed with this contract and finally terminated the concession contract. Inceysa brought a case under ICSID. El Salvador objected to the jurisdiction of ICSID. It claimed that the concession had been obtained by defrauding the State during the public bidding process.

The “in accordance with host State law” clause in the Spain – Ecuador BIT is not included in the definition of investment but in the provisions on promotion, admission and protection. The Tribunal found that an exclusion of illegal investments from the protection of a BIT need not be contained in the definition of investment itself. It may also be contained in the BIT's articles that indicate its scope of

protection or even in the chapter related to “Promotion and Admission”. (34) The relevant provisions in Inceysa read:

Spain – Ecuador BIT (courtesy translation from Spanish)

#### Article 2 Promotion and Admission

Each Contracting Party [...] will *admit* investments *according to its legal provisions*.

The present Article will also apply to investments made before its entry into force by investors of a Contracting Party *in accordance with the laws of the other Contracting Party* in the territory of the latter [...]

#### Article 3 Protection

[...]

Each Contracting Party shall protect in its territory the investments made *in accordance with its legislation*

[...] (35)

El Salvador argued that its consent to the jurisdiction of the Centre was limited to differences related to investments made in accordance with the laws of El Salvador. The Tribunal found that the argument that Inceysa's investment was not protected by the BIT was a matter of jurisdiction and not a substantive defence to the merits of the matter. (36)

The Tribunal found it established that Inceysa had submitted in the bid for the concession false financial documentation and had not presented its real financial condition. (37) Inceysa had intentionally misrepresented its qualifications and capacities (38) and concealed its relationship with another bidder. (39)

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The Tribunal (40) based its decision to decline jurisdiction on the violation of several rules:

It found that falsifying the facts constituted an obvious violation of the principle of good faith by Inceysa. As provided by the legal maxim, *nemo auditur propriam turpitudinem allegans* “nobody can benefit from his own wrong” Inceysa was not entitled to the protection granted by the BIT. (41)

Furthermore, the Tribunal found that to protect investments made fraudulently would be a violation of international public policy. (42) Finally, it held that the acts committed were against the legal principle that prohibits unlawful enrichment. Such enrichment must be sanctioned by preventing its consummation. (43) Since the investment was made in a clearly illegal manner, it was not covered

by the necessary consent to arbitrate the dispute. (44)

### **III. Denial of Substantive Protection**

Not only can a tribunal deny protection of an illegal investment by declining jurisdiction. It can also deny investment protection at the merits stage.

#### **A. No Substantive Protection for Illegal Investments**

This approach was adopted by the Tribunal in *World Duty Free*. (45) The case concerned an exclusive concession to run the duty free operations at Kenya's inter [page "315"](#) national airports in Nairobi and Mombasa. The contract under which the Claimant brought its ICSID claims (the 1989 Agreement) had been procured by a payment to the then sitting Head of State. (46)

The Respondent argued that the 1989 Agreement was unenforceable and requested the dismissal of the claims. (47) The Tribunal classified the payment as bribe. (48) It found bribery to be in violation of international public policy and to be a crime under Kenyan as well as English law. It was not entirely clear whether Kenyan and/or English law was the applicable law. But both legal orders contained identical rules on corruption and on the legal effects of corruption. (49)

The Tribunal held that it could not enforce a contract secured by corruption:

157. In light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus, claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal. (50)

Furthermore, the Tribunal held that

there can be no affirmation or waiver in this case based on the knowledge of the Kenyan President attributable to Kenya. The President was here acting corruptly, to the detriment of Kenya and in violation of Kenyan law (including the 1956 Act). There is no warrant at English or Kenyan law for attributing knowledge to the state (as the otherwise innocent principal) of a state officer engaged as its agent in bribery. (51)

The Tribunal dismissed the claims since corruption is against international public policy and against Kenyan and English Law:

The Claimant is not legally entitled to maintain any of its pleaded claims in these proceedings as a matter of *ordre public international* and public policy under the contract's applicable laws. (52)

The claim advanced by World Duty Free Limited was dismissed. (53)

The Tribunal in *Plama*, (54) a case decided under the Energy Charter Treaty, adopted a similar approach. There, the Tribunal denied at the merits stage the pro [page "316"](#) tention for an investment obtained through misrepresentation and dismissed all claims.

According to the Tribunal the Claimant had misrepresented the actual composition of the investing consortium. The Claimant had presented itself as a consortium of major companies having substantial assets. In truth, an individual, who personally did not have significant financial resources, was acting alone as the sole investor in the guise of that "consortium". The Arbitral Tribunal was persuaded that Bulgaria would not have given its consent to the investment had it been aware of these facts. (55)

The Tribunal decided that the investment was obtained by deceitful conduct, that is, in violation of Bulgarian law. Like the *Inceysa* tribunal, it was of the view that granting the protection to Claimant's investment would be contrary to the principle *nobody can benefit from his own wrong*. The Tribunal found that it "would also be contrary to the basic notion of international public policy" to enforce a contract obtained by fraudulent misrepresentation. (56)

Furthermore, the Tribunal found that Claimant's conduct was contrary to the principle of *good faith* (57) which is part not only of Bulgarian law but also of international law, as also noted by the tribunal in the *Inceysa* case:

The principle of good faith encompasses, *inter alia*, the obligation for the investor to provide the host State with relevant and material information concerning the investor and the investment. This obligation is particularly important where the information is necessary for obtaining the State's approval of the investment. (58)

## ***B. Justification for Government Interference***

The illegality of an investment has negative consequences for the protection of the investment if a host State successfully invokes violations of host State law as a defence for its interferences with the investment. In such cases tribunals did not find that the substantive protections of the investment protection treaty do not apply.



However, they held that these protection standards had not been violated by the host State when taking action in response to the illegalities committed by the investor.

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In *Genin v. Estonia*, the Claimants were the principal shareholders in EIB (Estonian Innovation Bank). One of the Claimants' arguments was that the Respondent, through its agency, the Bank of Estonia, violated the BIT by revoking EIB's banking licence. The Respondent successfully justified the revocation of the banking licence by invoking serious violations of the Estonian banking code by EIB. (59)

*Thunderbird v. Mexico* (60) involved a Canadian company operating three video gambling facilities in Mexico. Mexican Law prohibited gambling and luck-related games within Mexican territory. The government closed the facilities as illegal. *Thunderbird* challenged the closures before a NAFTA tribunal.

*Thunderbird* alleged that a breach of the fair and equitable treatment protection under Article 1105 NAFTA had occurred since it had relied on an official opinion of the gaming regulator on the legality of the machines. The gaming regulator had issued an opinion on the legality of the machines in which it restated the prohibition on gambling but confirmed that it had no power to prohibit machines that operated in the form and conditions described by the investor. (61)

Later the gaming regulator began to close each of the facilities in which *Thunderbird* had an ownership stake on the basis that the machines used in those facilities were prohibited gambling equipment under Mexican law.

The Tribunal found that when obtaining the official opinion *Thunderbird* had not disclosed key information about the machines. This was fatal for any 'legitimate expectation' and for the investor's reliance on any representation.

The Tribunal denied a violation of fair and equitable treatment and held that no compensation was owed for a regulatory taking since the investor never enjoyed a vested right in the business activity that was subsequently prohibited. (62)

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Therefore, three types of reaction to illegal investments have emerged so far in the case-law of arbitral tribunals:

- denial of jurisdiction (no legal investment or no valid consent)
- denial of applicability of the substantive standards at the merits stage
- no violation of a standard because of a justified interference.

#### ***IV. Standards for the Relevance of a Violation of Host State Law***

In those cases where the investments were obtained in an illegal way investment protection including access to the standards of protection was denied either in the decision on jurisdiction or when dealing on the merits.

Where the illegalities occurred in the performance of the investment the tribunals did not deny access to the substantive standards. But they decided that the standards had not been violated by the State action with respect to the investment. This was the case irrespective of whether the activity per se was illegal or whether the way in which the investment operated was illegal.

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

The possibility to take illegalities also into consideration when deciding on the breach of the substantial standards will make the job of investment tribunals easier. In case of doubt a tribunal may choose to look at the illegality when examining the compliance with the substantive standards by the host State rather than to deny investment protection from the outset. This is also an appropriate approach for those cases, where the illegality is not apparent from the outset.

The case-law so far does not provide for exact standards to decide when a breach of host State law leads to the exclusion from investment protection. However, here are some elements which were taken into consideration by tribunals:

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## ***A. Major Infractions Affecting the Legitimacy of the Project as a Whole***

### ***1. The Gravity of the Contravention of Host State Law***

Tribunals have examined whether the way in which the investments were obtained or the activity per se was in violation of important principles of host State law or international law.

The Tribunal in *Inceysa* <sup>(63)</sup> explicitly stated that an investment made in significant contravention of Salvadorian law, such as through gross misrepresentation or fraud in a government tender

process does not enjoy investment protection.

In the cases in which investment protection was denied Tribunals found that misrepresentations, <sup>(64)</sup> corruption, <sup>(65)</sup> fraud <sup>(66)</sup> or intentional circumvention of a constitutional norm and a norm of an anti dummy law <sup>(67)</sup> had occurred. In all of these cases the Tribunals found that the investment was obtained as a consequence of the breach of legal requirements.

The Tribunals in *LESI and Alstadi v. Algeria* <sup>(68)</sup> and in *Rumeli v. Kazakhstan* <sup>(69)</sup> stated that a certain level of violation of host State's laws and regulations is required to defeat the Tribunal's jurisdiction based on a BIT's requirement that the disputed investments be in conformity with the host State's laws. The Rumeli Tribunal stated that

168. ... As determined by the Arbitral Tribunal in the *LESI* case, such a provision will exclude the protection of investments only if they have been *made in breach of fundamental legal principles of the host country* (*'en violation des principes fondamentaux en vigueur'*). <sup>(70)</sup>

In *Desert Line v. Yemen* the Tribunal summarized arbitral precedents and also resorted to the standard of a violation of fundamental principles of host State law as triggering the exclusion from investment protection. It stated that such clauses are [page "320"](#)

intended to ensure the legality of the investment by excluding investment made in breach of fundamental principles of the host State's law, e.g. by fraudulent misrepresentations or dissimulation of true ownership. <sup>(71)</sup>

In *Phoenix v. Czech Republic*, the Tribunal in an *obiter dictum* referred to a situation in which an investment activity *per se* is in contradiction with fundamental norms of international law. The Tribunal concluded that in such a situation no investment protection should be granted:

... nobody would suggest that ICSID protection should be granted to investments made in violation of the most fundamental rules of protection of human rights, like investments made in pursuance of torture or genocide or in support of slavery or trafficking of human organs. <sup>(72)</sup>

By contrast, arbitral tribunals have considered minor errors in the observance of bureaucratic formalities of the domestic law as irrelevant.

In *Tokios Tokeles v. Ukraine* <sup>(73)</sup> the respondent alleged that the full

name under which the Claimant registered its subsidiary was improper because it was not a recognized legal form under Ukrainian law. The Tribunal took note of the fact that the Respondent did not allege that the Claimant's investment and business activity were illegal *per se*. It also found relevant that despite the not entirely correct formalities the investment had been registered. The Tribunal held that

to exclude an investment on the basis of such minor errors would be inconsistent with the object and purpose of the Treaty. In our view, the Respondent's registration of each of the Claimant's investments indicates that the "investment" in question was made in accordance with the laws and regulations of Ukraine. (74)

In *Metalpar v. Argentina* (75) the illegality concerned failures to register companies at the appropriate time. Registration was a requirement under Argentinean law but not provided for in the BIT. Argentina argued that this failure should bar the companies from access to ICSID. The Tribunal rejected this contention. It stated that Argentinean law prescribed its own sanctions for such failures. Furthermore, to punish registration failures with exclusion from investment protection would be disproportionate:

84. A juicio del Tribunal, la falta de registro oportuno podría sancionarse denegando la inscripción de determinados documentos de la sociedad, mediante el apercibimiento, o la imposición de una multa a la sociedad o a [page "321"](#) sus funcionarios, pero sería desproporcionado castigar esa omisión negándole al inversionista una protección esencial como es el acceso a los tribunales arbitrales del CIADI. Además, sería ilógico admitir que determinada conducta (la falta de registro oportuno) para la que el ordenamiento legal argentino prevé unas sanciones específicas pudiera sancionarse, además, de otra forma no prevista en ese ordenamiento. (76)

Courtesy translation from Spanish

In the view of the Tribunal, the lack of timely registration could be sanctioned by a denial of the inscription of certain documents of the society, by a warning or the imposition of a fine to the company or its officials, but it would be disproportionate to punish this omission with denying an investor an essential protection as the access to ICSID arbitration.

Additionally, it would be illogical to admit that certain behaviour (the lack of timely registration) for which the Argentinean legal system provides for specific sanctions could be punished, additionally, in other forms not provided for in that legal order.

The Tribunal in *Mytilineos v. Serbia* (77) which rejected the host State's claim to deny investment protection also hinted to the fact that the activity per se was not illegal. It referred to *Tokios Tokelés* with approval and stressed that it was important for the *Tokios Tokelés* Tribunal that the investment activity as such was legal:

The [*Tokios Tokelés*] tribunal rejected this claim and found that Claimant's activity was covered by the definition of investment under the BIT since those investment activities in the publishing business were not illegal under the law of the host State. The tribunal further suggested that minor registration irregularities are harmless errors as long as the investment was not '*illegal per se*'. (78)

Since it was not even argued by Respondent in *Mytilineos* that the business activities were illegal, The Tribunal found no reason for the investment not to be protected under the BIT:

154. In the present case, even Respondents did not contend that Claimant's activities were illegal. In fact they expressly stated that 'Respondents do not contend that the Agreements were not in compliance with the laws either – they only say that the Agreements were not registered as investment agreements, most certainly because the parties did not consider them as framing investments at all, but only as regulating long-term commercial transactions.'

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157. The Tribunal thus concludes, by a majority, that for the purposes of the BIT the investment has been made in accordance with the laws of Serbia and Montenegro and is thus protected under the BIT. (79)

## ***2. The Importance of the Offending Arrangement for the Profitability of the Investment***

The importance of the offending arrangement for the profitability of the investment can serve as further element in establishing whether the investment project as a whole lacks legitimacy. It can be a supporting element for deciding whether investment protection should be denied entirely or whether the illegality should better be taken into consideration when assessing whether the host State has violated a substantive standard.

The Tribunal in *Fraport* discussed this element when it stated that it will work in favour of an investor who committed an illegality if that illegality would not be of major influence for the profitability of the investment. The Tribunal said:

396. ... Another indicator that should work in favour of an investor that had run afoul of a prohibition in local

law would be that the offending arrangement was not central to the profitability of the investment, such that the investor might have made the investment in ways that accorded with local law without any loss of projected profitability. (80)

In *Fraport*, however, the investor apparently was of the opinion that without the illegal arrangements the investment could not operate in a profitable way:

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

398. The record indicates that ... local counsel explicitly warned that a particular structural arrangement would violate a serious provision of Philippine law. Moreover, the violation *qua* violation was explicitly discussed at the level of the Board of Directors. In view of the due diligence study prepared by financial experts (who had apparently not been briefed on the local law restrictions), the investor, *Fraport*, concluded that the only plausible way for its equity investment to prove profitable was to arrange secretly for management and control of the project in a way which the investor knew were not in accordance with the law of the Philippines. This was accomplished by Article 2.02 of the *FAGPAIRCARGO-PAGS-PTI* Shareholders' Agreement of 6 July 1999 which allowed *Fraport* (or *FAG* as it was then known) to have a casting and controlling vote over matters which fell within its 'area of expertise and competence'. Thus the violation could not be deemed to be inadvertent and irrelevant to the investment. It was central to the success of the project. The awareness that the arrangements were not in accordance with Philippine law was manifested by the decision to make the arrangements secretly and to try to make them effective under foreign law. All of these facts derive from internal *Fraport* documents whose credibility can hardly be impeached by *Fraport*. (81)

### **3. *The Investor's Awareness of the Illegality***

Although not always easy to prove, a further element, that is taken into consideration by tribunals in establishing whether they should grant investment protection, is the investor's awareness of the illegality of the investment.

The Tribunal in *Fraport v. Philippines* took knowledge of and

information by local counsel on the existence of an illegality as a benchmark:

396. When the question is whether the investment is in accordance with the law of the host state, considerable arguments may be made in favour of construing jurisdiction *ratione materiae* in a more liberal way which is generous to the investor. In some circumstances, the law in question of the host state may not be entirely clear and mistakes may be made in good faith. An indicator of a good faith error would be the failure of a competent local counsel's legal due diligence report to flag that issue. ...

397. In this case, the comportment of the foreign investor, as is clear from its own records, was egregious and cannot benefit from presumptions which might ordinarily operate in favour of the investor.

An indication of the investor's awareness of the illegality is whether there were efforts to hide the illegality. <sup>(82)</sup> In *Fraport* the Tribunal mentioned that secret shareholder agreements show that the investor knew from the beginning that the construction of its investment was illegal and that it tried to hide that illegality:

355. ... The Tribunal's concern here is ... with the secret shareholder agreements. In the context of the internal *Fraport* documents, the secret shareholder agreements show that *Fraport* from the outset understood, with precision, the Philippine legal prohibition but believed that if it complied with it, the prospective investment could not be profitable. So it elected to proceed with the investment by secretly violating Philippine law through the secret shareholder agreements. These agreements evidence that *Fraport* planned and knew that its investment was not 'in accordance' with Philippine law.

Beside the actual awareness of the illegality which was established in *Fraport*, a certain due diligence can be required from an investor. The Tribunal in *Fraport* [page "324"](#) stated, however, that in case of an investment made in good faith, which was not the case there, a certain leniency can be granted to investors.

The Tribunal in *Desert Line v. Yemen* approved this approach. <sup>(83)</sup> In that case Respondent argued that since Claimant's investment was never formally "accepted" by the Respondent as an investment according to its laws and regulations Claimant should not have access to investment protection. The investment had, however, been endorsed at the highest level of the State and benefits of the Yemenite Investment Law had been extended to the investment by an ad hoc decision of the Vice Prime Minister. Therefore, the *Desert Line* Tribunal found that the purely formal requirement of "acceptance" should not lead to a deprivation of investment

protection but that the leniency mentioned by the Fraport Tribunal should be applied:

117. Such leniency would be appropriate in this case, as is confirmed when one puts the hypothetical question: is the likelihood that the investor would have received a certificate if he had believed it was necessary and requested it? The answer is overwhelmingly affirmative, both because of the general endorsement of the investment at the highest level of the State, and in light of the extension of YIL benefits by the *ad hoc* decision communicated by the Vice Prime Minister.

### ***B. Cure or Estoppel Because of Informal Acceptance by the Host State***

Knowing acceptance by the host State can cure the breach of the host State law or estopp the host State from raising the illegality. Here are some examples:

In *SwemBalt v. Latvia* <sup>(84)</sup> the Latvian authorities removed a ship owned by SwemBalt from its berth where it was allegedly illegally moored. It prevented the investor from using the ship and then auctioned the ship without payment of compensation. The Tribunal repeatedly relied upon Respondents behaviour to decide upon the legality of the investor's actions or the validity of legal acts. Among other things it found that four months tolerance of the authorities of an allegedly illegally moored ship was too long. Therefore, the government could not rely on the alleged illegality:

34. ... We find it surprising that SwemBalt has not been informed at an earlier stage, when during the autumn of 1993 it negotiated with ... authorities about the project, about the illegality hereof. It is also surprising that the harbour master ... should have taken part with a pilot and two tow *page* ["325"](#) boats in towing the ship to Kipsala, if the mooring of the ship was illegal. Finally, it is surprising that the authorities waited for more than four months before taking any measures in that regard, if really the whole enterprise was illegal.

35. In these circumstances we find that SwemBalt has shown, that in all likelihood it has complied with Lavian law, that the Respondent has not shown that the investment was not made in accordance with the laws and regulations of Latvia, and that in any event the actions of the Respondent were out of proportion with any non-compliance that may have existed. <sup>(85)</sup>

In *Tokios Tokeles v. Ukraine* the Tribunal found that the registration of each of the Claimant's investments despite incorrect formalities indicated that the "investment" in question was made in accordance



with the laws and regulations of Ukraine. As a consequence, the alleged illegalities could no longer be relied on by the government. (86)

In *Tecmed v. Mexico* (87) Mexico justified a resolution denying the renewal of a permit for a waste disposal facility with irregularities committed during the landfill's operation. The authorities could not have been unaware of the existence of the alleged irregularities or infringements. However, they did not act and inform the investor that these irregularities might jeopardize the permit's renewal. Therefore, the Tribunal did not accept the irregularities as justification and considered the denial on these grounds to be excessively formalistic. (88) It found that a violation of fair and equitable treatment and an expropriation had occurred. (89)

As already mentioned, the Tribunal in *Kardassopoulos v. Georgia* (90) held that Georgia could not rely on an "in accordance with host State law" clause since it was the State-owned enterprises that violated Georgian law. (91) However, the Tribunal found Respondent also to be *estopped* from arguing that the agreements were void *ab initio* under Georgian law. The Tribunal's rationale was that Claimant had a legitimate expectation that his investment in Georgia was in accordance with relevant local laws since the content of the agreements had been approved by Georgian Government officials for many years without objections as to their legality. (92)

Other Tribunals mentioned the possibility of an estoppel, acquiescence to a violation of host State law or a waiver to invoke it but denied it in practice: in *Fraport v. Philippines* (93) the Tribunal mentioned the possibility of an estoppel: [page "326"](#)

346. There is, however, the question of estoppel. Principles of fairness should require a tribunal to hold a government estopped from raising violations of its own law as a jurisdictional defense when it knowingly overlooked them and endorsed an investment which was not in compliance with its law.

It denied, however, that an estoppel had occurred:

347. But a covert arrangement, which by its nature is unknown to the government officials who may have given approbation to the project, cannot be any basis for estoppel: the covert character of the arrangement would deprive any legal validity (assuming that informal and possibly *contra legem* endorsements would have legal validity under the relevant law) that an expression of approbation or an endorsement might otherwise have had. There is no indication in the record that the Republic of the Philippines knew, should have known or could have known of the covert arrangements which were not in accordance with Philippine law when

Fraport first made its investment in 1999. <sup>(94)</sup>

387. As a matter of law, the Claimant is correct that the cumulative actions of a host government may constitute an informal 'acceptance' of a foreign investment that otherwise violates its law. The Claimant is also correct that a failure to prosecute something of the order of a violation of the ADL, such that an investor reasonably inferred that it was acting lawfully and made further investments, could obviate an objection to jurisdiction *ratione materiae*. The issue here, however, is fact. The Claimant, knowing of the violation of the ADL, consciously concealed it, such that any actions that might otherwise have been viewed by a foreign investor in good faith as endorsements by the Philippine government cannot be deemed to have cured the violation or estopped the Government. The Respondent could hardly have initiated legal action against the Claimant for violations which the Claimant had concealed. <sup>(95)</sup>

Furthermore, the Tribunal also excluded the possibility that a waiver had occurred. It held that the investor cannot claim that

... high officials of the Respondent subsequently waived the legal requirements and validated Fraport's investment, for the Respondent's officials could not have known of the violation. <sup>(96)</sup>

In *World Duty Free v. Kenya* <sup>(97)</sup> Claimant alleged that Kenya would either be estopped or would have waived its right to invoke the bribery. The Tribunal found in this regard that Kenya only learned of the fact when it received Claimant's writ *page "327"* ten witness statement. Therefore, it rejected the contention of an estoppel as well as of a waiver. It stated:

184. ... There can be no affirmation or waiver by Kenya without knowledge; and as Lord Mustill stated in his opinion, '[a] party cannot waive a right which he does not know to exist'.

The knowledge of the Kenyan President was not attributed to Kenya for the purpose of a waiver:

185. Moreover, there can be no affirmation or waiver in this case based on the knowledge of the Kenyan President attributable to Kenya. The President was here acting corruptly, to the detriment of Kenya and in violation of Kenyan law (including the 1956 Act). There is no warrant at English or Kenyan law for attributing knowledge to the state (as the otherwise innocent principal) of a state officer engaged as its agent in bribery.

In *Thunderbird v. Mexico* the Tribunal found that the fact that it took six months until the gaming regulator began to close facilities was not sufficient to establish that prior to that date, the authorities had authorised (or were intentionally tolerating) Thunderbird's operations. (98)

In *Desert Line v. Yemen* (99) the Tribunal found that Respondent had waived the certificate requirement because of the endorsement of the investment at the highest level of the State and the extension of benefits under the Yemenite Investment Law by the Vice Prime Minister to the investment. It held that the Respondent "is estopped from relying on it to defeat jurisdiction". (100) The Tribunal referred to the approach of the *Fraport* Tribunal concerning estoppel with approval:

'Principles of fairness should require a tribunal to hold a government estopped from raising violations of its own law as a jurisdictional defense when it knowingly overlooked them and endorsed an investment which was not in compliance with its law.' (101) This comment applies *a fortiori* when the alleged problem is not violation of law, but merely – as here – the failure to accomplish a formality foreseen by law, and not even required by it except as a condition of obtaining benefits unconnected with those of the BIT itself. (102)

The essential criteria, as established by these Tribunals, are that a State knowingly overlooks a failure to comply with its law and endorses an investment which [page "328"](#) was not in compliance with its law. Therefore, an informal acceptance can cure a violation of host State law, if the host State knowingly tolerates the conduct of the investor for a certain time.

### ***C. Time Element – Illegality at the Time of the Establishment or Later on***

A further issue to be considered is the time element. Several different types of situations may arise.

An investment may be illegal *ab initio*. But it is also possible that an investment was in accordance with host State law at the moment of the initiation of the investment and the contravention of host State law occurs later on during the operation of the investment. This may either be the result of a change of host State law during the time of operation of the investment or the result of a change of the investor's actions.

Should such illegalities deprive a tribunal of its jurisdiction or be handled at the merits stage?

The Tribunal in *Fraport* (103) stated in an *obiter dictum* that the relevant point in time for purposes of jurisdiction is the start of the investment:

344. With respect to the temporal extension of the condition in the relevant provisions of the BIT, it has been contended by the Respondent and some of its experts that an investment, in order to maintain jurisdictional standing under the BIT, must not only be 'in accordance' with relevant domestic law at the time of commencement of the investment but must continuously remain in compliance with domestic law, such that a departure from some laws or regulations in the course of the operation of the BIT would deprive a tribunal under the BIT of jurisdiction.

345. Although this contention is not relevant to the analysis of the problem which the Tribunal has before it, namely the entry of the investment and not the way it was subsequently conducted, the Tribunal would note that this part of the Respondent's interpretation appears to be a forced construction of the pertinent provisions in the context of the entire Treaty. The language of both Articles 1 and 2 of the BIT emphasizes the *initiation* of the investment. Moreover the effective operation of the BIT regime would appear to require that jurisdictional compliance be limited to the initiation of the investment. If, at the time of the initiation of the investment, there has been compliance with the law of the host state, allegations by the host state of violations of its law in the course of the investment, as a justification for state action with respect to the investment, might be a defense to claimed *substantive* [page "329"](#) violations of the BIT, but could not deprive a tribunal acting under the authority of the BIT of its jurisdiction. (104)

The Tribunal in Phoenix (105) held that modifications of host State law after the establishment of an investment should not lead to a limitation of the jurisdiction of an investment tribunal:

102. The core lesson is that the purpose of the international protection through ICSID arbitration cannot be granted to investments that are made contrary to law. The fact that an investment is in violation of the laws of the host State can be manifest and will therefore allow the tribunal to deny its jurisdiction. Or, the fact that the investment is in violation of the laws of the host State can only appear when dealing with the merits, whether it was not known before that stage or whether the tribunal considered it best to be analyzed a[t] the merits stage, like in the case of *Plama*.

103. Of course, the analysis of the conformity of the investment with the host State's laws has to be performed taking into account the laws in force at the moment of the establishment of the investment. The

State is not at liberty to modify the scope of its obligations under the international treaties on the protection of foreign investments, by simply modifying its legislation or the scope of what it qualifies as an investment that complies with its own laws.

104. There is no doubt that the requirement of the conformity with law is important in respect of the access to the substantive provisions on the protection of the investor under the BIT. This access can be denied through a decision on the merits. However, if it is manifest that the investment has been performed in violation of the law, it is in line with judicial economy not to assert jurisdiction. <sup>(106)</sup>

This approach, to address illegalities that arise after the establishment of an investment at the merits stage, finds support in the language of many BITs on this issue. Here are some examples: <sup>(107)</sup>

The Chinese Model BIT (2003) contains the “in accordance with host State law” clause in the clause on admission. It reads:

Article 2 Promotion and Protection of Investment

1. Each Contracting Party shall ... admit such investments in accordance with its laws and regulations.

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The French Model BIT (2006) provides:

Article 1 Définitions

...

1. Le term ‘investissment’ désigne ...

Il est entendu que lesdits avoirs doivent être ou avoir été investis conformément à la législation de la Partie contractante ...

Article 3 Encouragement et admission des investissements

Chacune des Parties contractantes encourage et admet, dans le cadre de sa législation et des dispositions du present accord, les investissements effectués par les investisseurs de l'autre Partie ...

The German Model BIT (2005) provides in Article 9

This Treaty shall also apply to investments made prior to its entry into force by investors of either Contracting State in the territory of the other Contracting State consistent with the latter's legislation.

Czech Republic – Israel BIT<sup>(108)</sup> provides in Article 1

For the purposes of the present Agreement

1. The term ‘investment’ shall comprise any kind of assets invested in connection with economic activities by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter and shall include, in particular, though not exclusively: ...

The BITs which contain the clause in its regulations on admission all refer to the admission as the relevant point in time. At that point the investment must be in conformity with host State law for jurisdictional purposes. The text of the French Model BIT which contains such a clause in the definition of investment as well as in the regulations on admission also indicates that the relevant point in time is when the investment is made.

The same is true for treaties which like the Czech Republic – Israel BIT contain the clause only in the definition of investment. It also speaks in the past when it uses the phrase “any kind of assets invested ... in accordance with the laws ...”.

The treaties as well as the two decisions referred to above all focus on the time of the establishment of the investment. At first sight this approach appears eminently reasonable. This leads, however, to the question whether “the time of the investment” can always be determined with accuracy. In particular, it may be open to doubt whether an investment is necessarily a one time event that can be reduced to a particular date.

An investment is often a process rather than an instantaneous act. To take a relatively simple example: shares of a local company are sometimes acquired in several steps over time rather than at once. An investment operation is often composed of a number of diverse transactions and activities, which must be treated as an integrated whole. Therefore, an investment is often a complex process involving diverse transactions which have a separate legal existence but a common economic aim.

To a certain extent this is already reflected in the definition of “investment” contained in BITs and other treaties covering a variety of different rights and transactions. Tribunals have emphasized repeatedly that what mattered for the existence of an investment was not so much ownership of specific assets but rather the combination of rights that were necessary for the economic activity at issue. This doctrine of the “general unity of an investment operation” was set out already in the very first case that came before an ICSID tribunal, *Holiday Inns v. Morocco*.<sup>(109)</sup>

There is consistent case law showing that tribunals, when examining the existence of an investment for purposes of their jurisdiction, have not looked at specific transactions but at the

overall operation. <sup>(110)</sup> Tribunals have refused to dissect an investment into individual steps taken by the investor, even if these steps were identifiable as separate legal transactions. What mattered for the identification and protection of the investment was the entire operation directed at the investment's overall economic goal.

Therefore, the approach described above will not lead to a satisfactory result when it cannot be decided when exactly the investment was established. The illegality may have occurred at a time when certain steps in the process of establishment were already undertaken while others still follow at a later stage.

What could tribunals look at in such situations? The issue is not “to react or not to react at all” but rather which of the three options 1) denial of jurisdiction, 2) denial of applicability of the substantive standards at the merits stage or 3) no violation of a standard because of a justified interference should be chosen.

In situations where the illegality occurred already to obtain the initial investment like corruption or fraud a denial of jurisdiction will be the appropriate reaction. In cases of doubt option two, to deny the applicability of the substantive standard at the merits stage, seems to be the appropriate response.

The Tribunal in *Berschader* <sup>(111)</sup> opted for the latter approach. It said: [page "332"](#)

111. The Respondent has further contended that the investments relied upon by the Claimants were illegal and, as a result, do not satisfy the requirements of compliance with the laws of the Russian Federation contained in Article 1.2 of the Treaty. The Tribunal is of the view that the lawfulness of the investments relied upon by the Claimants is a not an issue affecting the jurisdiction of the Tribunal, but rather a substantive issue pertaining to the merits of the case. It would, therefore, be inappropriate for the Tribunal to consider this issue at this stage in the proceedings.

Modifications of host State law during the investment process have to be carefully scrutinized by tribunals. The paradox mentioned earlier whereby host State law may limit the scope of legal review and at the same time is the object of that legal review may gain relevance here.

To give an example, if the conduct of an investor was in accordance with host State law at the time of the investment and the host State, later during the lifetime of the investment, adapts its legal order to bring it into line with international human rights standards, the issue will be complicated. <sup>(112)</sup> In such a case it should be decided as a matter of substance whether investment protection should be denied. Whether ‘human rights abuses’ of an investor which were in accordance with host State law at the time of the initial investment

but are in breach of a new national norm should lead to a loss of investment protection cannot be answered in the abstract. The same holds true for new environmental regulations or health regulations. In such a situation the expectations of the investor will have to be balanced against the regulatory interest of the State under the respective treaty protection standards. Often, it will be preferable not to deny investor protection from the outset but to strive for an approach that leads to an economic burden sharing between the investor and the host State. The result should depend on a number of factors: amongst them the conduct and the legitimate expectations of the investor as well as the regulatory interests of the State and the economic consequences for the State and the investor.

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The form in which the objection is raised will also influence at what stage of the proceedings the treatment of illegal investments will be addressed. It will make a difference whether the Respondent claims that the tribunal should deny jurisdiction because of the illegality or whether the objection is only brought as a substantive defence.

## ***V. Summary and Conclusions***

A disqualification of illegal investments from international protection is common to many investment protection treaties. Efforts of respondent States to use "in accordance with host State law" clauses in order to impose definitions of investment contained in local law have failed. These clauses only concern the legality of an investment and not its definition.

Furthermore, only illegalities imputable on the investor will lead to an exclusion from investment protection. This will not be the case if the illegality is attributable to State organs.

"In accordance with host State law" clauses are found in different contexts (definition of investment, admission provision etc.) in bilateral investment protection treaties. They relate to the way in which the investment is established as well as to the investment activity as such.

Clauses in the definition of investment referring to host State law limit the jurisdiction only with regard to the legality of the investment. The meaning of the term "investment" as such does not depend on host State law. If the clauses are contained in the definition of investment host State law has a paradoxical double role as point of reference for tribunals and as object of review. The different contexts in which the "host State law" clauses are found in the various treaties have not so far had any influence on the interpretation of these clauses by tribunals. (113)

Despite the scarce case-law on the issue, arbitral practice provides some guidance on relevant criteria for the exclusion of illegal investment from protection. Major infractions of host State law that



affect the legitimacy of an investment project as a whole have severe consequences for the protection of an investment. Tribunals use three approaches: 1) Tribunals that denied jurisdiction have either held that there is no protected investment or that there is no consent to arbitrate. 2) In other cases they decided that there was an investment, but that it is not protected and hence dismissed the case on the merits. 3) In situations, where Respondent successfully invoked violations of host State law as a justification for an interference, tribunals decided that no substantial violation had occurred.

The key criterion for illegality was the gravity of the infraction. Supplementary elements were the influence of the illegality on the profitability of an invest [page "334"](#) ment project and the investor's awareness of the illegality. Efforts to hide illegalities will play against an investor. Minor infractions did not lead to a denial of investment protection. But they may be taken into account when deciding on the violation of the substantial guarantees.

Cure or estoppel with regard to an illegality in favour of the investor is possible. One of the requirements for an estoppel or a waiver is active knowledge of the State of the illegality. If State organs tolerate a certain conduct over a certain time this can be regarded as waiver.

Unilateral decisions of the state to modify the definition of investment in a BIT via a modification of the laws and regulation in the host State after the establishment of an investment will not lead to a loss of jurisdiction. In such cases the illegality will have to be taken into consideration at the merits stage. If appropriate, protection should be denied at that stage. [page "335"](#)

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<sup>1</sup> Christoph Schreuer et al., *The ICSID Convention: A Commentary* 140 (2d ed. 2009); *see also* Andrea Carlevaris, *The Conformity of Investments with the Law of the Host State and the Jurisdiction of International Tribunals*, 9 *The Journal of World Investment and Trade* 35–49 (2008); Christina Knahr, *Investments "in Accordance with Host State Law"*, 4 *TDM* No. 5.

<sup>2</sup> *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001, 6 *ICSID Reports* 400, para. 46.

<sup>3</sup> *See, e.g., Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*, *supra* note 2, at para. 46 (... this provision refers to the validity of the investment and not to its definition.); *LESI-DIPENTA v. Algeria*, ICSID Case No. ARB/03/08, Award, 10 January 2005, *available at*: <http://ita.law.uvic.ca/documents/dipentav.algeria.pdf>, para. II, 24(iii); *Gas Natural v. Argentina*, Decision on Jurisdiction, 17 June 2005, ICSID Case No. ARB/03/10, *available at* <http://ita.law.uvic.ca/documents/GasNaturalSDG-DecisiononPreliminaryQuestionsonJurisdiction.pdf>, paras. 33, 34;

Bayindir v. Pakistan, ICSID Case No. ARB/03/29, Decision on Jurisdiction, 14 November 2005, *available at* <http://ita.law.uvic.ca/documents/Bayindr-jurisdiction.pdf>, paras. 105–110; Mytilineos v. State Union of Serbia and Montenegro and Republic of Serbia, Decision on Jurisdiction, 8 September 2006, *available at* <http://ita.law.uvic.ca/documents/MytilineosPartialAward.pdf>, paras. 137–157; Saipem v. Bangladesh, ICSID Case No. ARB/05/07, Decision on Jurisdiction, 21 March 2007, *available at* <http://ita.law.uvic.ca/documents/Saipem-Bangladesh-Jurisdiction.pdf>, paras. 79–82, 120–124; L.E.S.I. S.p.A. et ASTALDI S.p.A. v. Algeria, ICSID Case No. ARB/05/3, Decision on Jurisdiction, 12 July 2006, *available at* <http://ita.law.uvic.ca/documents/LESIAlgeria.pdf>, para. 83 (iii); Desert Line Projects LLC v. The Republic of Yemen, ICSID Case No. ARB/05/17, Award, 6 February 2008, *available at* <http://ita.law.uvic.ca/documents/DesertLine.pdf>, paras. 97–123.

<sup>4</sup> See Mytilineos v. State Union of Serbia and Montenegro and Republic of Serbia, *supra* note 3, at paras. 137–157; specific approval requirements were applicable e.g. in the following cases: Yaung Chi Oo v. Myanmar, ICSID Case No. ARB/01/1, Final Award, 31 March 2003, 42 ILM 540 (2003), paras. 53–62; Gruslin v. Malaysia, ICSID Case No. ARB/99/3, Award, 27 November 2000, *available at* [http://ita.law.uvic.ca/documents/Philippe\\_Gruslin\\_v\\_Malaysia.pdf](http://ita.law.uvic.ca/documents/Philippe_Gruslin_v_Malaysia.pdf), para. 9.2.

<sup>5</sup> See, e.g., Germany – Philippines BIT

#### Article 1 Definition of Investment

For the purpose of this Agreement:

1. the term “investment” shall mean any kind of asset accepted *in accordance with the respective laws and regulations* of either Contracting State, ... (emphasis added).

#### Lithuania – Ukraine BIT

Article 1 (1) of the BIT defines “investment” as “every kind of asset invested by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter ...” (Tokios Tokenles v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction, 29 April 2004, *available at* [http://ita.law.uvic.ca/documents/Tokios-Jurisdiction\\_000.pdf](http://ita.law.uvic.ca/documents/Tokios-Jurisdiction_000.pdf), para. 74).

#### Bangladesh – Italy BIT

#### Article 1 (1)

The term “investment” shall be construed to mean any kind of property invested before or after the entry into

force of this Agreement by a natural or legal person being a national of one Contracting Party in the territory of the other in conformity with the laws and regulations of the latter.

Oman – Yemen BIT

Article 1 (1)

The term “Investment” shall mean every kind of asset owned and invested by an investor ... and that is accepted, by the host Party, as an investment according to its laws and regulations, and for which an investment certificate is issued.

Spain – Mexico BIT

Artículo I, Definiciones

4. Inversión significa, entre otros, los siguientes activos propiedad de, o controlados por, inversores de una Parte Contratante y establecidos en el territorio de la otra Parte Contratante de conformidad con la legislación de esta última: ...

Article I, Definitions

4. Investment means inter alia the following assets, property of or controlled by investors of one Contracting Party and established on the territory of the other Contracting Party in accordance with the legislation of the latter: ... (courtesy translation from Spanish).

<sup>6</sup> See, e.g., Spain – Ecuador BIT

Article 2 Promotion and Admission

Each Contracting Party [...] will *admit* Investment *according to its legal provisions*.

The present Article will also apply to investments made before its entry into force by investors of a Contracting Party *in accordance with the laws of the other Contracting Party* in the territory of the latter [...]

Article 3 Protection

...

Each Contracting Party shall protect in its territory the investments made, *in accordance with its legislation* [...]

(courtesy translation from Spanish, emphases added).

## Netherlands – Bolivia BIT

## Article 2

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

- <sup>7</sup> Plama Consortium Limited v. Bulgaria, ICSID Case No. ARB/03/24, Award, 27 August 2008, *available at* <http://ita.law.uvic.ca/documents/PlamaBulgariaAward.pdf>.
- <sup>8</sup> *Id.* at para. 138.
- <sup>9</sup> *Id.*
- <sup>10</sup> Phoenix Action, Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award, 15 April 2009, *available at* <http://ita.law.uvic.ca/documents/PhoenixAward.pdf>, para. 101.
- <sup>11</sup> Ioannis Kardassopoulos v. Georgia, Decision on Jurisdiction, ICSID Case No. ARB/05/18, 6 July 2007, *available at* <http://ita.law.uvic.ca/documents/Kardassopoulos-jurisdiction.pdf>, para. 182.
- <sup>12</sup> *Id.*
- <sup>13</sup> *Id.* at para. 184.
- <sup>14</sup> Southern Pacific Properties (Middle East) Limited v. Egypt, Award, 20 May 1992, 32 ILM 933, paras. 81–85 (1993).
- <sup>15</sup> See, e.g., Fraport AG Frankfurt Airport Services Worldwide v. Philippines, Award, 16 August 2007, ICSID Case No. ARB/03/25, *available at* <http://ita.law.uvic.ca/documents/FraportAward.pdf>; Inceysa Vallisoletana S.L. v. Republic of El Salvador, ICSID Case No. ARB/03/26, Award, 2 August 2006, *available at* [http://ita.law.uvic.ca/documents/Inceysa\\_Vallisoletana\\_en\\_001.pdf](http://ita.law.uvic.ca/documents/Inceysa_Vallisoletana_en_001.pdf).
- <sup>16</sup> See, e.g., Plama Consortium Limited v. Bulgaria, *supra* note 7.
- <sup>17</sup> Fraport AG Frankfurt Airport Services Worldwide v. Philippines, *supra* note 15.
- <sup>18</sup> Emphases added.
- <sup>19</sup> *Id.* at para. 86.
- <sup>20</sup> *Id.* at para. 398.
- <sup>21</sup> *Id.* at para. 401.
- <sup>22</sup> Saluka v. Czech Republic, Partial Award, 17 March 2006, *available at* <http://ita.law.uvic.ca/documents/Saluka-PartialawardFinal.pdf>, para. 183.
- <sup>23</sup> Netherlands – Czech BIT: Article 1

For the purposes of the present Agreement:

- (a) the term “investments” shall comprise every kind of asset invested either directly or through an investor of a third State and more particularly, though not exclusively: ...

24 Netherlands – Czech BIT: Article 2

Each Contracting Party shall in its territory promote investments by investors of the other Contracting Party and shall admit such investments in accordance with its provisions of law.

25 Saluka v. Czech Republic, *supra* note 22, at para. 214.

26 Phoenix Action, Ltd. v. Czech Republic, *supra* note 10.

27 Article 1 (1) Israel – Czech Republic BIT:

1. The term “investment” shall comprise any kind of assets invested in connection with economic activities by an investor of one Contracting Party in the territory of the other Contracting Party *in accordance with the laws and regulations of the latter* and shall include, in

particular, though not exclusively: ...

28 *Id.* at paras. 102–104.

29 *Id.* at para. 134.

30 OKO Pankki Oyj, VTB Bank (Deutschland) AG and Sampo Bank Plc v. Estonia, ICSID Case No. ARB/04/6, Award, 19 November 2007, 22 ICSID Review – FILJ 466–501 (2007).

31 Article 2 of the Estonia – Finland BIT: Applicability of this Agreement

- (1) This Agreement shall only apply to investments made in accordance with the laws, regulations and procedures of the host country.

Article 2 of the Estonia – Germany BIT:

- (1) Jede Vertragspartei wird in ihrem Hoheitsgebiet Kapitalanlagen von Staatsangehörigen oder Gesellschaften der anderen Vertragspartei nach Möglichkeit fördern und diese Kapitalanlagen in Übereinstimmung mit ihren Rechtsvorschriften zulassen. Sie wird Kapitalanlagen in jedem Fall gerecht und billig behandeln.

32 *Id.* at paras. 189–190.

33 Inceysa Vallisoletana S.L. v. Republic of El Salvador, *supra* note 15.

34 *Id.* at paras. 186–188.

35 Emphases added.

<sup>36</sup> *Id.* at para. 160. Although the argument that Inceysa's investment is not protected by the Agreement because it is an investment that was not made in accordance with the laws of El Salvador can be identified as a substantive defense related to the merits of the matter, this presumption is incorrect. Indeed, if it is determined that the investment is not protected by the Agreement, it would imply recognizing that the necessary premise for the Arbitral Tribunal to validly assume jurisdiction was not met. Consequently, in the end, the Arbitral Tribunal would be deciding on its own competence and not on the Claimant's indemnity claims.

<sup>37</sup> *Id.* at paras. 103, 104, 110.

<sup>38</sup> *Id.* at paras. 118, 122.

<sup>39</sup> *Id.* at para. 115.

<sup>40</sup> *Id.* at para. 187 referring to *Salini v. Morocco*, Decision on Jurisdiction, *supra* note 2, at para. 46:

In envisaging “the categories of invested assets [...] in accordance with the laws and regulations of the said party,” the provision in question refers to the legality of the investment and not to its definition. It aims in particular to ensure that the bilateral Agreement does not protect investments which it should not, generally because they are illegal.”

<sup>41</sup> *Id.* at para. 240.

<sup>42</sup> *Id.* at paras. 246, 252.

<sup>43</sup> *Id.* at para. 254.

<sup>44</sup> *Id.* at para. 257.

<sup>45</sup> *World Duty Free v. Kenya*, Award, ICSID Case No. ARB/00/7, 4 October 2006, *available at* <http://ita.law.uvic.ca/documents/WDFv.KenyaAward.pdf>; *see also* Respondents application for dismissal, 1 TDM issue 2 (2004); on corruption and investment arbitration *see, e.g.*, Florian Haugenender & Christoph Liebscher, *Corruption and Investment Arbitration: Substantive Standards and Proof*, in *Austrian Arbitration Yearbook 2009* 539–564 (Klausegger et al. eds., 2009); Hilmar Raeschke-Kessler & Dorothee Gottwald, *Corruption*, in *The Oxford Handbook of International Investment Law* 584–616 (Muchlinski et al. eds. 2008); Hilmar Raeschke-Kessler, *Corruption in Foreign Investment-Contracts and Dispute Settlement between Investors, States and Agents*, 9 *The Journal of World Investment & Trade* 5–33 (2008); Hilmar Raeschke-Kessler, *Corrupt Practices in the Foreign Investment Context: Contractual and Procedural Aspects*, in *Arbitrating Foreign Investment Disputes, Procedural and Substantive Legal Aspects* 471–501 (Horn ed., 2004).

<sup>46</sup> *Id.* at para. 130.

<sup>47</sup> *Id.* at paras. 105–124.

<sup>48</sup> *Id.* at para. 136.

<sup>49</sup> *Id.* at para. 159.

<sup>50</sup> *Id.* at para. 157.

- 51 *Id.* at para. 185.
- 52 *Id.* at para. 188.
- 53 *Id.* at para. 192.
- 54 *Plama Consortium Limited v. Bulgaria*, *supra* note 7.
- 55 Claimant represented to the Bulgarian Government that the investor was a consortium – which was true during the early stages of negotiations. It then failed, deliberately, to inform Respondent of the change in circumstances, which the Tribunal considers would have been material to Respondent's decision to accept the investment. On the basis of the evidence in the record, Bulgaria had no reason to suspect that the original composition of the consortium, consisting of two major experienced companies, had changed to an individual investor acting in the guise of that “consortium”, and no duty to ask.
- 56 *Id.* at para. 143.
- 57 *Id.* at para. 144.
- 58 *Id.* at para. 144.
- 59 *Genin and others v. Estonia*, ICSID Case No. ARB/99/2, Award, 25 June 2001, *available at* <http://ita.law.uvic.ca/documents/Genin-Award.pdf>, paras. 348–365.
- 60 *International Thunderbird Gaming Corporation v. Mexico*, Award, 26 January 2006, *available at* <http://ita.law.uvic.ca/documents/Genin-Award.pdf>.
- 61 Thunderbird had not offered to provide the regulator with a physical sample or inspection of the particular game machine at issue but described the games. The request concluded that the proposed operation was not of the type prohibited by Mexican law and sought confirmation of this conclusion by the gaming regulator. The gaming regulator issued an official opinion on the legality of the machines to Thunderbird's request. It restated the prohibition on gambling and luck-related games under Mexican law. It then confirmed that it had no power to prohibit machines that operate in the form and conditions stated by the investor. It emphasized that the video games skill machines could be operated as long as they did not become, in any manner whatsoever, gaming or betting machines.
- 62 *Id.* at para. 208.

The tribunal found that

164. It cannot be disputed that Thunderbird knew when it chose to invest in gaming activities in Mexico that gambling was an illegal activity under Mexican law. ... Thunderbird must be deemed to have been aware of the potential risk of closure of its own gaming facilities and it should have exercised particular caution in pursuing its business venture in Mexico. At the time EDM requested an official opinion from SEGOB on the legality of its machines, EDM must also be deemed to have been aware that its machines involved some

degree of luck, and that dollar bill acceptors coupled with winning tickets redeemable for cash could be reasonably viewed as elements of betting. Yet EDM chose not to disclose those critical aspects in the *Solicitud*.

166. Considering the foregoing, the Tribunal finds that there was no legitimate expectation created by the Oficio to the effect of bringing Thunderbird's claims in the present case under Article 1102, 1105 and/or 1110 of the NAFTA.

- 63 *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, *supra* note 15, at para. 202.
- 64 *Plama Consortium Limited v. Bulgaria*, *supra* note 7.
- 65 *World Duty Free Company Limited v. The Republic of Kenya*, Award, *supra* note 45.
- 66 *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, *supra* note 15.
- 67 In *Fraport* the Tribunal found that the investor knowingly and intentionally circumvented the rule that in case of a public utility franchise, the proponent and facility operator must be owned and controlled up to at least sixty percent (60%) by Filipinos. This rule was contained in the constitution and the Anti Dummy law.
- 68 *L.E.S.I. S.p.A. et ASTALDI S.p.A. v. Algeria*, *supra* note 3, at para. 83.
- 69 *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Kazakhstan*, ICSID Case No. ARB/05/16, Award, 29 July 2008, *available at* <http://ita.law.uvic.ca/documents/Telsimaward.pdf>.
- 70 *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Kazakhstan*, *supra* note 69, at para. 168. Emphasis added. Footnote omitted.
- 71 *Desert Line Projects LLC v. The Republic of Yemen*, *supra* note 3, at para. 104.
- 72 *Phoenix Action, Ltd. v. Czech Republic*, *supra* note 10, at para. 78.
- 73 *Tokios Tokelés v. Ukraine*, *supra* note 5.
- 74 *Id.* at para. 86.
- 75 *Metalpar S.A. and Buen Aire S.A. v. Argentine Republic*, ICSID Case No. ARB/03/5, Decision on Jurisdiction, 27 April 2006, *available at* <http://ita.law.uvic.ca/documents/Metalpar-Argentina-Jurisdiction.pdf>.
- 76 *Id.* at para. 84.
- 77 *Mytilineos v. State Union of Serbia and Montenegro and Republic of Serbia*, *supra* note 3.
- 78 *Id.* at para. 151. Footnote omitted.
- 79 *Id.* at paras. 154, 157. Footnote omitted.



- 80 Fraport AG Frankfurt Airport Services Worldwide v. Philippines, *supra* note 15, at para. 396.
- 81 *Id.* at paras. 355, 398.
- 82 *Id.* at para. 387.
- 83 Desert Line Projects LLC v. The Republic of Yemen, *supra* note 3, at paras. 116, 117.
- 84 SwemBalt v. Latvia, Award, 23 October 2000, *available at* <http://ita.law.uvic.ca/documents/Swembalt-Latvia-Award-23Oct2000.pdf>; for a case note see Farouk Yala, *Final Arbitral Award Rendered in 2000 in UNCITRAL Ad Hoc Arbitration, SwemBalt AB v. Republic of Latvia*, Stockholm Arbitration Report 97–131 (2004:2).
- 85 *Id.* at paras. 34, 35.
- 86 Tokios Tokeles v. Ukraine, Decision on Jurisdiction, *supra* note 5, at para. 86.
- 87 Técnicas Medioambientales Tecmed, S.A. v. United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, *available at* [http://ita.law.uvic.ca/documents/Tecnicas\\_001.pdf](http://ita.law.uvic.ca/documents/Tecnicas_001.pdf).
- 88 *Id.* at para. 149.
- 89 *Id.* at paras. 151, 174.
- 90 Ioannis Kardassopoulos v. Georgia, *supra* note 11.
- 91 *See supra* p. 7.
- 92 *Id.* at paras. 185–194.
- 93 Fraport AG Frankfurt Airport Services Worldwide v. Philippines, *supra* note 15.
- 94 *Id.* at para. 347.
- 95 *Id.* at para. 387.
- 96 *Id.* at para. 401.
- 97 World Duty Free Company Limited v. The Republic of Kenya, *supra* note 45.
- 98 International Thunderbird Gaming Corporation v. Mexico, *supra* note 60, at para. 165.
- 99 Desert Line Projects LLC v. The Republic of Yemen, *supra* note 3.
- 100 *Id.* at paras. 117, 118.
- 101 Fraport AG Frankfurt Airport Services Worldwide v. Philippines, *supra* note 15, at para. 346.
- 102 Desert Line Projects LLC v. The Republic of Yemen, Award, *supra* note 3, at para. 120.
- 103 Fraport AG Frankfurt Airport Services Worldwide v. Philippines, *supra* note 15.
- 104 *Id.* at paras. 344, 345.
- 105 Phoenix Action, Ltd. v. Czech Republic, *supra* note 10.
- 106 *Id.* at paras. 102–104. Footnotes omitted.
- 107 *See also* the examples of “in accordance with host State law

clauses” in footnotes 5 and 6.

108 BIT applicable in Phoenix.

109 *Holiday Inns v. Morocco*, ICSID Case No. ARB/72/1, Decision on Jurisdiction, 12 May 1974. The decision is unreported. A detailed account with extensive quotations was published by Pierre Lalive, *The First “World Bank” Arbitration (Holiday Inns v. Morocco) – Some Legal Problems*, 51 *British Year Book of International Law* 123 (1980); *also in*: 1 ICSID Reports 645 (1993).

110 *See, e.g.*, PSEG v. Turkey, ICSID Case No. ARB/02/5, Decision on Jurisdiction, 4 June 2004, 11 ICSID Reports 434, paras. 106–124; Joy Mining v. Egypt, Award, 6 August 2004, 19 ICSID Review – FILJ 486 para. 54 (2004) (*but see* the apparent contradiction with the Tribunal’s statement at paras. 42, 44); Patrick Mitchell v. Democratic Republic of the Congo, Decision on Annulment, 1 November 2006, *available at* <http://ita.law.uvic.ca/documents/mitchellannulment.pdf>, para. 38; Saipem v. Bangladesh, *supra* note 3, at paras. 112–114.

111 *Berschader v. Russia*, Award, 21 April 2006, *available at* <http://ita.law.uvic.ca/documents/BerschaderFinalAward.pdf>, para. 111.

112 For the relationship between human rights and investment law *see, e.g.*: Luke Eric Peterson & Kevin Gray, *International Human Rights in Bilateral Investment Treaties and in Investment Treaty Arbitration* (2003), *available at* [http://www.iisd.org/pdf/2003/investment\\_int\\_human\\_rights\\_bits.pdf](http://www.iisd.org/pdf/2003/investment_int_human_rights_bits.pdf); Ursula Kriebaum, *Privatizing Human Rights, The Interface between International Investment Protection and Human Rights*, in *The Law of International Relations – Liber Amicorum Hanspeter Neuhold* 165–189 (Reinisch & Kriebaum eds., 2007); Lahra Liberti, *Investissements et Droits de l’Homme*, in *New Aspects of International Investment Law 2007*, 791–852 (Kahn & Wälde eds., 2007); Walid Ben Hamida, *Investment Arbitration and Human Rights*, 4 *Transnational Dispute Management* 2007; Moshe Hirsch, *Interactions between Investment and Non-Investment Obligations in International Investment Law*, in *The Oxford Handbook of International Investment Law* 154–181 (Schreuer et al. eds., 2008); Bruno Simma & Theodore Kill, *Harmonizing Investment Protection and International Human Rights: First Steps towards a Methodology*, in *International Investment Law for the 21st Century, Essays in Honour of Christoph Schreuer* 678–707 (Binder et al. eds., 2009); Ursula Kriebaum, *Human Rights of the Population of the Host State in International Investment Arbitration*, 10 *Journal of World Investment and Trade* 653–677 (2009).

113 *See also* Andrea Carlevaris, *The Conformity of Investments with the Law of the Host State and the Jurisdiction of International Tribunals*, 9 *The Journal of World Investment and Trade* 48 (2008).

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