ICCA 2014: Pleading and Proof of Fraud and Comparable Forms of Abuse

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Chair: Klaus Reichert SC (London)
Main Speakers: Dr. Aloysius Llamzon (The Hague), Anthony Sinclair (London)
Commentators: Utku Cosar (Istanbul), Carolyn B. Lamm (Washington, DC)
Rapporteur: Elizabeth Karanja (Nairobi)

No one would seriously challenge the proposition that investor wrongdoing is a systemic threat to international investment arbitration. But what constitutes investor wrongdoing? What are the standards that govern pleading and proving issues of corruption, fraud, misrepresentation and similar serious allegations of misconduct? How are arbitral tribunals addressing these issues? The Precision Stream on 'Pleading and Proof of Fraud and Comparable Forms of Abuse' addressed these vexing questions.

Opening the panel, Dr. Aloysius Llamzon identified three operative categories of investor wrongdoing: (i) corruption, (ii) fraud, deceit and misrepresentation, and (iii) other breaches of host state law, which may occur either in the acquisition of the investment or ex post. He stepped away from a line of arbitral cases asserting that an investment must have been made or acquired in good faith. Instead of relying on such abstract concepts, Llamzon suggested that investor misconduct in the vast majority of treaty cases falls under one or more of the identified operative categories.

The second panelist, Anthony Sinclair, laid out three tools to deal with investor wrongdoing: (i) the 'in accordance with host state law' or legality clause contained in certain BITs, (ii) the 'unclean hands' doctrine, and (iii) international public policy. Addressing the legality clause, Sinclair distinguished between illegality in the 'making' of an investment, and subsequent illegality in the carrying out of the investment. Whereas compliance with host state law at the inception of the investment qualifies the offer of treaty protection and goes to the tribunal's jurisdiction, Sinclair suggested that subsequent illegality goes to admissibility of the claims or the merits of the dispute.

In the absence of an express legality requirement in the BIT, Sinclair proposed that the 'clean hands' doctrine may be relied upon to bar an investor's claim due to its illegal or improper conduct in relation to those claims. The inequitable conduct that would trigger the application of the 'clean hands' doctrine must typically be willful, and must have a nexus to the matters in dispute. Sinclair nonetheless acknowledged that the International Court of Justice (ICJ) has yet to accept the 'clean hands' doctrine in a majority decision and that its status as a general principle of law is 'uncertain.'

Sinclair next commented on international public policy, which he defined as principles of mandatory

application regardless of applicable law or national rules. Bribery of foreign officials or other forms of corruption or fraud are likely to impinge upon international public policy. Among other decisions, Sinclair referred to *Plama v. Bulgaria*, where the tribunal found that the enforcement of a contract obtained by fraudulent misrepresentation was 'contrary to international public policy.' Concluding, Sinclair questioned whether international public policy amounts to a vehicle for arbitrators to enforce their own ethical or moral standards. 'Are we stretching the concept too far?', he posited.

Next, commentator Utku Cosar laid out three key issues in connection with corruption allegations: (i) burden of proof, (ii) consequences of a successful plea of corruption, and (iii) sanctions. With respect to burden of proof, Cosar referred to *Metal-Tech v. Uzbekistan*, where the tribunal acknowledged that 'corruption is by essence difficult to establish' and that it is thus 'generally admitted that it can be shown through circumstantial evidence.' She also underscored a tribunal's powers to investigate and inquire *propio motu* about issues of corruption, and to draw adverse inferences when appropriate. The question arises: should tribunals take an active stance in investigating allegations of misconduct or remain passive arbiters of the contentions of the parties?

Cosar next discussed the legal consequences of analyzing corruption. She agreed with Dr. Llamzon and Sinclair that if the BIT contains an express legality clause, as was the case in *Metal-Tech*, the result should be a denial of jurisdiction. In the absence of an express legality clause, Cosar asked whether the misconduct of both parties should be assessed by the tribunal at the merits stage. After all, corruption is a two-way street. Concluding, Cosar addressed possible sanctions for misconduct, suggesting that the tribunal should not only condone illegality in the award but should also take it into account in the allocation of costs.

The last panelist, Carolyn B. Lamm, commented on at least three salient issues: (i) standard of proof, (ii) principles of treaty interpretation, and (iii) timing of the unlawful conduct. As to burden of proof, she argued that there is no strict standard to prove corruption or fraud (unless part of *lex specialis*), and went on to identify five possibilities: beyond a reasonable doubt, clear and convincing evidence, preponderance of the evidence, balance of probabilities, and *prima facie* evidence. Lamm rejected the adoption of a high standard of proof (as advocated by Dr. Llamzon and Sinclair), noting that a heightened standard is 'neither needed nor appropriate' in a system that lacks the power to compel the production of evidence.

Lamm next commented on the principles of treaty interpretation set out in Article 31 of the *Vienna Convention on the Law of Treaties*, requiring that treaties be construed in light of their 'object and purpose'. She noted that, in the absence of an express 'legality' clause in a treaty, legality should nonetheless be read as an implicit requirement of an investment treaty, whose 'object and purpose' must include the protection and promotion of investments that are made legally. With respect to the timing of wrongdoing, Lamm argued that fraud or corruption, both at the inception of the investment and during its operation, must be condemned. She advocated the rejection of investments born out of, or implemented by, fraudulent or corrupt acts, if not as a jurisdictional issue, as an admissibility matter. Asking a state to ignore illegality, Lamm argued, would amount to an 'affront to sovereignty.'

Far from giving 'precise' answers, the panel discussions revealed not only the inherent difficulties in proving investor misconduct, but also the challenging task faced by tribunals seeking to craft the proper standard of proof to sustain allegations of misconduct or illegality. While no comprehensive framework for addressing pleas of illegality in investment treaty arbitration emerges, the question remains open: should misconduct on the part of the putative investor be addressed as a question of jurisdiction, or is it rather a question of admissibility or one for the merits?