Kluwer Arbitration Blog

Investor misconduct and investment treaty arbitration: mapping the terrain

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The treatment of investor misconduct in investment treaty arbitration raises a series of complex issues. Allegations of investor misconduct (such as fraud, illegality and corruption) can arise in the context of the making of an investment, during its operation, or in the investment treaty claim making process. How should a tribunal address investor misconduct if it is proven? When does investor misconduct deprive a tribunal of jurisdiction? What powers do investment treaty tribunals have to decline investor claims based on principles such as abuse of rights, abuse of process or international public policy? If a tribunal declines an investment the substantive benefits of the investment treaty before addressing the investor's claim on the merits, should we refer to this as a form of substantive inadmissibility? When, if ever, is investor misconduct an issue that goes to the merits, damages or an award of costs?

In my posts in the coming months I will explore these issues, which form part of an ongoing research project on mapping the complex intersections between investor misconduct and investor-state arbitration.

Although there may be little sympathy for the investor that has engaged in serious misconduct, it is not so clear that investor misconduct is necessarily a jurisdictional issue, as suggested in a number of cases, notably *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5 (*Phoenix*). One of the problems with addressing investor misconduct as a jurisdictional issue is that in complex investment relationships, misconduct may not be unilateral. From a policy perspective, there is much force in the point made by Dr. Cremades in his dissent in *Fraport v. Philippines*:

> If the legality of the Claimant's conduct is a jurisdictional issue, and the legality of the Respondent's conduct a merits issue, then the Respondent Host State is placed in a powerful position. In the Biblical phrase, the Tribunal must first examine the speck in the eye of the investor and defer, and maybe never address, a beam in the eye of the Host State. Such an approach does not respect fundamental principles of procedure. (Dissent, para. 37)

As discussed in previous posts by other Kluwer Arbitration Bloggers (here and here), in *Phoenix* the tribunal found that good faith was a jurisdictional requirement and declined jurisdiction. At

para. 100, the tribunal stated that:

> The purpose of the international mechanism of protection of investment through ICSID arbitration cannot be to protect investments made in violation of the laws of the host State or investments not made in good faith, obtained for example through misrepresentations, concealments or corruption, or amounting to an abuse of the international ICSID arbitration system. In other words, the purpose of international protection is to protect legal and *bona fide* investments.

On the good faith requirement, the tribunal applied the *bona fide* test to what it referred to as Phoenix's abusive distortion of the requirements for jurisdiction. However, the Tribunal also noted that good faith: "is not so limited and may also play its role when it comes to the analysis of the substantive protection for investments under international treaties, which is a matter for the merits" (para. 143).

As John Gaffney has argued in a previous post, rather than viewing the misconduct at issue in *Phoenix* as a question of jurisdiction, the outcome in the case could have been "achieved through the exercise by the Tribunal of an inherent power to dismiss the proceedings for abuse of process, rather than on alleged failure to meet one of a number of investment criteria required to establish the Tribunal's jurisdiction."

The good faith requirement outlined in *Phoenix* as a jurisdictional requirement appears to be at odds with the approach of some other tribunals, where misconduct has been the basis for denying the claim either as substantively inadmissible or on the merits. For example, in *Plama v. Bulgaria*, the tribunal found that the investor was not entitled to the substantive protections of the Energy Charter Treaty because it obtained its investment through fraudulent misrepresentations. Likewise, in *Azinian v. Mexico*, the tribunal, having found that the investment was made on false pretences, rejected the investor's claims and decided in favour of Mexico. In *World Duty Free v. Kenya*, the tribunal dismissed World Duty Free's claim and stated that 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." (para. 188). In all these cases, the tribunals dismissed the claims on the merits or on the basis of substantive inadmissibility, rather than for lack of jurisdiction.

As noted above, from a policy perspective there is merit to addressing issues of misconduct as either questions of admissibility or the merits (and in less egregious cases perhaps at the damages or costs phase of the proceedings). Cases of illegality raise unique issues, particularly where the illegality under local law means that no property rights could ever have been acquired. This issue will be discussed in later postings.

It might also be noted that viewing investor misconduct as a jurisdictional issue has two further implications. If investor misconduct is jurisdictional, a state may be unable to bring a counterclaim to a merits determination. Second, upon review by either an ICSID annulment committee or a national court, an arbitral award dismissing a case for lack of jurisdiction might be subject to a higher degree of review for failure to exercise jurisdiction compared to a review of an award where a tribunal dismisses the claim on the merits or on the basis of substantive inadmissibility.

As I continue to work and post on these issues any comments or views would be most welcome.

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