The Clean Hands Doctrine
Through the Looking-Glass of Investment Treaty Arbitration

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Abstract

International arbitration has become the model for dispute resolution in foreign investment transactions. While the investment treaty arbitration system has been established to better protect foreign investment from the host state’s misconduct, recent case law has demonstrated that the system is far from being one-sided: in fact, investors’ actions have increasingly been subject to an intense scrutiny on the basis of the so called ‘clean hands doctrine’ invoked by the defendant host states to exclude the foreign investors from obtaining international protection. In fact, if the claimant has been involved in an unlawful act in relation to its claim, a positively established clean hands defense can ultimately bar that party to pursue its claim.

This paper aims to analyze the current arbitral approach to the clean hands doctrine in the investment treaty arbitration framework and to suggest another pathway as to treat the clean hands defense. In fact, so far, arbitrators have addressed the ‘unclean hands’ of the investor at the preliminary phase of the dispute as a matter of jurisdiction or admissibility, thus, precluding the assessment of the involvement or the acquiescence of the host state in the investors’ wrongdoing. On the contrary, here, it will be argued that arbitral tribunals should treat the clean hands doctrine as a merit issue in order to have the possibility to balance - for equity reasons - the conduct of both the investor and the host state in the commission of the unlawful act.
1. Introduction

Foreign investment plays a vital role in the advancement of the world’s economy. Global flows of investment in 2018 amounted to $1.43 trillion. Foreign investors desire guarantee that their investments are safe in the hosting country by means of not being unfairly “expropriated” or so harmed due to changes in the hosting country’s regulations or laws. They also want a dispute resolution mechanism that does not rely on the judicial system of the host country, in order to avoid unfair treatment particularly in the case where the opposing party is likely to be the state or its entity.

Arbitration has become the model for dispute resolution in most foreign investment transactions. The investment treaty arbitration system has been established to better protect foreign investment from the host state’s misconduct. Recent years have demonstrated, however, that the system is far from being one-sided: in fact, investors’ actions have increasingly been subject to intense scrutiny for any wrongdoing that they might have done in the establishment or in the development of their investments. In fact, the host states have begun to increasingly invoke the so called clean hands defense to exclude the foreign investors from the treaty protection. In fact, according to the doctrine at stake, a claimant will not be allowed to pursue a claim if it is proven that the party itself has been involved in an unlawful act in relation to its claim. As a consequence of a successfully established clean hands defense, the tribunals have declared, depending on the premises, their lack of jurisdiction to hear the dispute, the inadmissibility of the claim brought by the investor, or, at least, the arbitrators have to assess the defense at the merits phase where the clean hands doctrine can ultimately serve as a mechanism to limit the amount of compensation in favor of the investor. Even if the practice in the investment treaty arbitration framework is not yet well-settled, a clean hands defense has been displayed as an effective argument to convince the tribunal that the investor could not be granted international protection. Nonetheless, investment arbitration tribunals could not focus

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4 World Duty Free v Kenya, ICSID Case No. ARB/00/7, Award (Oct. 4, 2006); Metal-Tech Ltd. v Republic of Uzbekistan, ICSID Case No. ARB/10/3, Award (Oct. 4, 2013); Plama Consortium Ltd. v Bulgaria, ICSID Case No. ARB/03/24, Award (Aug. 27, 2008); Fraport AG Frankfurt Airport Services Worldwide v Philippines, ICSID Case No. ARB/03/25, Award (Aug. 16, 2007), Incesya Vallisoletana v Republic of El Salvador, ICSID Case No. ARB/03/26, Award (Aug. 2, 2006).
6 Hulley Enterprises (Cyprus) Limited, Yukos Universal Limited (Isle of Man) and Veteran Petroleum Limited (Cyprus) v Russian Federation, PCA Case Nos. AA226-228, Final Awards (Jul. 18, 2014), 435, 492, 436.
7 E.g. World Duty Free Company Ltd. v The Republic of Kenya, ibid. 180-181 where the tribunal, unanimously, held that an investor that has engaged in bribery should not be granted international protection when his hands are unclean due to
only on investor’s actions while forgetting the involvement or acquiescence of the host state in the wrongdoings committed by the investor. In fact, if the host state has been involved or acquiesced to the alleged unlawful conduct, this circumstance should ultimately result in a sufficient legal ground to sidestep the application of the clean hands doctrine in (at least) the preliminary phase of the dispute.

In the light of the above, the paper aims to analyze the current arbitral approach to the clean hands doctrine in the investment treaty arbitration framework and to suggest another pathway as to treat the clean hands defense. In fact, traditionally, arbitrators have addressed the ‘unclean hands’ of the investor at the preliminary phase of the dispute. However, here, it will be argued that if arbitrators consider the clean hands defense as a substantive defense, rather than a matter of arbitrability, they could have the opportunity to better assess and to balance the conduct of both the investor and the host state in the commission of the unlawful act. In fact, following the traditional approach, when a clean hands defense is positively established, the host states is capable to evade any potential liability despite their contribution to the unlawful act perpetrated by the investor. Thus, assessing the defense at the merit stage, as a substantive matter, will lead to the rational consequence that findings of unclean hands would not come down heavily only on investors while exonerating in principle the host states from any responsibility. Otherwise, the clean hands doctrine would be misrepresented. In fact, the reasoning behind the suggested approach is based on equity principles – to which the clean hands doctrine belongs to - that solicit courts and tribunals to use their discretion to appropriately bring a fair outcome.

2. The Clean Hands Doctrine in a Nutshell

The clean hands doctrine is a principle of equity, a system based on a judicial assessment of fairness, which has been developed as opposed to the to the strict and rigid rules of common law. Equity is a judge-made law. The doctrine at hand has been expressed through the maxim “he who comes into

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8 Ibid.
10 ANENSON T. L., Announcing the ‘Clean Hands’ Doctrine, University of California, Davis, Vol. 51, 1832.
equity must come with clean hands”\textsuperscript{11}. It was firstly established by the Courts of Equity in England in the late eighteenth century and then developed in most common and civil law systems\textsuperscript{12}.

The clean hands doctrine is an affirmative defense (positive response) that the defendant may claim the claimant has ‘unclean hands’ because the latter has misled the other party or has done something wrong regarding the matter under consideration. In other words, the clean hands defense is invoked by the respondent to defeat the claimant’s claim on the ground that the latter is guilty itself of some wrongdoing concerning the very matter for which he seeks relief\textsuperscript{13}. As per the doctrine, the claimant’s wrongdoing (rectius, the claimant’s unclean hands) may limit its claim or reparation. In fact, if a claimant is found engulfed in an illegal action in relation to the claim brought before a court or a tribunal it appears fair that the claimant itself may be excluded from the necessary \textit{locus standi in judicio} for complaining of corresponding illegalities on the other part, especially if these were consequential on or were embarked upon in order to counter its own illegality\textsuperscript{14}.

The application of unclean hands protects judicial integrity since allowing a party with unclean hands to recover in an action generates doubts as to the justice provided by the judicial system. Thus, the court, in fact, acts to protect itself and not the opposing party and the integrity of the justice system is the ultimate purpose of unclean hands\textsuperscript{15}.

As it will be discussed further, the clean hands doctrine has been invoked and sometimes applied in international investment arbitration\textsuperscript{16}. The reasoning behind the raising of a clean hands defense in investment treaty arbitration, specifically, is that the lawfulness of the investor’s investment should be considered a pre-condition for the arbitral tribunal to grant compensatory justice\textsuperscript{17}. In particular, the scenarios under which the host states have raised the doctrine and the arbitral tribunals have found that it applies include, so far, cases under which the investor has been involved in acts of: corruption,

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\item \textbf{MOLOO R.,} \textit{A Comment on the Clean Hands Doctrine in International Law}, ibid, citing Sir Gerald Fitzmaurice. As referenced by the tribunal in \textit{Incesya Vallisoletana v Republic of El Salvador}, ibid, 240, there are a number of Latin maxims associated with the clean hands doctrine e.g. \textit{ex delicto non oritur actio} (an unlawful act cannot serve as the basis for an action at law), \textit{nemo ex suo delicto meliorem suam conditionem facit} (no one can put himself in a better legal position by means of a delict), \textit{ex turpi causa non oritur actio} (an action cannot arise from a dishonorable cause), \textit{inadimplenti non est adimplendum} (one has no need to respect his obligation if the counter-party has not respected its own) and \textit{nullus commodum capere potest de injuria sua propria} (no one can be allowed to take advantage of its own wrong).
\item \textbf{POMEROY J.,} \textit{Equity Jurisprudence}, 5th ed., 1941, 397-404.
\item \textbf{ANENSON T. L.,} \textit{Announcing the ‘Clean Hands’ Doctrine}, University of California, Davis, ibid, 1843.
\end{enumerate}
fraud or misrepresentation or deliberate violations of legal provisions of the host state. Arbitrators have applied the clean hands doctrine both on the grounds of the “in accordance with the law” treaty provision, where present in the relevant Bilateral Investment Treaty (hereinafter BIT) (infra 3.1.2.1), or as a general principle of international law (infra 3.1.2.2).

3. Investment Treaties and Investor-State Arbitration

The body of international investment law is compounded by a decentralized system of International Investment Agreements (hereinafter IIAs). Among the more than 3,000 international agreements concerning foreign investments, the majority is represented by BITs; additionally, there are some important multilateral investment agreements (e.g. the NAFTA or the ECT). The IIAs typically establish the terms and conditions under which nationals of one country invest in the other, including their rights and protections. Moreover, most IIAs provide for the mechanism for settlement of disputes directly between foreign investors and host states. International investment arbitration serves as a tool to resolve legal disputes between foreign investors and host states. The tribunal rules whether the host state fulfilled its international and national law obligations and establishes the right of the claimant, most of the time the investor, to resort to arbitration and benefit from the protection under the treaty.

Parties to an IIA are often reluctant to submit to the jurisdiction of the other party’s home courts. The mutual unwillingness to risk having a dispute decided by a court that is believed to be more sympathetic to the other party’s interest is usually the main reason parties agree to submit future disputes to arbitration.

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18 DE ALBA M., supra.
22 According to the UNCTAD report, as of February 2015, the total number of international investment agreements was 3,268. UNCTAD, Recent Trends in IIAs and ISDS, IIA Issue Note No. 1, 2015 (UNCTAD/WEB/DIAE/PBC/2015/1), 19 February 2015.
disputes to arbitration. Arbitral jurisdiction is generally based on an offer of consent to arbitration made by the states parties to the treaty. That offer may be accepted by nationals of another state party to the treaty, usually simply by starting arbitration proceedings. With regard to the applicable law, investment treaties typically contain provisions on the law to be applied by investment tribunal. Some of these provisions are narrowly framed, referring only to the treaty and to general international law. More often, provisions are wider and cover also the host state law. Thus, usually, arbitration takes places on a background of parallel application of both the domestic law of the host state and the international legal system (including the provisions of the IIA and rules of general international law).

3.1 ‘Unclean Hands’ as a Prospective Defense Strategy against Investor's Unlawful Acts

The reasoning behind the clean hands defense in investment treaty arbitration is that the lawfulness of the investor’s investment is a condition precedent for the arbitral tribunal to grant compensatory justice. When a state faces a claim by an investor, the former will likely employ all available legal arguments to avoid its liability which, in turn, would lead to an obligation to compensate. Thus, by invoking the clean hands defense, the host state aims at precluding the claimant’s claim to go further. The defense has been proven, in fact, to be an effective argument to convince the tribunal that the investor should not be granted protection. In fact, if the doctrine is positively established, the consequence will likely be that the tribunal will declare, sic et simpliciter and depending on the premises (infra 3.1.2), its lack of jurisdiction or the inadmissibility of the claim or, at least, it will

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31 Mytilineos Holdings SA v Serbia and Montenegro and Serbia, UNCITRAL, Partial Award on Jurisdiction, (September 8, 2006); Perestroika Sailing Maritime Services GmbH and Others v Ukraine, ICSID Case No. ARB/8/08, Decision on Jurisdiction, (March 8, 2010); Tokios Tokelés v Ukraine, ICSID Case No. ARB/02/18, Decision on jurisdiction (April 29, 2004); Incesya Vallesoletana S.L. v Republic of El Salvador, ibid; Phoenix Action Ltd. V Republic of Bulgaria, ibid; Fraport AG Frankfurt Airport Services Worldwide v Philippines, ibid.
33 DE ALBA M., ibid.
assess the defense at the merits phase where the clean hands doctrine can ultimately serve as a mechanism at disposal of arbitrators to limit the amount of compensation in favor of the investor.\(^{35}\)

No matter how despicable a host state’s conduct might have been, the fact that an investor is involved in unlawful actions related to the treaty protected investment has been, so far, of significant relevance for the investor’s chance to fully access investment protection.\(^{36}\) The host states have identified the clean hands defense as an opportunity to escape expensive investment disputes since arbitrators tend not to consider \textit{tout court} the host state involvement or acquiescence in the investor’s unlawful act, limiting their assessment to the investor’s behavior.\(^{37}\) Thus, it is not unexpected that investor’s unlawful acts have emerged as a potentially viable state defense in the investment arbitration context.\(^{38}\) However, following the present approach, the clean hands defense risk to be distort in its meaning and to be employed unfairly, contrary to its own very aim to provide equitable solutions. In fact, assessing the defense at the preliminary phase of the dispute does not allow the arbitrators to have a fully knowledge of the relevant facts.

3.1.1. Scenarios

According to the arbitral case law, not every illegality perpetrated by the investor should lead to a rejection of international protection in favor of the investor under the clean hands doctrine.\(^{39}\) In fact, there are some requirements that must be fulfilled for the arbitral tribunal to consider the applicability of the doctrine at hand: first, the unclean hands of the investor must concern the very matter for which the investor seeks relief;\(^{40}\) secondly, the violation should not be a technical or a \textit{de minimis} violation\(^{41}\) and lastly, the scenarios under which tribunals have found that the clean hands doctrine could be applied include cases under which the investor has been involved in acts of corruption, fraud or misrepresentation or deliberate violations of legal provisions of the host state.\(^{42}\) However, it is worth briefly shedding a light on such unlawful acts in the context of IIAs.

\(^{35}\) \textit{Halley Enterprises (Cyprus) Limited, Yukos Universal Limited (Isle of Man) and Veteran Petroleum Limited (Cyprus) v Russian Federation}, ibid, paras. 435, 492, 436.


\(^{38}\) Ibid, 723, 742.


\(^{40}\) \textit{Martin E.}, \textit{A Dictionary of Law}, 3rd ed., 1994 (“a person who makes a claim in equity must be free from any taint of fraud with respect to that claim. For example, a person seeking to enforce an agreement must not himself be in breach of it”). See also, \textit{Yackee J. W.}, ibid.

\(^{41}\) \textit{Tokios Tokeléś v Ukraine}, ibid, 86.

3.1.1.1. Corruption

Corruption refers to any transfer of something of value, including money, to a public official, for his benefit, so that he acts in contrast or refrain from acting in conformity of his official duties. The vast majority of legal systems around the world have recognized the prohibition of corruption as an essential rule and have improved and amended national and international laws regarding corruption.

Arbitral tribunals have applied the clean hands doctrine where the investor is found guilty of corruption, even to the point of allowing a host state to escape liability for expropriating a contract obtained through corruption. Investment tribunals have accepted the principle that they cannot provide treaty protection where an investment is tainted by corruption on the basis that corrupt acts are not in compliance with national laws as well as with international law and transnational public policy.

Metal-Tech v The Republic of Uzbekistan is the paradigmatic investment treaty dispute that had been dismissed due to corruption considerations by an investment tribunal. The tribunal held that the investor’s payments of nearly US$ 4 million to a group of individuals, including an Uzbek public official and the brother of Uzbekistan then-prime minister, while presented as payment for alleged consultancy fees in the entry-stage of the investment, constituted, in fact, corruption and breached a requirement, contained in the relevant Israeli-Uzbekistan BIT, that investments shall be made “in accordance with the (Uzbek) law” that prohibits corruption. As a result of the interpretation of the BIT, Uzbek law and the ICSID Convention, according to Articles 31-32 of the Vienna Convention...

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48 Ibid.
49 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSIID Convention), done at Washington on 18 March 1965, (entered into force 14 Oct. 1996), Art. 42(1), 575 UNTS 159, Article 25(1): “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (…) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.”
on the Law of the Treaties (1969)\textsuperscript{50}, and on the basis of the evidences presented, the tribunal declared that it lacked jurisdiction to hear the dispute\textsuperscript{51}. Metal-Tech pointed out that where the contract has been tainted by corruption, recovery may no longer be available to an investor under a BIT in investment treaty arbitration\textsuperscript{52}.

3.1.1.2. Fraud and misrepresentation

Fraud can be defined as a “knowing misrepresentation of the truth or concealment of a material fact (by an investor) to induce the state to act in a manner that is detrimental to its interests”\textsuperscript{53}.

Although a prohibition on fraud has not been as widely recognized as in the case of corruption, there are some arbitral cases where an investor has been barred from seeking relief before a tribunal due to fraud concerns\textsuperscript{54}. The rationale behind this determination is that the State would never had approved the investment if it would have known the real facts misrepresented by the investor\textsuperscript{55}.

For instance, in \textit{Plama v Bulgaria}\textsuperscript{56}, the ICSID tribunal concluded that the investor has engaged in “deliberate concealment amounting to fraud, calculated to induce Bulgarian authorities to authorize the transfer of shares to an entity that did not have the financial and managerial capabilities required”\textsuperscript{57}. Additionally, the tribunal held that granting the ECT protection “to the claimant’s investment would have been contrary to the basic notions of international public policy – that a contract obtained by wrongful means (fraudulent misrepresentation) should not be enforced by a tribunal”\textsuperscript{58}, on the basis of the maxim \textit{nemo auditor propriam turpitudinem allegans} (no one can be heard to invoke his own turpitude)\textsuperscript{59}. The tribunal added that the ECT should be interpreted according to the aim of encouraging respect for the rule of law, meaning that it cannot apply to investments made not in compliance with the law\textsuperscript{60}.

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\textsuperscript{51} The tribunal based its decision to decline jurisdiction on the Uzbekistan’s lack of consent to refer the dispute to arbitration. In fact, such consent, under Article 8(1) of the Israeli-Uzbekistan BIT was limited to disputes “concerning an investment”, which Article 1(1) of the BIT itself defined as “any kind of assets, implemented \textit{in accordance with the laws} and regulations of the Contracting Party in whose territory the investment is made”. Accordingly, the tribunal concluded that Metal-Tech’s claim under the BIT did not meet the consent requirement set out in Article 25(1) of the ICSID Convention.
\textsuperscript{53} Incesya Vallesoletana, ibid, 102-128.
\textsuperscript{54} Incesya Vallisoletana v Republic of El Salvador, ibid,143.
\textsuperscript{55} Ibid, 102-128.
\textsuperscript{56} Plama Consortium Limited v Bulgaria, ibid.
\textsuperscript{57} Ibid, 135.
\textsuperscript{58} Ibid, 143.
\textsuperscript{59} Ibid, 136-138.
\textsuperscript{60} Ibid, 138-140.
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Likewise, in *Incesya v El Salvador*, the ICSID tribunal held that the investor had made fraudulent misrepresentation and non-disclosures during a public bid for a concession to mechanical inspection services for vehicles in El Salvador\(^{61}\). The tribunal concluded for the deceitful intent of the investor, finding that Incesya had falsely and “deliberately” made the host state believe that its strategic partner was a large public entity with notably background, while it was not\(^{62}\). The tribunal concluded that such conduct had led the host state to award the bid to Incesya\(^{63}\) and declared its lack of jurisdiction to hear the case “since its investment cannot benefit from the protection of the BIT”\(^{64}\). The Incesya tribunal attributed fraud to the maxim *nemo auditor propriam turpitudinem allegans* and to the maxim *ex dolo malo non oritur action* (an action does not arise from fraud)\(^{65}\).

Thus, when a tribunal determines that an investor procured the contract through fraudulent means, this behavior constitutes a sufficient ground to deny protection to the investor\(^{66}\).

### 3.1.1.3. Deliberate Violation of Legal Provisions

A deliberate violation of fundamental legal provisions of the host state has also been recognized by several tribunals to constitute sufficient grounds for the application of the clean hands doctrine\(^{67}\). Illegality may encompass forms of transgressions of host state laws and regulation regarding the admission of foreign investment. For example, prohibition against foreign investors acquiring a particular category of investments, such as public utilities. Alternatively, investments which are otherwise lawful (e.g. shareholding) may have been obtained through illegal means\(^{68}\).

For instance, in *Fraport v Philippines*, the tribunal was provided with evidence of the fact that a secret shareholder’s agreement took place between the investor and its local partner that gave the former managerial control over the joint venture company which secured a concession aimed at building and operating a new terminal at Manila Ninoi Aquino International Airport\(^{69}\). In this case, the emphasis was put in analyzing whether the breach of the host state’s law was indeed deliberate. That is, if the investor was aware that its course of action clearly contravened the legal order of the state where it was making its investment, yet decided to move forward with the illegal action\(^{70}\). The tribunal held that the investor was aware of the fact that under Philippines law, foreign citizens were prohibited

\(^{61}\) *Incesya Vallisoletana v Republic of El Salvador*, ibid, 236.
\(^{62}\) Ibid, 112.
\(^{63}\) Ibid, 118, 123.
\(^{64}\) Ibid, 239.
\(^{65}\) Ibid, 242.
\(^{66}\) See also *Phoenix Action Ltd. v Republic of Bulgaria*, ibid.
\(^{67}\) E.g. *Fraport Ag Frankfurt Airport Services Worldwide v Philippines*, ibid.
\(^{68}\) Ibid.
\(^{69}\) Ibid.
\(^{70}\) DE ALBA M., ibid, 329.
from intervening in the management, operation or control of public utility companies. Thus, given that Fraport decided to secretly arrange management and control of the project in a way it knew was not in accordance with Philippine law, it lost its right to have such investment protected under the Germany-Philippines BIT.

3.1.2 The Legality Requirement

The legality of the investment (rectius the investor’s ‘clean hands’) in investment arbitration has been treated by arbitrators as a requirement for the conferral of adjudicative power upon the tribunal. The plea of illegality, depending on which ground it is sustained, can be considered a question of jurisdiction or of admissibility or it can be left to assessment on the merits phase, meaning that the consideration of the legality requirement depends upon the language of the relevant IIA. In fact, many investment treaties contain a provision according to which an investor, to be granted protection under the treaty itself, must act ‘in accordance with the host state law’ in the establishment and in the development of his investment. Most of arbitrators and authors confirm that where such a provision is contained in the relevant treaty, it operates as a limit on the host state’s consent to arbitrate and thereby is a condition for jurisdiction. The purpose of any ‘in accordance with the law’ clause, in fact, is to prevent the BIT from protecting investments that should not be protected because they would be illegal.

On the other hand, there are some investment treaties that do not contain an express legality provision. When parties do not explicitly agree to exclude investments that are not made in compliance with the laws of the host state, precluding jurisdiction would result in a limitation not intended by the treaty itself. However, even if there is not express wording qualifying the scope of the host state consent, a legality requirement can nonetheless be found by inference. The most common interpretation is that, in the case where an ‘in accordance with the law’ provision cannot be found in the investment treaty, the breaches of host state laws perpetrated by the investor, whether at the inception of the investment or subsequently, is not a jurisdictional matter. Rather, it is a matter, which, in the light of

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71 Ibid, 327.
72 Ibid, 401.
73 See LLAMAZON A., SINCLAIR A., ibid, 451-530. See also Hulley Enterprises (Cyprus) Ltd., Yukos Universal Ltd. (Isle of Man) and Veteran Petroleum Ltd. (Cyprus) v Russian Federation, ibid, para 1352.
75 SCHILL S., Illegal Investments in International International Arbitration, ibid.
76 SORNARAJAH M., The International Law on Foreign Investment, ibid, 106; BOTTINI G., Legality and Investments Under ICSID Jurisprudence, ibid, 297; MILES C. A., Corruption, Jurisdiction and Admissibility in International Investment Claims, ibid, 347.
78 Phoenix Action Ltd. v Republic of Bulgaria, ibid, 136-143.
the circumstances of the case, might lead to a declaration of inadmissibility of the claim or present the host state with a possible defense to allegation of treaty breach in the merit phase\textsuperscript{79}.

3.1.2.1 The Jurisdictional Approach to the Plea of Illegality

The legality requirement can be set through the explicit provision contained in some BITs that limit the treaty’s protections to investments made ‘in accordance’ with domestic laws of the host state\textsuperscript{80}. If such an ‘in accordance with the law’ clause is placed in the relevant treaty, it has been understood to imply that investments made in violation of national laws are not covered by the treaty\textsuperscript{81}. The rationale is that an investment made in contravention of the host state law does not qualify as an investment under the definition of the BIT. Thus, if the treaty contains an explicit legality requirement, the tribunals have frequently determined that the investments procured by ‘unclean hands’ fall outside the scope of the investment treaty itself and thus dismissed claims on a jurisdictional basis\textsuperscript{82}. In other words, when such a requirement is included in the relevant BIT and the investor did not act in conformity of the host state law, tribunals have decided that they lack jurisdiction rationae materiae to hear the dispute\textsuperscript{83}.

For instance, in \textit{Incesya v El Salvador} the tribunal found that the investor had fraudulently misrepresented itself in a bidding process in order to obtain the government contract by providing false documents\textsuperscript{84}. The \textit{Incesya} tribunal held that on the grounds of the language of the El Salvador-Spain BIT and its travaux préparatoires, “the will of the parties to the BIT was to exclude from the scope of application and protection of the agreement disputes originating from investments which were not made in accordance with the laws of the host state”\textsuperscript{85}. In other words, the tribunal determined that it lacked jurisdiction over the dispute because Incesya investment did not meet the BIT’s requirement of legality\textsuperscript{86}. According to this approach, the lawfulness of the acquisition of the

\textsuperscript{79} \textit{Plama Consortium Limited v Bulgaria}, ibid, 143.

\textsuperscript{80} E.g. Article 1, Agreement between the Government of Canada and the Government of the Republic of Argentina for the Promotion of Investments (1993), available at https://investmentpolicyhub.unctad.org/Download/TreatyFile/77.\textsuperscript{80}

\textsuperscript{81} \textit{Tokios Tokelés v Ukraine}, ibid, 86 quoted in \textit{Mytilineos v Serbia and Serbia and Montenegro} to dismiss a jurisdictional objection based on the lack of required registration on the relevant investment agreements as such; \textit{Mytilineos v Serbia and Serbia and Montenegro}, ibid,151; \textit{Alpha Projektholding Gmbh v Ukraine}, ICSID Case No. ARB/07/16, Award (November 8, 2010), 294; \textit{Inmaris Perestroika Sailing Maritime Services Gmbh and Others v Ukraine}, ibid, para 145. See also, DOLZER R., SCHREUER C., \textit{Principles of International Investment Law}, 2nd ed., Oxford, Oxford University Press, 2012, 51-52.\textsuperscript{82}


\textsuperscript{83} DOUGLAS Z., \textit{The Plea of Illegality in Investment Treaty Arbitration}, ibid, 177-186.

\textsuperscript{84} \textit{Incesya Vallesoletana S.L. v Republic of El Salvador}, ibid, 236 (omissis).

\textsuperscript{85} \textit{Incesya Vallisoletana v Republic of El Salvador}, ibid, 195.

\textsuperscript{86} Ibid, 335.
investment should be considered as a condition precedent for the investment treaty’s conferral of adjudicative power upon the tribunal.

Nonetheless, a limitation upon the host state’s consent to arbitration should not be implied in respect of investments that have been acquired in contravention of the host state law. The host state’s consent to international arbitration is, of course, a condition precedent for the tribunal’s jurisdiction. But, for jurisdictional purposes it is sufficient that the claimant has acquired an asset that is cognizable by the law of the host state as a property rights and the circumstances surrounding the acquisition satisfies the financial and economic characteristic of an investment. Only if the asset is not recognized under the host state’s laws then there is no investment. Thus, where the financial and economic characteristics of the investment have been fulfilled, the ‘unclean hands’ of the investor in the acquisition or development of the investment do not compromise the existence of the investment itself which remains, in fact, an investment even if it is not legal. Thus, the legality of the investment could not be treated as an issue relevant to the tribunal’s jurisdiction but must be consider as a question of admissibility or, rather, a question on the merit stage.

3.2.1.2 The Admissibility Approach to the Plea of Illegality

Absent an explicit ‘in accordance with the host state law’ treaty clause, some arbitral tribunals have inferred an implicit requirement parallel to that legality provision. However, where the ‘in accordance with the law’ clause is not expressed, the denial of protection to the investment has been treated by arbitrators as a question of admissibility, rather than a jurisdictional matter. In fact, if a legality clause is not mentioned in the relevant treaty, it means that parties did not explicitly agree to exclude investments that are not made in compliance with the laws of the host state from the treaty’s protection. Thus, precluding jurisdiction would result in a limitation not intended by the treaty itself.

While jurisdiction is about the scope of the state’s consent to arbitrate, admissibility is about whether the particular claim, as presented, can or should be resolved by an international tribunal, which otherwise has found jurisdiction. Inadmissibility of claims allows international courts or tribunals, having assumed jurisdiction over an international claim, to refuse exercising that jurisdiction. Absent the legality requirement, tribunals have considered that the investor’s ‘unclean hands’ do not

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88 In Yaung Chi Oo Trading Pte. Ltd. v Government of the Union Myanmar, ASEAN Case No. ARB/01/01, Award (March 31, 2003), 58, Phoenix Action Ltd. v Czech Republic, 101 and Gustaf F. W. Hamester Gmb Hamp Co. KG v Republic of Ghana, ICSID Case No. ARB/07/24, Award, (June 18, 2010) (omissis).
vitiates the consent to arbitrate the dispute but rather provided a basis capable to exclude the claim on

ground of inadmissibility.\(^{92}\)

For instance, the *Plama* tribunal held that even if the ECT does not contain a provision requiring the

conformity of the investment with a particular law, it does not mean that the treaty covers also the

investments made contrary to domestic or international law since the treaty’s aims was the

strengthening of the rule of law on energy issues.\(^{93}\) Thus, the tribunal concluded that recognizing the

ECT’s protections to *Plama*’s investment would have been contrary to the principle *nemo audito

propriam turpitudinem allegans*.\(^{94}\) Nonetheless, the consequences of breaching the host state law in

*Plama* turned different from the conclusions where the relevant treaty contains an ‘in accordance with

the host state law’ clause. In fact, the tribunal stated that the investor’s misrepresentation did not

vitiates the consent to arbitrate the dispute but rather provided a basis capable to exclude the claim on

ground of inadmissibility.\(^{95}\)

Where there are events or circumstances tainted by some sort of internationally recognized illegality

or incompatibility with international public policy, such a finding typically involves a determination

of whether the making of the investment in question or the circumstances out of which the claim

arises were so tainted. Even if the admissibility approach could appear, *prima facie*, correct in order

to treat the investor’s ‘unclean hands’, there is no need to make any inquiry into whether a certain

objection concerns the ‘admissibility’ of a claim.\(^{96}\) As the making of such determination is often

closely linked to the merits of the case, preliminary objections to inadmissibility are frequently

joined to the merits. Thus, if admissibility is discussed at all, it must proceed further to a decision on

jurisdiction or a finding that the admissibility objection in relevant for the merit where the tribunal

can have a full knowledge of facts related thereto.

3.2 Host State’s Acquiescence or Involvement in Investor’s Unlawful Conduct

According to the arbitral approach discussed above, if the clean hands defense is successfully raised

at the preliminary phase of the dispute - as a matter of jurisdiction or admissibility -, the host states

will escape the arbitral proceedings and consequent findings of liability. However, it shall be noted

that there are certain circumstances where the host state should be precluded from raising the legality

defense, at least at the preliminary stage of the proceeding.\(^{97}\) Namely when the host state is involved

\(^{92}\) Ibid, 135, 138-140, 146.

\(^{93}\) *Plama Consortium Ltd. v Bulgaria*, ibid, 138.

\(^{94}\) Ibid, 143.

\(^{95}\) Ibid, 135, 138-140, 146. See also, *MOLOO R., KHACHATURIAN A.*, *The Compliance with the Law Requirement in International Investment Law*, ibid, 1490.


\(^{97}\) *MOLOO R., KHACHATURIAN A.*, *The Compliance with the Law Requirement*, ibid, 1497.
or acquiescent to the unlawful conduct committed by the investor. Thus, if a tribunal finds that the host state has been involved or acquiesced to the alleged unlawful conduct perpetrated by the investor, there are sufficient legal grounds to bypass the application of the ‘clean hands doctrine’ as a matter of arbitrability, otherwise the ultimate purpose of the clean hands defense – the preservation of the integrity of the court – would be frustrated. In fact, following the current arbitral approach, arbitrators, by focusing only on the investor’s unlawful conduct, would exclude any consideration of the host state contribution to the ‘unclean hands’ of the investor. This approach frustrates the ultimate purpose of the clean hands doctrine itself, that is, in short, to ensure a fair award.

In the light of the above, we can discuss two hypothesis where the host state role should be taken into consideration by the tribunal: first, the state’s involvement in the commission of the investor’s unlawful act through the actions of its official; second, the state’s awareness of the illegal actions of the investor where the state itself does not take any action to confront the investor’s misconduct.

The first hypothesis, where the arbitral tribunal should assess the role of the host state, arises where governmental authorities have been corrupted. In fact, the state’s officials, acting under the cape of governmental authority, could have led the investor to believe that its conduct was lawful or necessary for the purpose of establishing or further developing the investment. Under Article 7 of the Articles on State Responsibility for International Wrongful Acts, states may be held responsible for the ultra vires acts of their officials. It makes it clear that the conduct of a state organ or entity empowered to exercise elements of governmental authority, acting in its official capacity, is attributable to the state even if the organ or entity acted in excess of authority or contrary to instructions. One form of ultra vires conduct, covered by Article 7, would be for a state official to accept a bribe to perform some act or to avoid its duties. Thus, the state should be estopped from invoking the investor’s unlawful conduct, for the purposes of trying to deny protection to the investment, since the host state had mislead the investor by behaving as it did agree with the alleged unlawful conduct. In short, this leads to the application of the general principle of international law known as estoppel, meaning that a party is not allowed to benefit from its own contradictions. Thus, if the state is aware of the illegality but, nonetheless, endorse the investment, it should be estopped from raising that illegality.

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100 Opinion of the Spanish Governments given in 1898 at the request of Italy in respect of a dispute with Peru, Archivio del Ministero degli Affari esteri italiano, P. No. 43, (“If this were not the case, one would end by authorizing abuse, for in most cases there would be no practical way of proving that the agent had or had not acted on orders received”).
102 Temple of Preah Vihear (Cambodia v Thailand), Merits, 1962, ICJ Reports 101, 143-144 (omissis).
before the tribunal. Moreover, the failure or reluctance of the host state to prosecute or punish its corrupt officials should play a significant role in arbitral decisions and arbitrators should not allow the host state to profit from its own violation of international law.

Only by addressing the clean hands defense at the merit stage the arbitral tribunal is capable to evaluate the conduct of both parties and to balance their role in the commission on the unlawful conduct, having a full understanding of the relevant facts. In so doing, the consequences of findings of corruption will not come down heavily only on the investors while exonerating in toto the host states that have, as well, through the conduct of their public officials, took part in the corrupt scheme. For instance, in Kardassopoulos v Georgia, the state argued that the tribunal did not have jurisdiction rationae materiae under the ECT provisions and the relevant BIT, because a joint venture agreement and a concession between the investor and two state-owned enterprises were void under Georgian law. However, claimants contended that representations made by the state-owned companies created a legitimate expectation regarding the validity of the joint venture agreement and the concession. The claimant relied on the wording of Article 2.1 of the joint venture agreement provided that it was established “in accordance with the provisions of the legislation for joint ventures”. More importantly, were the assurances given to the investor regarding the validity for the joint venture agreement and the concession, endorsed by most senior government officials, who were also involved in the negotiation process. As result, the tribunal held that Georgia’s position was unsustainable; it applied the principle of attribution and relied on the fact that Article 7 of the Articles of State Responsibility stipulates that “even in cases where an entity empowered to exercise governmental authority acts ultra vires, the conduct in question is nevertheless attributable to the state”. Such conclusion was confirmed by the Fraport tribunal, which held that fairness requires a tribunal to hold a government estopped from raising violations of its own law as a jurisdictional defense when the state itself knowingly overlooked them and endorsed an investment not in compliance with its laws. Therefore, a state should be prevented from invoking unlawful conduct

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103 Fraport Ag Frankfurt Airport Services Worldwide v Philippines, supra, 346.
104 HABAZIN M., supra.
105 According to ILC Articles, Commentaries, 2001, available at http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf because an official of the state is, by definition, complicit in the corrupt activity, the corruption itself should be attributed to the state under Article 7 of the ILC Articles on State Responsibility.
106 Ioannis Kardassopoulos v The Republic of Georgia, ICSID Case No. ARB/05/18, Decision on Jurisdiction, (July 6, 2007), 191.
107 Ibid, 185.
108 Ibid.
110 Ibid, 190.
111 Ibid.
112 Fraport Ag Frankfurt Airport Services Worldwide v Philippines, ibid, 346.
committed by the investor when the state itself, through its representatives, has been involved in the commission of such conduct\textsuperscript{113}.

The second hypothesis where the tribunal should assess the state’s role in the commission of the investor’s unlawful act is when a state is aware – or should be aware- of the unlawful act committed solely by the investor but has not taken any actions to confront them\textsuperscript{114}. The silence or lack of protest maintained over a significant period of time, may be treated as tacit recognition or acquiescence in the position taken by the other party\textsuperscript{115}. However, for the silence to constitute acquiescence, the state must have had knowledge of the facts against which it refrained from making a protest or acting\textsuperscript{116}.

Several investment arbitration tribunals have recognized the possibility of a state acquiescing to unlawful conduct. For instance, in \textit{Tokios Tokelés v Ukraine}, the tribunal acknowledged that Ukraine had registered Tokios Tokelés subsidiary as a valid enterprise and endorsed each of such company’s investments in Ukraine, as demonstrated by official documents\textsuperscript{117}. Ukraine tried to argue that such investments could not be protected since they were made in contravention to Ukraine law\textsuperscript{118} but the tribunal held that, even assuming that Ukraine’s allegations were true, the fact that such investments were duly registered and the relevant governmental entity never invoked any defects, clearly indicated that Tokios Tokelés had made an investment in accordance the laws and regulations of Ukraine\textsuperscript{119}.

Even more on point is the decision in \textit{Tecmed v Mexico}, where the tribunal rejected Mexico’s argument on some alleged irregularities committed by the investor in the operation of a waste disposal facility\textsuperscript{120}. The tribunal took into special consideration the fact that the environmental authorities were aware of such infringements but did not inform the investor that the irregularities might jeopardize the renewal of the relevant permit\textsuperscript{121}. Moreover, the investor was never sanctioned for such irregularities by the Mexican authorities\textsuperscript{122}. Thus, the tribunal held that those violations of the environmental regulations could not be a justification for denying a renewal of a permit\textsuperscript{123}. Moreover,


\textsuperscript{114} \textit{De Alba M.}, ibid, 333.


\textsuperscript{117} \textit{Tokios Tokelés v Ukraine}, ibid, 86.

\textsuperscript{118} Ibid, 83.

\textsuperscript{119} Ibid, 86.

\textsuperscript{120} \textit{Técnicas Medioambientales Tecmed, S.A. v The United Mexican States}, ICSID Case No. ARB(AF)/00/2, Award (May 29, 2003), 151.

\textsuperscript{121} Ibid.

\textsuperscript{122} Ibid.

\textsuperscript{123} Ibid.
in Desert Line v Yemen, Yemen argued that the tribunal did not have jurisdiction *ratione materiae* since the Yemen General Investment Authority never issued the required investment certificate to the investor. Nevertheless, the tribunal found that the lack of investment certificate could not be raised by Yemen in order to deny the jurisdiction of the tribunal. This was because the investment enjoyed general endorsement from the highest levels of authorities of the Government and a Yemeni Vice Prime Minister even had extended certain benefits to Desert Line’s investment pursuant to the Yemeni Investment Law. The tribunal held that such state had waived the certificate requirement and could not rely on the lack of such certificate for the purpose of denying jurisdiction.

The decisions referred above allow to conclude that if a state knowingly overlooks a failure to comply with its laws or endorse an investment tainted by corruption, such violations, perpetrated by the investor, could not serve as sufficient grounds to deny the arbitral tribunal jurisdiction or to render the claim inadmissible but should be rather assessed at the merit phase where the arbitral tribunal can have a full knowledge of the relevant facts, taking into consideration also the role of the host state in the commission of the illegality.

4. The Clean Hands Doctrine as a Question of Substantive Law that should be Addressed at the Merit Stage

As emerges from the above paragraphs, the traditional approach which leads to the application of the clean hands defense as a matter of jurisdiction or admissibility (depending on the treaty language), should be overtaken at least in cases where the host state is involved or acquiescent to the investor’s unlawful conduct. Otherwise the host state’s contribution to the investor’s unlawful conduct won’t be a matter of discussion. The clean hands doctrine should be rather treated as an issue of substantive law and employed, if appropriate, at the stage of the consideration of merits. It should be noted however, that international tribunals are still reluctant to apply the clean hands doctrine at the stage of consideration of merits.

The clean hands doctrine is indeed very close, if not similar, to the principle of good faith, which is an established general principle of substantive law, and to the rule prohibiting one from benefiting from his/her own wrongful conduct, which is also considered by some scholars to be a general

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124 Desert Line Project LLC v Republic of Yemen, ibid, 92.
125 Ibid, 117.
126 Ibid, 119.
127 Ibid, 121.
128 Inmaris Perestroika Sailing Maritime Services Gmbh and Others v Ukraine, ibid, 140.
principle of law. Oral and written pleadings of some states before international tribunals create an impression that parties often use the term ‘clean hands’ as a substitute for the term ‘good faith’.

Good faith is a general principle of law that is assessed by courts and tribunals at the merit phase, where the parties’ conducts are balanced and assessed on the basis of a fully knowledge of the relevant facts.

In the writers’ opinion, the position that the clean hands doctrine is a question of arbitrability is incorrect since the clean hands defense should be treated, as the good faith principle, as a question of substantive law, not a procedural one. It may be raised and treated during the consideration of merits by an examination on a case-by-case basis. In fact, addressing such objection at the merit stage would enable the tribunal to obtain a clear understanding of some aspects of the preliminary objection and a full knowledge of facts related thereto.

The same perspective can be traced in the reasoning of the International Court of Justice (hereinafter ICJ) in the Case Concerning Oil Platform. In the Counter-Memorial and Counter-Claim submitted by the United States on June 23, 1997 the United States raised the doctrine of clean hands as a preliminary objection. The Court rejected the position and underlined that the clean hands doctrine was of substantive character. Applying the ICJ approach to investment arbitration would have positive effects on the fairness of the system; in fact, when the clean hands doctrine is applied at the merit stage, it gives adequate legal consideration to both parties’ arguments and possibly precluding claimants from obtaining compensatory justice due to absence of clean hands in its part.

5. Conclusion

As demonstrated by the arbitral case law taken into consideration in the present contribution, the investor’s clean hands have been regarded by arbitral tribunals as a preliminary condition to grant compensatory justice to the investor in cases where he seeks relief for alleged violation perpetrated by the host state with regard to the relevant investment treaty. Thus, the host states have identified in

133 LAUTERPACHT H., The Development of International Law by the International Court, ibid.
134 Case Concerning Oil Platform (Iran v U.S.), 2003, ICJ 1, 29-30 (Nov. 5).
135 Case Concerning Oil Platform (Iran v U.S.), ibid, 29.
the unclean hands defense an opportunity to wriggle out of costly investment disputes and to avoid any responsibility for their own violations of the relevant investment treaty.

However, the perspective that this article embraces is that the host states should not have an unlimited right to successfully raise the clean hands doctrine (as a jurisdictional or admissibility issue), following an investor’s failure to comply with the host state’s law or with the international law, since this provides an unfair advantage to the host states. In fact, they have been, so far, capable to avoid any responsibility even if they were involved or acquiescent in the investor’s unlawful action. It appears unfair – and contrary to the ultimate purpose of the clean hands doctrine as an equity principle – to permit the host state to tolerate or endorse the investor’s unlawful conduct nevertheless complains about its acquisition as soon as the investor itself initiate arbitral proceedings.

Even if to date nobody seems to dispute that the establishment and development of an investment presupposes the obligation for the investor to comply with the laws and regulations of the host state136, on one hand, there may be cases where the host state itself, through the actions of its agents, is actually involved in the infringement of the domestic or international law. On the other hand, the governmental authorities may remain acquiescent and not contest the violations perpetrated by the investor until the investor itself brings the matter before an arbitral tribunal, raising the clean hands defense eventually just to escape potential liability. Based on the estoppel principle, if the host state is involved through the actions of its agents, in the commission of the unlawful act - especially in those cases where the clean hands doctrine serves to contrast the corruption perpetrated by the investor - it should not be able to benefit from it. In fact, according to the customary rules on state responsibility for internationally wrongful acts as codified in the Articles drafted by the ILC, the actions of a governmental authority can be per se referred to the host state, even if the agent acted ultra vires. Nonetheless, according to the acquiescence principle - in cases other than corruption - a state should also not be able to fully successfully invoke the clean hands doctrine if it knew or should have known the unlawful act perpetrated by the investor but did not protest or prosecute its commission within its own legal order. In fact, the rule of law precludes a state to contest an investor unlawful conduct after having tolerating (rectius acquiescent) the same conduct for a relevant amount of time, giving the investor the feeling that he was acting in conformity with the law.

Arbitral tribunals should therefore distance themselves from that case law that completely denies reparation to investors with unclean hands since such a path would continue to unfairly guarantee immunity to the host states which, in turn, would not be encouraged to prosecute recognized

violations of the international legal order. Instead, the investment treaty arbitration system would benefit if the investment tribunals would consider the ‘unclean hands’ of the investors not as a jurisdictional or admissibility issue, but rather as substantive issue that must be assessed at the merit phase. In fact, following this approach, the investor's responsibility could be correctly assessed and balanced with respect to the involvement or acquiescence of the state. Thus, the investor and the host state would be encouraged to, respectively, comply with the laws and enhance its respect at a national and international level.

The practical outcome would be that the negative consequences of the violation of the domestic or international law would not come down heavily only on the investor but they will be also sustained by the host state which, in turn, will be encouraged to take actions against any infringement of the laws, guaranteeing the international legal order. The tribunal may rightly consider appropriate for the parties to share – at least - financial responsibility for the arbitration proceedings. In this way, the respect of the rule of law is also assured, giving to the investor the security condition he needs to establish and develop an investment in a foreign country.