why soft law corporate responsibility initiatives cannot find an equally hospitable home in international investment law. Not only do these initiatives provide nuance to interpretive questions on IIA obligations, but they may also help international investment law adapt to the changed circumstances of the increasingly powerful multinational corporation without having to change the IIA's legal rules.

In any case, several *amicus curiae* and states have already included these initiatives within their pleadings, suggesting an increasing reliance on their use.[114] Certainly, if future tribunals rely on the *Urbaser* judgment, soft law corporate responsibility initiatives are primed to join the already well stocked soft law toolkit of international investment law.

V. Conclusion

At the international level, the corporate responsibility to respect human rights is well established in soft law. The corporate responsibility to minimise environmental impact is also slowly becoming an established norm. In light of these international expectations of corporations, it is unreasonable to assume that international investment law is immune to these developments.

Regardless of whether states have included references to the UNGPs or CSR in their IIAs, the norm of the corporate responsibility to respect human rights, and to a lesser extent, corporate responsibilities to the environment, operate as normative background, influencing the expectations society has of corporations, even when they act as foreign investors.

In an age where international investment law continues to face criticisms about its lack of legitimacy, public participation and democratic deficits, it cannot be immune to societal expectations of corporations. Rather, international investment law must allow these norms to enter the IIA sphere, preferably via party submissions, and arbitrators must interpret obligations owed to investors in light of these norms. Of course, this does not suggest that soft law CSR norms should be used to trump state obligations to investors, since they remain soft law compared to the hard law of IIAs. Rather, the purpose of recognising the corporate responsibility to respect human rights and to minimise impacts on the environment is simply to ensure that IIAs cannot, indirectly, contribute to the long history of corporate harms to human rights and the environment.

[114] See, for example, *Bear Creek Mining v Peru*, ISCID Case No ARB/14/21, Amicus Curiae Brief Submitted By The Association Of Human Rights and the Environment-Puno and Mr Carlos Lopez (9 June 2016); *Glamis Gold v United States Of America*, Submission of the Quechan Indian Nation (16 October 2006) 13; *South American Silver v Bolivia*, UNCITRAL, PCA Case No 2013-15, Respondent Counter-Memorial (31 March 2015) para 220; *Mobil Investments v Canada*, ICSID Case No ARB(AF)/07/4, Canada's Counter-memorial (30 June 2016) para 170.

7

Responding to Investor Misconduct: The Line between Lawful and Unlawful Responses and Apportionment in Cases of Unlawful Responses

MARTIN JARRETT

I. Introduction: The Problem of Balancing the Exercise of Domestic Rights against Respect for International Obligations

When a state becomes aware of investor misconduct, which has been performed by an investor with investor status under an investment treaty that the state is party to, it faces a dilemma. Considerations of the rule of law mean that it has to act against the investor – the requirement of equality before the law demands that all persons must face the wrath of the law if they have breached it.[1] Typically, its action will take the form of the imposition of some sanction against the investor. Invariably, that sanction will cause some kind of devaluation of its investment or, in serious cases, the loss of the investment. Given that investment valuation or investment loss is the trigger event for claims under investment treaties, the state thereby opens the door for the investor to make a claim against it, a claim which could potentially lift the sanction and see the investor receive compensation.

The now-settled case of *Gazprom v Ukraine* offers a recent example of how this situation can play out.[2] After its investigations of the investor, Ukraine concluded that it had engaged in anti-competitive practices and fined it approximately

[1] T Bingham, *The Rule of Law* (Penguin, 2011) 55.

[2] This summary of *Gazprom v Ukraine*, UNCITRAL, PCA Case No 2019-10 draws from V Djanic, 'Ukraine's Deputy Justice Minister Announces Settlement of Multi-Billion Dollar BIT Arbitration with Gazprom' (IAReporter, 30 December 2019), available at www.iareporter.com/articles/ukraines-deputy-justice-minister-announces-settlement-of-multi-billion-dollar-bit-arbitration-with-gazprom.

USD 6.5 billion.[3] Using the Russia–Ukraine BIT,[4] the investor filed a claim in arbitration in which it alleged that the imposition of this fine constituted a treaty breach. This move on the part of the investor was seemingly successful. According to media reports,[5] Ukraine agreed to waive the investor's payment of the fine in the settlement between it and the investor.

Whether Ukraine was justified in imposing this fine or whether it amounted to illegal conduct deserving of international responsibility is not in focus. The point is that investors can play the investment-treaty card to challenge state responses to their misconduct. Whatever the rights and wrongs of the investor having this option are, that is the legal reality. It means that, in some cases, a state's response to an investor's misconduct will give rise to international responsibility for it under an investment treaty. Accepting that reality, this chapter examines the following questions: when both the investor and the state, because of its response, are guilty of misconduct, how have arbitral tribunals balanced out their respective degrees of misconduct, and what improvements can be made to the current balancing act?

Answering these questions begins with understanding how a state incurs international responsibility for responding to investor misconduct. Two investment protection standards are likely to be in play: expropriation and fair and equitable treatment, particularly that strain of this investment protection standard called 'denial of justice'. How states' responses to investor misconduct can lead them to breach these investment protection standards is the focus of section III. When they are found in breach, arbitral tribunals usually order that states pay compensation to investors.[6] This is apparently paradoxical. What starts off as a matter of investor misconduct eventually turns into a situation where the state compensates the investor. This outcome should provoke the question: what about the investor's misconduct and are there not some consequences for it? Arbitral tribunals have developed some novel answers to this question. They are examined in section IV. In combination with the analysis of section III, these examinations show the balance that arbitral tribunals have struck between holding states accountable to their international obligations under investment treaties, while also ensuring that the matter of the investor's misconduct does not go unresolved. This lays the foundation for section V, which critically appraises the balancing act

[3] In other media reports, the fine was valued at USD 7.2 billion. See for example, D Krasnolutska, 'Ukraine Approves Settlement with Gazprom Over Antitrust Claim' (Bloomberg, 28 December 2019), available at www.bloomberg.com/news/articles/2019-12-28/ukraine-approves-settlement-with-gazprom-over-antitrust-claim.

[4] Signed 27 November 1998, entry into force 27 January 2000.

[5] V Soldatkin et al, 'Russia's Gazprom to Pay Ukraine $2.9 Billion Before December 29 to Settle Row' (Reuters, 21 December 2019), available at www.reuters.com/article/us-russia-ukraine-gas-payment/russias-gazprom-to-pay-ukraine-2-9-billion-before-december-29-to-settle-row-idUSKBN1YP08M.

[6] In international law, the primary remedy to cure breaches of international obligations is restitution. See R Kolb, *The International Law of State Responsibility: An Introduction* (Elgar, 2017) 154–55. But in investor-state arbitrations, this primary remedy has been largely replaced by compensation. See B Sabahi, *Compensation and Restitution in Investor-State Arbitration: Principles and Practice* (Oxford University Press, 2011) 91.

that arbitral tribunals have performed when adjudicating cases involving investor misconduct and unlawful state responses to that misconduct, particularly focusing on the shortcomings of the main tool that is used for the balancing act: 'investment reprisal'. Before tackling those questions, however, some preliminary matters need to be dealt with, specifically the meaning of 'merits-relevant investor misconduct' and why this chapter exclusively focuses on it.

II. Distinguishing Jurisdiction-Relevant Investor Misconduct from Merits-Relevant Investor Misconduct

A. The Importance of the Distinction between Jurisdiction-Relevant Investor Misconduct and Merits-Relevant Investor Misconduct

As indicated above, this chapter is concerned with investor misconduct that is labelled as such because the relevant conduct of the investor is illegal under the domestic law of the state hosting its investment. This domestic investor misconduct can be contrasted with international investor misconduct. Most particularly, in cases where the investor misconduct takes the form of corruption,[7] arbitral tribunals have held that such conduct assumes the status of misconduct not only because it is contrary to domestic law, but also because it is contrary international public policy.[8]

[7] Some exceptions are *Churchill Mining and Planet Mining v Indonesia* and *Inceysa v El Salvador*. There, the investors' misconduct took the form of fraud. The arbitral tribunal held such fraudulent activity was contrary to international public policy; see *Churchill Mining PLC and Planet Mining Pty Ltd v Republic of Indonesia*, ICSID Case No ARB/12/14 and 12/40, Award (6 December 2016) (*Churchill v Indonesia*) para 508; *Inceysa Vallisoletana SL v Republic of El Salvador*, ICSID Case No ARB/03/26, Award (2 August 2006) (*Inceysa v El Salvador*) para 252. See also ch 12 (Amado, Kern and Rodriguez) of this volume, where the authors discuss the prospect of transforming an international public policy against corruption into an international obligation that is binding on investors.

[8] See, for example, *Churchill v Indonesia*, para 508; *Inceysa v El Salvador*, para 252; *World Duty Free v Republic of Kenya*, ICSID Case No ARB/00/7, Award (4 October 2006) para 139 (this is contract-based investor-state arbitration, as opposed to a treaty-based investor-state arbitration); *Vladislav Kim and others v Republic of Uzbekistan*, ICSID Case No ARB/13/6, Decision on Jurisdiction (8 March 2017) (*Kim v Uzbekistan*) para 593; *Metal-Tech Ltd v Republic of Uzbekistan*, ICSID Case No ARB/10/3, Award (4 October 2013) (*Metal-Tech v Uzbekistan*) para 292. Additionally, it has been reported in the case of *Spentex Netherlands BV v Uzbekistan*, ICSID Case No ARB/13/26, Award (27 December 2016), where the arbitral tribunal ruled that corruption amounted to a breach of international public policy: see K Betz, *Proving Bribery, Fraud and Money Laundering in International Arbitration: On Applicable Criminal Law and Evidence* (Cambridge University Press, 2017) 130–31; V Djanic, 'In Newly Unearthed Uzbekistan Ruling, Exorbitant Fees Promised to Consultants on Eve of Tender Process are Viewed by Tribunal as Evidence of Corruption, Leading to Dismissal of All Claims Under the Dutch BIT' (IAReporter, 22 June 2017) Amado, JS Kern and MD Rodriguez, available at www.iareporter.com/articles/in-newly-unearthed-uzbekistan-ruling-exorbitant-fees-promised-to-consultants-on-eve-of-tender-process-are-viewed-by-tribunal-as-evidence-of-corruption-leading-to-dismissal-of-all-claims-under-dutch.

The focus here is not only on domestic investor misconduct, but specifically, investor misconduct relevant at the merits stage of an investor-state arbitration. This is called 'merits-relevant investor misconduct'. Merits-relevant investor misconduct must be distinguished from jurisdiction-relevant investor misconduct. If investor misconduct is relevant to the arbitral tribunal's jurisdiction and the arbitral tribunal declines jurisdiction on account of it, then the international legality of the state's response to that misconduct will not be reviewed.[9] Practically, such a decision terminates the investor's claim.[10] If investor misconduct is relevant to the merits of the investor's claim, then the international legality of the state's response will be reviewed. If that review concludes that the state's response was in breach of one of the investment protection standards of the applicable investment treaty, then the state will accrue international responsibility for its response.[11] But that is not the end of the matter. There is still the lingering issue of the investor's misconduct. Taking the investor's misconduct, the state has the possibility to mount a defence. If its defence is successfully pleaded, then the state's international responsibility will typically be reduced[12] or, in exceptional cases,[13] eliminated.[14]

This explains the focus on merits-relevant investor misconduct. As noted in section I, one goal of this chapter is to find out where the pendulum of international responsibility lies in cases involving investor misconduct and unlawful state responses to that misconduct. The spectre of that pendulum only comes into view during the merits phase of an investor-state arbitration.

B. The Substantive Distinction between Jurisdiction-Relevant Investor Misconduct and Merits-Relevant Investor Misconduct

Given this focus on merits-relevant investor misconduct, the question is now: how is merits-relevant investor misconduct substantively distinguished from jurisdiction-relevant investor misconduct? This question can be answered with a

[9] CA Miles, 'Corruption, Jurisdiction, Admissibility and Competence in Investment Treaty Arbitration' (2014) 3 *Journal of International Dispute Settlement* 329, 334, 338.

[10] The other adjudicative body with potential jurisdiction over the investor's claim is the local courts in the host state, but it is unlikely to file a claim there. See R Dolzer and C Schreuer, *Principles of International Investment Law*, 2nd edn (Oxford University Press 2012) 231–32.

[11] See ILC, 'Responsibility of States for Internationally Wrongful Acts' (2001) *Yearbook of the International Law Commission*, VoluII, Pt 2, 32 (Art 1).

[12] See further section 4.A below.

[13] See further section 4.B below. As described there, the illegality defence has the potential to eliminate the state's international responsibility that it has accrued for breaching an international obligation.

[14] S Rosenne (ed), *The International Law Commission's Draft Articles on State Responsibility (Part 1, Articles 1–35)* (Nijhoff, 1991) 311; S Szurek, 'The Notion of Circumstances Precluding Wrongfulness' in J Crawford, A Pellet and S Olleson (eds), *The Law of International Responsibility* (Oxford University Press, 2012) 427. Although this view has been challenged, see J Crawford, *State Responsibility: The General Part* (Cambridge University Press, 2013) 275.

syllogism: investor misconduct is either merits-relevant or jurisdiction-relevant;[15] if it is not jurisdiction-relevant, then it can only be merits-relevant.[16] Accordingly, to understand what merits-relevant investor misconduct is, it must first be understood what jurisdiction-relevant investor misconduct is.

Investor misconduct becomes relevant to the arbitral tribunal's jurisdiction if, one, a state's consent to arbitration is conditioned on investment legality[17] and, two, the investor misconduct in question falls within the scope of that condition. In short, a condition of investment legality arises if the applicable investment treaty contains words to the effect that the investment must be established,[18] invested,[19] made,[20] or permitted[21] 'in accordance with host state law' and those words relate to the state's offer to arbitrate investor-state disputes,[22] as opposed to appearing the treaty provision on admission of investments.[23] 'In-accordance-with-host-state-law' clauses create explicit conditions of investment legality. For those investment treaties that do not explicitly condition the state's consent on the legality of the investment, which will sometimes be the case for older generation investment treaties, there is a doctrinal debate whether they might arise by implication.[24] It is beyond the remit of this chapter to attempt to resolve this debate, but it can be noted that in the absence of an 'in accordance with host state law' clause conditioning the state's consent to arbitration, there will be a question mark whether any investor misconduct can assume jurisdictional relevance.

If the state's consent is conditioned on investment legality, the next step to make any investor misconduct relevant to the jurisdiction is to bring such

[15] Although some arbitral tribunals have held that investor misconduct might also be a point of admissibility, this view is erroneous. The question of a claim's admissibility looks at whether the claim is mature enough for adjudication and, in making that determination, the relevant factors are matters pertaining to the claim *itself*, as opposed to issues of substantive investor misconduct, see further M Waibel, 'Investment Arbitration: Jurisdiction and Admissibility' in M Bungenberg et al (eds), *International Investment Law: A Handbook* (Hart, 2015) 1212.

[16] *Abaclat and others v Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (4 August 2011) (*Abaclat v Argentina*) para 648(i).

[17] ibid paras 648(i) and 649(i).

[18] See, for example, Agreement between the Government of the Republic of Finland and the Government of Mongolia on the Promotion and Protection of Investments (signed 15 May 2007, entry into force 19 June 2008), Art 1(1).

[19] See, for example, Agreement between the Republic of San Marino and Bosnia and Herzegovina on the Promotion and Reciprocal Protection of Investments (signed 2 August 2011, entry into force 24 May 2012), Art 1(1).

[20] See, for example, Agreement between Australia and the Oriental Republic of Uruguay on the Promotion and Protection of Investments (signed 5 April 2019, not yet in force), Art 1(1)(a).

[21] See, for example, Agreement between the Government of the Republic of Singapore and the Government of the People's Republic of Bangladesh for the Promotion and Protection of Investments (signed 24 June 2004, entry into force 19 November 2004), Art 1(a).

[22] *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award (18 June 2010) para 125.

[23] A Reinisch, 'How to Distinguish "In Accordance with Host State Law" Clauses from Similar International Investment Agreement Provisions?' (2018) 7 *Indian Journal of Arbitration Law* 70, 80–82.

[24] For an overview of the jurisprudence, see M Polkinghorne and SM Volkmer, 'The Legality Requirement in Investment Arbitration' (2017) 34 *Journal of International Arbitration* 149, 155–58.

misconduct within the notion of investment 'illegality'; in other words, to show that the investor conduct is contrary to host state law. What amounts to investor conduct contrary to host state law has been interpreted narrowly on account of two factors. Firstly, the investor misconduct must be performed during the initial stages of the life of the investment, as dictated by the requirement that the investment must be either *established*, *invested*, *made*, or *permitted* in accordance with the state law.[25] This same limitation has also been held to arise in respect of implicit conditions of investment legality.[26] Because of this first factor, investor misconduct performed during the operating life of the investment will not have jurisdictional relevance.[27] The second factor narrowing the scope of any condition of investment legality is the seriousness criterion. The seriousness criterion is a short-hand expression for the requirement that any investor misconduct must be sufficiently grave before it will fall foul of the condition. Although this requirement is generally not mentioned in any 'in accordance with the state law' clause, arbitral tribunals have consistently read this requirement into them.[28] It has also been included as an element of implicit conditions of investment legality.[29] Effectively, this seriousness criterion means that investors rarely fall foul of conditions for investment legality. Out of approximately 1,000 publicly known treaty-based investor-state arbitrations,[30] there have only been six cases in which an arbitral tribunal has ruled that the investor's misconduct[31] has amounted to the non-fulfilment of this condition.[32]

Because of the narrow scope of conditions of investment legality, instances of investor misconduct will only sometimes assume jurisdictional relevance. Accordingly, investor misconduct will generally assume relevance to the merits of the dispute, thereby giving it a role to play in the determination of the state's international responsibility. This prompts the question: what is that role?

[25] Sometimes referred to as the 'temporal scope of the legality requirement'. See Polkinghorne and Volkmer (ibid) 158.

[26] *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, para 127.

[27] ibid.

[28] J Hepburn, 'In Accordance with *Which* Host State Laws? Restoring the 'Defence' of Investor Illegality in Investment Arbitration' (2014) 5 *Journal of International Dispute Settlement* 531, 545.

[29] See *Phoenix Action, Ltd. v The Czech Republic*, ICSID Case No ARB/06/5, Award (15 April 2009) (*Phoenix v Czechia*) para 102.

[30] As of 31 December 2019, see UNCTAD, 'Investment Dispute Settlement Navigator' (Investment Policy Hub, 31 December 2019), available at investmentpolicy.unctad.org/investment-dispute-settlement.

[31] As opposed to misconduct performed by a government officer. In *Cortec Mining v Kenya*, for example, a 'rogue' official granted a permit in defiance of Kenyan law, leading the arbitral tribunal to conclude that it lacked jurisdiction. See *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v Republic of Kenya*, ICSID Case No ARB/15/29, Award (22 October 2018).

[32] *Spentex v Uzbekistan*; *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, ICSID Case No ARB/11/12, Award (10 December 2014); *Metal-Tech v Uzbekistan*; *Inceysa v El Salvador*; *Alasdair Ross Anderson v Republic of Costa Rica*, ICSID Case No ARB(AF)/07/3, Award (19 May 2010); *Fraport AG Frankfurt Airport Services Worldwide v The Republic of the Philippines*, ICSID Case No ARB/03/25, Award (16 August 2007). Note that this list does not include contract-based investor-state arbitrations.

III. Accruing International Responsibility for Responding to Investor Misconduct

It is best described as a contingent role. As mentioned in section II.A, the determination of international responsibility consists of two phases, namely the breach phase and the defence phase. In the breach phase, the basic question is: has the state's response to the investor misconduct breached one of the investment protection standards in the applicable investment treaty? Although the investor's misconduct features in this phase, it will not be the main feature. As this question indicates, the main role in the breach phase goes to the state's conduct. This changes in the defence phase. There, the investor's misconduct takes the lead role. However, unless the state's response is held to be in breach of one of the investment protection standards, the defence phase does not happen. This explains why the investor's misconduct is described as contingent – if there is a breach, only then will this misconduct enter the stage. Because the investor's conduct only has a role after the state has been found to be in breach, it is logical to first examine the question of breach, before then turning to the defence phase in section IV.

A. State Responses to Investor Misconduct and the Standard on Expropriation

A state's response to an instance of investor misconduct might potentially amount to a breach of any of the investment protection standards (primary rules)[33] usually found in investment treaties, but two rules are standout candidates: expropriation and fair and equitable treatment. Expropriation fundamentally prohibits state-mandated deprivations of investments belonging to foreign investors.[34] An example of the standard formulation of the provision reads as follows:[35]

> Investments shall not be expropriated, nationalized or subject, directly or indirectly, to measures of similar effects except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law.

[33] Because investment protection standards regulate state conduct, they are primary rules, see E David, 'Primary and Secondary Rules' in J Crawford, A Pellet and S Olleson (eds), *The Law of International Responsibility* (Oxford University Press, 2010) 27.

[34] C McLachlan, L Shore and M Weiniger, *International Investment Arbitration: Substantive Principles*, 2nd edn (Oxford University Press, 2017) paras 8.01–8.02.

[35] Agreement between the Republic of Turkey and the Transitional Islamic State of Afghanistan concerning the Reciprocal Promotion and Protection of Investments (signed 10 July 2004, entry into force 19 July 2005), Art 4(1).

In a number of cases,[36] states have fallen foul of the standard on expropriation in their reactions to investor misconduct. *Occidental v Ecuador* offers an example. There,[37] the investor had a production-sharing contract with the Ecuadorian state-owned oil company.[38] It subcontracted some of its rights and obligations under this contract to another company.[39] Under the production-sharing contract, the investor had to obtain Ecuador's consent prior to such subcontracting.[40] The arbitral tribunal[41] determined that it never obtained that consent.[42] Under the production-sharing contract, Ecuador had the right to declare '*caducidad*' (forfeiture)[43] of the contract for this breach,[44] the exercise of which was subject to certain procedural requirements,[45] such as giving the investor an opportunity to remedy the defect. Ecuador followed these procedural prerequisites. It subsequently made a declaration of *caducidad*.[46] Additionally, it confiscated the investor's physical assets for oil production,[47] allegedly with the investor's consent.[48] Among other causes of action,[49] the investor claimed that Ecuador's conduct breached the standard on expropriation.[50] This claim was successful.[51] The legal reasoning supporting this conclusion is light, but the arbitral tribunal held that its more substantive legal reasoning[52] in respect of its finding that Ecuador breached the standard on fair and equitable treatment also applied to its finding of expropriation.[53] On fair and equitable treatment, the arbitral tribunal concluded that although the investor was guilty of misconduct

[36] *Gemplus SA, SLP SA, Gemplus Industrial SA de C v The United Mexican States*, ICSID Case No ARB(AF)/04/3, Award (16 June 2010) (*Gemplus v Mexico*); *Bear Creek Mining Corporation v Republic of Peru*, ICSID Case No ARB/14/21, Award (30 November 2017) (*Bear Creek v Peru*); *Copper Mesa Mining Corporation v Republic of Ecuador*, PCA No 2012-2, Award (15 March 2016) (*Copper Mesa v Ecuador*).

[37] For a more detailed overview of the facts of this case, see B Sabahi and K Duggal, '*Occidental Petroleum v Ecuador* (2012): Observations on Proportionality, Assessment of Damages and Contributory Fault' (2013) 28 *ICSID Review – Foreign Investment Law Journal* 279, 280.

[38] *Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No ARB/06/11, Award (5 October 2012) (*Oxy v Ecuador*) para 105. The production-sharing contract was called the 'participation contract' in the arbitral award, although the arbitral tribunal clarified that it was best described as a production-sharing contract (see para 114).

[39] *Oxy v Ecuador*, para 129.

[40] ibid para 119.

[41] This finding was contested by the investor, ibid paras 147–60.

[42] ibid para 381.

[43] Sabahi and Duggal, '*Occidental Petroleum v Ecuador*' (2013) 80.

[44] *Oxy v Ecuador*, paras 120–21.

[45] See further, ibid para 179.

[46] ibid para 199.

[47] ibid para 199.

[48] ibid para 252.

[49] ibid para 456.

[50] For the details of the investor's arguments, see ibid 453.

[51] ibid para 455.

[52] ibid paras 384–453.

[53] ibid para 455.

described as 'imprudent and ill advised',[54] Ecuador's response was disproportionate,[55] as explained in the following extract:[56]

> The overriding principle of proportionality requires that any such administrative goal must be balanced against the Claimants' own interests and against the true nature and effect of the conduct being censured. The Tribunal finds that the price paid by the Claimants – total loss of an investment worth many hundreds of millions of dollars – was out of proportion to the wrongdoing alleged against [the investor], and similarly out of proportion to the importance and effectiveness of the 'deterrence message' which the Respondent might have wished to send to the wider oil and gas community.

This case can be compared with the outcome in *Yukos v Russia*. As in *Occidental v Ecuador*, the investor had engaged in investor misconduct, specifically it established a 'tax optimisation scheme'[57] among its local operating companies, although it might be have been characterised as a tax avoidance/evasion scheme.[58] The scheme was such that the arbitral tribunal characterised it as 'abusive'.[59] Its full extent was allegedly discovered by Russia through audits of the investor's local companies.[60] After the completion of these audits, the investor was ordered to pay approximately USD 24,180,000[61] in back taxes and fines for tax fraud.[62] The investor sought to pay this amount,[63] but various measures imposed by Russia blocked its path,[64] including the freezing of its bank accounts. Russia initiated the auction of the investor's main income-generating subsidiary.[65] A private company submitted the winning bid – a price that was far below the fair market value of the asset.[66] This private company was subsequently acquired by Russia's state-owned oil company immediately after the auction.[67]

Again, the investor succeeded in proving expropriation,[68] but the concept of disproportionality did not figure in the arbitral tribunal's reasoning. It centred its analysis on Russia's motivations for its response. After finding that Russia's response was not primarily motivated by reasons of tax collection,[69] but rather

[54] ibid para 384.

[55] ibid para 452.

[56] ibid para 450.

[57] *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No. 2005-04/AA227, Final Award (18 June 2014) (*Yukos v Russia*) para 75.

[58] ibid para 1614.

[59] The arbitral tribunal characterised the tax optimisation scheme as an 'abuse' of the relevant tax laws, see ibid para 1615.

[60] ibid para 109.

[61] ibid para 517.

[62] ibid para 95.

[63] ibid para 94.

[64] ibid para 95.

[65] ibid para 98.

[66] ibid para 1020.

[67] ibid para 1006.

[68] ibid para 1585.

[69] ibid para 1579.

the elimination of a political rival, the arbitral tribunal went on to conclude that the response was expropriatory.[70]

B. State Responses to Investor Misconduct and the Standard on Fair and Equitable Treatment (Denial of Justice)

In both *Occidental v Ecuador* and *Yukos v Russia*, the facts giving rise to international responsibility were primarily performed by the executive arm.[71] This will not be the case in all situations involving state responses to investor misconduct. In other cases, the relevant state response will be performed by the judicial arm. Typically, the state will become aware of some investor misconduct, activate some form of prosecution against the investor and, if the state's prosecution is successful, the judiciary will impose the response on the investor. Judicial conduct can also be expropriatory.[72] But owing to the difficulty of proving it,[73] most investors will complain about judicial conduct that takes the form of a response to their misconduct via a claim of denial of justice. Denial of justice is an outgrowth of the multifaceted standard on fair and equitable treatment.[74] An ancient cause of action, denial of justice is the vehicle through which arbitral tribunals review the propriety of the procedure in a particular adjudication involving the investor. Applied to cases involving investor misconduct, this means that the examination focuses on the procedural fairness of the trial where the investor is prosecuted for its misconduct.[75] Because adjudicative action is mostly performed by a state's judicial arm,[76] this explains why this rule of international investment law is most commonly used to complain about judicial conduct.[77]

A classic case where the investor used denial of justice to complain about the state's response to its misconduct was *Al-Warraq v Indonesia*. There, the investor had a shareholding in a local bank, and he was one its officers.[78] In that capacity, he was found to have committed six instances of investor misconduct,[79] all of which could be described as financial crimes. In the midst of the financial crisis of 2008/09, the local bank was given a bailout loan.[80] After the bailout, Indonesia began to investigate the investor.[81] Those investigations led to his prosecution for financial crimes.[82] He was tried in absentia and convicted.[83] His punishment consisted of the confiscation of his assets, the value of which exceeded approximately EUR 174,000.[84] Citing human rights conventions,[85] the arbitral tribunal ruled that trials held in absentia would generally be viewed as a denial of justice, save in exceptional circumstances.[86] This was not a case involving exceptional circumstances. Accordingly, Indonesia was held to have breached the standard on fair and equitable treatment.[87]

In keeping with the core of denial of justice, specifically that it will be found in cases involve procedural failings by the presiding adjudicative body, the arbitral tribunal in *Al-Warraq v Indonesia* found that Indonesia's trial processes were unfair because the investor was not adequately informed about his trial, he could not appoint a lawyer to represent him, and he had no opportunity to appeal his conviction.[88] This failing to afford investors their rights to fair trials has been the explanation for other cases[89] where states have breached the standard on fair and equitable treatment when responding to (alleged) investor misconduct. The point is that if the adjudicative processes that investors are subject to reach the minimum standards of due process, then a claim of denial of justice cannot be made out. Some emphasis needs to be placed on the fact that these are *minimum* standards of due process. An example of how far a state can go before it falls below these minimum standards can be seen in *Genin v Estonia*.[90]

[70] ibid para 1585.

[71] In *Yukos v Russia*, the Russian courts were involved in various ways in the dispute, but it is apparent from the facts that the conduct of the Russian state was being orchestrated by the executive arm.

[72] For an overview of the jurisprudence on judicial expropriation, see generally JM Cox, *Expropriation in Investment Treaty Arbitration* (Oxford University, Press 2019) ch 9.

[73] The explanation for this is that many arbitral tribunals have insisted that judicial expropriation not only involve an expropriatory decision by the local court, but also require that the processes of the court amount to denial of justice, see HG Gharavi, 'Discord Over Judicial Expropriation' (2018) 33 *ICSID Review – Foreign Investment Law Journal* 349, 351–52.

[74] McLachlan, Shore & Weiniger, *International Investment Arbitration* (2017) para 7.103.

[75] J Paulsson, *Denial of Justice in International Law* (Cambridge University Press, 2005) 82.

[76] Although both the legislative and executive arms are also capable of performing adjudicative functions, thereby meaning their (improper) adjudicative conduct can fall within the scope of denial of justice, see ibid 44.

[77] Although judicial conduct comes within the purview of the other investment protection standards commonly featuring in investment treaties, see M Sattorova, 'Denial of Justice Disguised? Investment Arbitration and the Protection of Foreign Investors from Judicial Misconduct' (2012) 61 *International & Comparative Law Quarterly* 223, 243.

[78] *Hesham Talaat M Al-Warraq v Republic of Indonesia*, UNCITRAL, Final Award (15 December 2014) (*Al-Warraq v Indonesia*) paras 73–78.

[79] ibid para 634.

[80] ibid para 96.

[81] ibid para 108.

[82] ibid para 124.

[83] ibid para 141.

[84] ibid para 141.

[85] See particularly ibid para 588.

[86] ibid para 595.

[87] ibid para 621.

[88] ibid para 621.

[89] *Ibrahim Abou Khalil v Senegal* (at the time of writing, the arbitral award for this case had not been made public, but media reports indicated that the investor prevailed using denial of justice as his cause of action. See D Charlotin, 'UNCITRAL tribunal upholds denial of justice claim against Senegal' (IAReporter, 22 July 2020), available at www.iareporter.com/articles/uncitral-tribunal-upholds-denial-of-justice-claim-against-senegal. See also, *Mohamed Abdel Raouf Bahgat v Arab Republic of Egypt*, PCA Case No 2012-07, Final Award (23 December 2019).

[90] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v The Republic of Estonia*, ICSID Case No ARB/99/2, Award (25 June 2001) (*Genin v Estonia*). In *Genin v Estonia*, the relevant process affecting the investor was performed by Estonia's executive arm, not its courts. Nonetheless, the arbitral tribunal still referred to the investor's claim as one of 'denial of justice'; see para 357. As for why adjudicative action performed by the executive arm can amount to denial of justice, see Paulsson, *Denial of Justice* (2005) 44.

Again, this case involved investor misconduct in respect of a local bank that the investor had purchased in an auction.[91] There were three distinct instances of investor misconduct: various occasions when share capital in the local bank fell below minimum levels, a lack of transparency regarding the identity of the shareholders, and other conduct concerning transactions with related parties.[92] But these instances of investor misconduct were not the direct cause of the main event which gave rise to the investor's claim, which was Estonia's revocation of the local bank's permit.[93] That revocation was based on what the arbitral tribunal described as an 'exceedingly formal ground':[94] the investor indicated that 'Eurocapital Group *Limited*' was a shareholder in the local bank, whereas Estonia had only given permission to 'Eurocapital Group *Company*' to have a shareholding in the local bank.[95] There was confusion regarding whether these companies were the same.[96] Estonia concluded that they were not. The result was that the share capital of Eurocapital Group Limited, which was the company listed as having a shareholding in the local bank, was discounted from its capital reserves, meaning that the local bank then had a large capital deficiency.[97] This large capital deficiency then entailed the revocation of the local bank's permit. The arbitral tribunal held that this process was lawful under the applicable investment treaty, with the critical extract in the arbitral award reading as follows:[98]

> Can the revocation of [the local bank's] license be justified on grounds that, at first blush, appear extremely technical? It is the opinion of this Tribunal that the decision taken by the Bank of Estonia must be considered in its proper context – a context comprised of serious and entirely reasonable misgivings regarding [the local bank's] management, its operations, its investments and, ultimately, its soundness as a financial institution.

Notwithstanding the fact that Estonia afforded the investor no possibility to contest the revocation of the local bank's permit,[99] the arbitral tribunal found that there was no denial of justice.[100] This decision is ostensibly difficult to reconcile with the decision in *Al-Warraq v Indonesia*. But what the arbitral tribunal emphasised was that while Estonia's conduct 'invited criticism'[101] and it hoped that Estonia would act with greater caution in the future,[102] Estonia's actions did not shock its sense of judicial propriety because Estonia acted out of justified concerns about the

[91] ibid para 43.
[92] ibid paras 352 and 353.
[93] ibid para 348.
[94] ibid paras 352 and 359.
[95] ibid para 351.
[96] ibid.
[97] ibid para 360.
[98] ibid para 361.
[99] ibid paras 358 and 364.
[100] ibid para 367.
[101] ibid para 365.
[102] ibid para 372.

investor's misconduct,[103] not arbitrariness.[104] The arbitral tribunal for *Al-Warraq v Indonesia* held that Indonesia's conduct did shock its judicial propriety.[105] This illustrates the point that not only must the state's response to investor misconduct involve procedural impropriety for it to be classified as a denial of justice, but such impropriety must be shocking.[106] This 'shocking' element is vague.[107] Although arbitral tribunals are inclined to interpret it in such a way to offer some latitude to states,[108] the line is not clearly drawn and states will, on occasion, step over it. In that circumstance, what options does the state have to defend itself?

To answer that question, it is helpful to revert back to the balancing metaphor. If a state's response breaches the applicable investment treaty, the pendulum swings towards the investor's favour. It stands to benefit from an order of compensation to remedy the state's breach.[109] But in cases of proven investor misconduct, arbitral tribunals are loath to make such orders. There are certain defences in international investment law that can push the pendulum back in favour of the state. How far the pendulum can be pushed back is considered in the next section.

IV. Eliminating or Reducing International Responsibility for Unlawfully Responding to Investor Misconduct

A. Contributory Fault (Investment Reprisal)

One defence[110] pleaded with increasing frequency is contributory fault. It finds its doctrinal foundations in Article 39 of the Articles on State Responsibility:[111] 'In the determination of reparation, account shall be taken of the contribution

[103] ibid para 371.
[104] ibid paras 369–70.
[105] See *Al-Warraq v Indonesia*, para 621.
[106] *Case Concerning Elettronica Sicula SpA (ELSI) (United States of America v Italy)* (Judgment) [1989] ICJ Rep 15, para 128.
[107] Paulsson (n 75) 66.
[108] As explained by the arbitral tribunal for *Al-Warraq v Indonesia*: 'The Tribunal also stresses that the threshold to establish a claim of denial of justice is high' (see para 620). See further SW Schill, 'Deference in Investment Treaty Arbitration: Re-Conceptualizing the Standard of Review' (2012) 3 *Journal of International Dispute Settlement* 577, 584.
[109] See further Kolb, *The International Law of State Responsibility* (2017) 154–55; Sabahi, *Compensation and Restitution in Investor-State Arbitration* (2011) 91.
[110] Although contributory fault is described as a defence in this chapter, it appears under the heading 'Reparations for Injury' in the ILC, 'Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries' (2001) *Yearbook of the International Law Commission*, Vol II Pt Two (Articles on State Responsibility), thereby indicating that it functions as a remedy rule. For the explanation on why this characterisation is erroneous, see M Jarrett, *Contributory Fault and Investor Misconduct in Investment Arbitration* (Cambridge University Press, 2018) ch 2.
[111] Articles on State Responsibility, 29 (Art 39), discussed in *MTD Equity Sdn Bhd and MTD Chile SA v Republic of Chile*, ICSID Case No ARB/01/7, Decision on Annulment (21 March 2007) (*MTD v Chile*, Annulment) para 99.

to the injury by wilful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought'.

Although this provision indicates that contributory fault is a solitary concept, it is better understood as comprising two forms: 'investment mismanagement' and 'investment reprisal'. As the name suggests, investment reprisal can be pleaded where the state takes (internationally illegal) measures of reprisal (responses) in reaction to investor misconduct.[112] It is more in focus in this chapter because it can be pleaded by states in cases involving investor misconduct, but, to properly understand how it is distinguishable from investment mismanagement, it is worth briefly describing investment mismanagement.

In cases of investment mismanagement, the investor's contribution to its investment loss does not take the form of a provocation of the state, but rather a direct contribution to the investment loss. Such a contribution becomes mismanagement when, at the time of its performance, there is a risk that the state might breach the applicable investment treaty. The paradigm case is *MTD v Chile*. Despite signs that it would not get the permit it needed,[113] the investor ploughed ahead with its investment plan by purchasing the land for its investment activity.[114] Its application for this permit was rejected.[115] Because this rejection was inconsistent with other Chilean conduct,[116] Chile was found to have breached the applicable investment treaty.[117] But the investor did not escape condemnation. After concluding that the investor's management of the initial stages of its investment was plagued by a lack of due diligence,[118] the arbitral tribunal apportioned 50 per cent of the international responsibility to the investor.[119] Because investment mismanagement cannot be pleaded as a defence in situations where the state has reacted to investor misconduct, it is not in focus here.

Investment reprisal was successfully pleaded in *Occidental v Ecuador* and *Yukos v Russia*. In both cases, the result was the same: the investors had to accept 25 per cent of the international responsibility for their investment losses.[120] In *Occidental v Ecuador*, the dissenting arbitrator concluded that the investor should have been apportioned 50 per cent,[121] although she noted that apportionment largely turned on

[112] At the time writing, this concept had not been recognised in the jurisprudence of international investment law. The arbitral tribunal for *Yukos v Russia*, however, recognised that in some cases of contributory fault, the investor had provoked the state's wrongful conduct and then this indirect contribution nonetheless constituted a cause for the purposes of Art 39 of the Articles on State Responsibility. See *Yukos v Russia*, para 1605.

[113] *MTD Equity Sdn Bhd and MTD Chile SA v Republic of Chile*, ICSID Case No ARB/01/7, Award (25 May 2004) (*MTD v Chile*, Award) para 169.

[114] For further details, see ibid para 49.

[115] ibid paras 80–81.

[116] ibid para 166.

[117] ibid para 253(1).

[118] ibid para 177.

[119] ibid para 246.

[120] *Yukos v Russia*, para 1637; and *Oxy v Ecuador*, para 687.

[121] *Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No ARB/06/11, Dissenting Opinion (20 September 2012) (*Oxy v Ecuador*, Dissenting) para 8.

an adjudicator's appreciation of the factual situation.[122] In reaching these decisions, the arbitral tribunals did not explicitly define the content of investment reprisal, but synthesising from their reasoning, it is apparent that it consists of two elements.

First, there must be some form of investor misconduct. As the investors' conduct was illegal under the states' domestic law, this element was satisfied in both *Occidental v Ecuador*[123] and *Yukos v Russia*.[124] In another case where investment reprisal was successfully pleaded, namely *Copper Mesa v Ecuador*, this element was satisfied by the investor's planning and directing violent acts against the local population in the vicinity of the investment activities.[125]

An open question is whether investor misconduct that is not contrary to domestic law, but otherwise objectively offensive, can satisfy this element. There are two cases[126] where the state pleaded investment reprisal and the investor's 'misconduct' was formally legal,[127] but was (arguably) wrongful when viewed from an objective perspective. The arbitral tribunals ruled in those cases that the pleas of investment reprisal failed for other reasons[128] and did not continue to comment on this question. One of these cases was *Bear Creek v Peru*. There, Peru failed to establish that the investor's (alleged) misconduct caused its response.[129] This is the second element: the investor misconduct must have provoked the state's response. Arbitral tribunals have insisted that the degree of provocation must be 'material'[130] – their findings, however, defy this insistence. In *Occidental v Ecuador*, for example, the arbitral tribunal held that this element was satisfied,[131] notwithstanding evidence that Ecuador's response was primarily motivated by political considerations, specifically the ill will towards the investor on account of an arbitral award in its favour and against Ecuador.[132] The arbitral tribunal for *Yukos v Russia* adopted an even weaker interpretation. It held that even though Russia used the investor's misconduct as a 'pretext' for its expropriated reaction, this element was nonetheless satisfied.[133] According to this jurisprudence, the investor's misconduct need not have any actual causal effect, but rather must be a good reason for reacting.

[122] ibid para 7.

[123] *Oxy v Ecuador*, para 680.

[124] *Yukos v Russia*, para 1611.

[125] *Copper Mesa v Ecuador*, para 6.100.

[126] *Gemplus v Mexico*; *Bear Creek v Peru*.

[127] In *Gemplus v Mexico*, this investor 'misconduct' was hiring a director who had previously committed serious crimes. Because the investor had no knowledge of his past, nor could have obtained that knowledge, Mexico's plea failed, see *Gemplus v Mexico*, para 11.14. In the other case, *Bear Creek v Peru*, Peru argued that the investor's use of its Peruvian legal representative to obtain its permit was illegal because the arrangement between them managed to circumvent Peruvian law on foreign ownership of mining permits. The arbitral tribunal concluded that it was not illegal, see *Bear Creek v Peru*, para 126.

[128] In *Gemplus v Mexico*, the investor had no knowledge of the prior criminal activities of its directors; see *Gemplus v Mexico*, para 11.14.

[129] *Bear Creek v Peru*, para 567.

[130] *Copper Mesa v Ecuador*, para 6.88; *Yukos v Russia*, para 1600; and *Oxy v Ecuador*, para 670.

[131] *Oxy v Ecuador*, para 680.

[132] ibid para 684.

[133] *Yukos v Russia*, para 1615.

Once these legal elements have been established, the apportionment of international responsibility can begin. Arbitral tribunals have repeatedly emphasised that they enjoy some discretion when apportioning international responsibility between investors and states.[134] This explains the varying percentages that the investors have had to accept as representing their contributions to their losses. As noted above, the percentages were 25 per cent for the investors in *Occidental v Ecuador*[135] and *Yukos v Russia*.[136] In *Copper Mesa v Ecuador*, the arbitral tribunal went to 30 per cent,[137] while in *Bear Creek v Peru*, the dissenting arbitrator measured the investor's contribution at 50 per cent.[138]

Two things stand out about investment reprisal. First, it has not been successfully pleaded as a defence in respect of a finding of denial of justice. In all the cases mentioned above, the arbitral tribunals made findings of expropriation.[139] The explanation for this inapplicability of investment reprisal in respect of findings of denial of justice is that proving the causation element is nigh impossible. Particular instances of procedural impropriety in the context of adjudicative proceedings are the founding facts of a claim of denial of justice. It is difficult to imagine how investor misconduct could specifically provoke such improprieties. A second stand-out feature is that no arbitrator or arbitral tribunal has been willing to apportion more than 50 per cent of the international responsibility to the investor. Effectively, this implicit limitation means that a finding of investment reprisal can only bring the pendulum back to the halfway point between investors and states. To swing the pendulum all the way back in the state's favour, something stronger is needed.

B. Illegality Defences

That something is the illegality defence. The imprecise expression of the 'illegality defence' is used because the jurisprudence of international investment law has not settled on a description for the defence under consideration, with various descriptors being used, such as 'unclean hands',[140] the *ex turpi causa* defence,[141] and

[134] *Copper Mesa v Ecuador*, paras 6.94 and 6.96; *Yukos v Russia*, paras 1600 and 1637; *Oxy v Ecuador*, paras 670 and 686; *MTD v Chile*, Annulment, para 101.

[135] *Oxy v Ecuador*, para 687.

[136] *Yukos v Russia*, para 1637.

[137] *Copper Mesa v Ecuador*, para 6.102.

[138] *Bear Creek Mining Corporation v Republic of Peru*, ICSID Case No ARB/14/21, Partial Dissenting Opinion of Professor Philippe Sands (12 September 2017) para 39.

[139] *Bear Creek v Peru*, para 415; *Copper Mesa v Ecuador*, para 11.4; *Yukos v Russia*, para 1888(e); and *Oxy v Ecuador*, para 876(iii).

[140] For an overview of clean hands in international investment law, see generally P Dumberry, 'State of Confusion: The Doctrine of 'Clean Hands' in Investment Arbitration after the Yukos Award' (2016) 17 *Journal of World Investment & Trade* 229.

[141] See, for example, *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No ARB/03/24, Award (27 August 2008) (*Plama v Bulgaria*) para 146.

'post-establishment illegality'.[142] What binds all of these concepts together is that merely on account of its illegal conduct, an investor cannot recover from the state, which reflects how the illegality defence operates in domestic tort law.[143] This also reveals what makes the illegality defence stronger in comparison to investment reprisal: it is a complete defence that operates to *eliminate* the state's international responsibility. Additionally, it has been pleaded as a defence in respect of a finding of denial of justice, as demonstrated in *Al-Warraq v Indonesia*.

As recounted in section III.B above, Indonesia's trial of the investor amounted to denial of justice. The fact of the investor's misconduct still lingered. To bring into it into consideration, the arbitral tribunal relied on an unusual provision in the applicable investment treaty which reads as follows:

> The investor shall be bound by the laws and regulations in force in the host state and shall refrain from all acts that may disturb public order or morals or that may be prejudicial to the public interest. He is also to refrain from exercising restrictive practices and from trying to achieve gains through unlawful means.[144]

As the arbitral tribunal found that he had breached Indonesian law and Indonesian 'public order',[145] on multiple occasions,[146] the investor was simultaneously in breach of this provision. Drawing inspiration from the 'unclean hands' doctrine, the arbitral tribunal ruled that this treaty breach rendered the investor's claim inadmissible.[147] A finding of inadmissibility is legally distinct from a rejection of the investor's claim on the merits on account of a successful plea of a defence,[148] but the practical outcomes are the same:[149] no international responsibility for the state.[150]

This makes the illegality defence a more powerful defence than investment reprisal. Because the triggering event for the illegality defence and investment reprisal are the same, namely the investor's illegal conduct under the state's domestic law, it will be queried why states in the cases where they successfully pleaded investment reprisal did not plead the illegality defence instead, given that it offers a better outcome for the state. In *Yukos v Russia*, Russia did plead the illegality

[142] See generally Jarrett, *Contributory Fault* (2018) 149–55.

[143] For an overview, see generally M Fordham, 'The Role of *Ex Turpi Causa* in Tort Law' (1998) *Singapore Journal of Legal Studies* 238.

[144] Agreement on Promotion, Protection and Guarantee of Investments Among Member States of the Organisation of the Islamic Conference (signed 5 June 1981, entry into force 1 February 1988) Art 9.

[145] *Al-Warraq v Indonesia*, para 645.

[146] For details of this misconduct, see ibid paras 635–42.

[147] ibid paras 646–47.

[148] Articles on State Responsibility, 72 (Ch V, Commentary 7).

[149] For this reason, some arbitral tribunals have had difficulty making the distinction, see CN Brower and J Ahmad, 'The State's Corruption Defence, Prosecutorial Efforts, and Anti-Corruption Norms in Investment Treaty Arbitration' in K Yannaca-Small (ed), *Arbitration under International Investment Agreements: A Guide to the Key Issues*, 2nd edn (Oxford University Press, 2018) para 18.16. For a brief explanation of the concept of admissibility, see Waibel, 'Investment Arbitration' (2015) 1212.

[150] *Al-Warraq v Indonesia*, para 648.

defence,[151] or what it called the Unclean Hands Doctrine,[152] in preference to investment reprisal. It listed many instances of alleged investor misconduct,[153] including the misconduct that formed the foundation of its successful plea of investment reprisal.[154] Russia's plea of the illegality defence failed. In a devastating[155] blow to the existence of the Unclean Hands Doctrine, the arbitral tribunal opined as follows:[156]

> The Tribunal is not persuaded that there exists a 'general principle of law recognized by civilized nations' within the meaning of Article 38(1)(c) of the ICJ Statute that would bar an investor from making a claim before an arbitral tribunal under an investment treaty because it has so-called 'unclean hands.'
>
> General principles of law require a certain level of recognition and consensus. However, on the basis of the cases cited by the Parties, the Tribunal has formed the view that there is a significant amount of controversy as to the existence of an 'unclean hands' principle in international law.

What this extract reveals is that there should be serious doubts about the doctrinal foundations of the Unclean Hands Doctrine,[157] and by extension the illegality defence in international investment law. In *Al-Warraq v Indonesia*, the arbitral tribunal had the benefit of pointing to a treaty clause providing that the investor had to respect local law to shore up its reasoning. Most arbitral tribunals will not have this luxury. Rather, they will have to ground the illegality defence that they apply in a general principle of law. Only one arbitral tribunal[158] has been willing to go down this path, specifically the arbitral tribunal for *Plama v Bulgaria*.[159] In sum, a body of jurisprudence on the illegality defence has not been built, thereby making it difficult for states to plead.

It is considered that these features have engendered a preference for investment reprisal over the illegality defence among arbitral tribunals.[160] And because of this preference, investment reprisal will be the default tool when arbitral tribunals seek to balance out the state's unlawful response to the investor's misconduct. Because it has assumed this status, it is worth critically examining the jurisprudence on investment reprisal in view of answering the question: can this tool be better crafted to carry out this balancing role?

[151] For the arbitral tribunal's recount of its arguments, see *Yukos v Russia*, paras 1281–90.
[152] ibid para 1273.
[153] ibid para 1281.
[154] ibid para 1307.
[155] What makes this dictum particularly devastating is that Stephen Schwebel served on the arbitral tribunal for *Yukos v Russia*. In the *Nicaragua v United States*, he wrote a dissenting opinion in which he advocated for the existence of the clean hands doctrine in international law, see *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v United States of America)* (Dissenting Opinion of Judge Schwebel) [1986] ICJ Rep 259, paras 269–71.
[156] *Yukos v Russia*, para 1358.
[157] S Schwebel, 'Clean Hands, Principle' in R Wolfrum (ed), *Max Planck Encyclopedia of Public International Law* (Oxford University Press, 2013) para 3.
[158] Although in *Fraport v Philippines (I)*, the dissenting arbitrator held that the investor's misconduct was relevant to the merits and The Philippines should have used the misconduct as the basis for a plea of illegality: see *Fraport AG Frankfurt Airport Services Worldwide v The Republic of the Philippines*, ICSID Case No ARB/03/25, Dissenting Opinion of Mr BM Cremades (19 July 2007) para 38.
[159] *Plama v Bulgaria*, para 146.
[160] See particularly *Copper Mesa v Ecuador*, para 6.97 and *Yukos v Russia*, paras 1307–08 (where the arbitral tribunal lists the instances of investor misconduct but concludes that it will discuss these instances as a matter of contributory fault, without offering any reasoning in support of that conclusion).

V. A Critical Appraisal of the Jurisprudence on Investment Reprisal

A. Investment Reprisal as a Self-Help Remedy

A number of faults can be identified with the current approach. First, by accepting investment reprisal as part of international investment law, arbitral tribunals have legitimised states' recourse to self-help to deal with instances of investor misconduct. Law rarely endorses self-help remedies. Law rather encourages recourse to adjudicative bodies for the resolution of legal disputes. When law does recognise a self-help remedy, it strictly controls its use. An example in international law is countermeasures. It is recognised as a defence in the Articles on State Responsibility, but a full chapter of six Articles regulate how this defence might be used.[161] By contrast, the other defences codified in the Articles on State Responsibility only have one article explaining their application.[162] The jurisprudence on investment reprisal currently places no conditions on the circumstances when it may be used. To repair this problem, one idea would be to give states access to international justice to complain about investor misconduct. But turning this idea into reality would be a long-term venture. There is currently no possibility for a state to take a direct action against an investor in investment treaty arbitration.[163] Making such a possibility a reality would involve considerable investments in law reform, assuming that there was sufficient political will behind such a reform idea. Moreover, there are already adjudicative bodies where states can bring actions in respect of investor misconduct: their own domestic courts.

Various factors support pushing states towards domestic adjudication for resolving their disputes with investors. First, domestic courts will have the most expertise on the law that the investor has (allegedly) breached. Second, using domestic courts to prosecute investor misconduct constitutes a win for the rule of law in the state. A functional judiciary is a key plank of a state governed by

[161] Articles on State Responsibility, 26, 30 (Arts 49–54).
[162] ibid 27–28 (Arts 20–25).
[163] For a discussion of this issue, see G Laborde, 'The Case for Host State Claims in Investment Arbitration' (2010) 1 *Journal of International Dispute Settlement* 97, 102–07.

the rule of law. When misconduct under domestic law leads to judicial proceedings, this is the epitome of a functional judiciary. Third, if the investor is subject to maltreatment in the domestic courts, then it still has the option of filing a claim in investor-state arbitration alleging denial of justice. In light of these reasons, the question is therefore: how should states be pushed towards domestic adjudication?

One option would be to exclude pleas of investment reprisal. It is doubtful whether this option would be realistically accepted into the jurisprudence. Through the various cases mentioned in this chapter, investment reprisal has become a settled part of international investment law. If an arbitral tribunal denied its existence, then it would be denying itself the use of a tool that can be flexed to do justice between the parties. Another option with a softer edge is possible. It involves arbitral tribunals giving deference to local courts when they adjudicate on cases of investor misconduct. If these local courts enjoy the deference from arbitral tribunals, then their procedures are less likely to amount to a denial of justice. This practically means that the state's (judicial) response is less likely to give rise to international responsibility, thereby gently encouraging the use of local courts. Fortunately, this option is already in operation. As detailed in section III.B above, arbitral tribunals already follow a policy of showing deference to domestic courts. Proof of this policy can be seen in *GPF v Poland*. There, the investor had a contract with the City of Warsaw for the redevelopment of some historic buildings.[164] However, the investor demolished these buildings.[165] Via an application to the relevant local courts, the City of Warsaw sought to terminate its contract with the investor.[166] Its application was successful.[167] The appellate courts upheld this decision.[168] The investor filed a claim in investment treaty arbitration, with one its causes of action being expropriation by the Polish courts.[169] This claim failed.[170] In making its case for expropriation, the investor argued that the Polish courts had misapplied Polish law. In dismissing this argument, the arbitral tribunals held that investor-state arbitration was not a venue for the substantive review of domestic decisions given that arbitral tribunals must unconditionally defer to domestic courts on matters of substantive law.[171] This outcome was not surprising. It should be contrasted with the likely decision if the City of Warsaw had immediately

[164] *GPF GP Sàrl v Republic of Poland*, SCC Case No V 2014/168, Final Award (29 April 2020) (*GPF v Poland*) para 10.
[165] ibid para 86.
[166] ibid para 93.
[167] ibid para 95.
[168] ibid paras 96–97.
[169] ibid para 189.
[170] ibid para 607.
[171] ibid para 474. Although admittedly in some parts of its reasoning, the arbitral tribunal is seemingly engaging in a substantive review of the Polish courts' decision, see particularly *GPF v Poland*, paras 480–83.

terminated the contract. In this situation, notwithstanding the legality of such action under Polish law, the investor would have had a far better chance of succeeding.

B. Arbitrariness in the Apportionment of International Responsibility

A second point of criticism is that the process of apportionment is apparently characterised by its arbitrariness. The case in point is *Occidental v Ecuador*, although other cases where the arbitral tribunal or arbitrator made a finding of investment reprisal can equally be criticised on account of the arbitrariness of their decision-making on apportionment.[172] The investor in *Occidental v Ecuador* was initially awarded approximately USD 2,359,000,000 in compensation, but this amount was cut to approximately USD 1,769,000,000 on account of the finding of investment reprisal.[173] Effectively, the investor was handed a formal punishment of USD 590,000,000 for its misconduct. The dissenting arbitrator's penalty came to USD 1,179,500,000.[174] To give these figures some perspective, if they were paid as penalties under the Foreign Corrupt Practices Act, they would put the investor inside the top 10 list for the highest penalties paid under this legislation.[175] But the investor's misconduct barely met the description of misconduct.[176] Admittedly, it denied Ecuador the chance to vet the subcontractor,[177] but this was the absolute extent of the wrongfulness of its conduct. Ecuador suffered no material harm.[178] The investor remained legally liable to Ecuador for the misconduct of the subcontractor.[179] The subcontractor had already received authorisation by Ecuador to act as a subcontractor in respect of another investment in the upstream oil sector.[180] The authorisation almost certainly would have been forthcoming to the investor if it had sought it.[181]

[172] See, for example, *Copper Mesa v Ecuador* where the arbitral tribunal recounted some of pertinent facts, before it simply concluded: 'Taking all these factors into account … the Tribunal assesses the [investor's] contribution … at 30 per cent. On the facts of this case, it could not be less': see *Copper Mesa v Ecuador*, para 6.102.
[173] These amounts are exclusive of interest, see *Oxy v Ecuador*, para 825. Although the investor later settled its claim for enforcement of this arbitral award for USD 980,000,000, see E Hoffmann, 'Ecuador is paying Occidental $980M to settle its lawsuit' (Seeking Alpha, 10 Jan. 2016), available at seekingalpha.com/news/3022556-ecuador-paying-occidental-980m-settle-lawsuit.
[174] *Oxy v Ecuador*, Dissenting, para 8.
[175] H Cassin, 'Airbus shatters the FCPA top ten' (The FCPA Blog, 3 February 2020), available at fcpablog.com/2020/02/03/airbus-shatters-the-fcpa-top-ten.
[176] Also remembering that there was considerable evidence that Ecuador had authorised the subcontracting, *Oxy v Ecuador*, para 683.
[177] ibid para 679.
[178] ibid para 447.
[179] ibid para 333.
[180] ibid para 445.
[181] ibid para 445.

Finally, as the arbitral tribunal ruled that the investor's negligence was the explanation for not obtaining the authorisation, the investor misconduct was more in the form of an oversight, as opposed to a malicious act.[182]

This problem of arbitrary apportionment is not beyond repair. The process of reparation begins with jettisoning the idea that apportionment can be based on the causal potency of the investor's contribution, an idea most clearly exhibited in the arbitral tribunal's reasoning in *Occidental v Ecuador*:[183]

> The Tribunal recalls that the violation of the law by [the investor] was invoked by Ecuador as the principal legal basis for the [response]. On the other hand, [other factors] were also causes which ... contributed in a material and significant way to [Ecuador's response]. In other words, it is a conjunction of different factors which ... were the causes ... of the Respondent's [response]. *The difficult task of the Tribunal in this case is to weight the relative causal link of this series of causes.*

As this extract indicates, apportionment based on causal potency examines the degree to which a contribution causes a consequence and then values that degree.[184] But the idea that the degree to which a contribution causes a particular outcome can be accurately valued is fanciful.[185] Consequences always have a multitude of causes,[186] but the idea that some are more potent than others is nonsensical because causality is a binary concept – either an event is a cause or it is not.[187] And even if it is accepted that some causes could be more causally potent than others, there is no reason-grounded method to measure a cause's degree of potency. As the dissenting arbitrator in *Occidental v Ecuador* implicitly admitted, the valuation of the degree of causal potency is a matter of how an adjudicator 'appreciates' the case; in other words, this is primarily a subjective process.[188] This explains why the process of apportionment is defined more by arbitrariness than objectivity. A more objective approach is possible.

The first step towards that new approach is discarding the notion that international responsibility apportioned to the investor should correspond to the degree to which the investor's misconduct provoked the state's wrongful international conduct. Not only is the valuation of this degree impossible, but it also constitutes an erosion of individual responsibility. Embracing that principle is the second step. It provides that the person performing an act is solely responsible for

[182] ibid para 380.

[183] ibid para 685 (emphasis added).

[184] See also *Copper Mesa v Ecuador*, paras 6.97–6.98.

[185] The same observation has also been made in respect of apportionment in Anglo-American tort law; see J Goudkamp and L Klar, 'Apportionment of Damages for Contributory Negligence: The Causal Potency Criterion' (2016) 53 *Alberta Law Review* 849, 861.

[186] JS Mill, *A System of Logic, Ratiocinative and Inductive* (Cambridge University Press, 2011) 506.

[187] RW Wright, 'Allocating Liability Among Multiple Responsible Causes: A Principled Defence of Joint and Several Liability for Actual Harm and Risk Exposure' (1988) 21 *UC Davis Law Review* 1141, 1146.

[188] This attitude is also apparent among the arbitral tribunal for *Copper Mesa v Ecuador* given its emphasis on how apportionment centred on its assessment of the facts: see particularly *Copper Mesa v Ecuador*, paras 6.98–6.102.

the consequences causally related thereto, as opposed to the conduct of persons causing that act. Because of this principle, it is the state that has to bear sole responsibility for the consequences that it causes. But this does not mean that the investor misconduct should be overlooked. If a person is solely responsible for the consequences of his or her conduct, then the investor must be responsible for the harm caused by its misconduct. Accordingly, the investor should be apportioned international responsibility corresponding to the extent of this harm. For example, if the investor has its investment expropriated and that investment has a value of 3,000,000 ducats, but the investor's misconduct causes environmental damage that will cost 2,200,000 ducats to repair, then the investor should be apportioned 73.3 per cent of the international responsibility.

VI. Conclusion

Returning to the first question posed in section I on what balance arbitral tribunals have struck in cases involving state responses to investor misconduct, the first point is that such responses can breach investment protection standards found in investment treaties. It could not be any other way. If state responses to investor misconduct could not breach these primary rules, they would lose much of their legal value because states could routinely disguise their otherwise unlawful conduct as responses to investor misconduct. But investor misconduct still figures prominently in the final determination of the offending state's international responsibility. It assumes this prominence via certain defences, namely investment reprisal and the illegality defence. The illegality defence is the more powerful of the two. It can act to eliminate the state's international responsibility. But its doctrinal foundations are very unstable. Moreover, there is an apparent preference among arbitral tribunals for investment reprisal. A successful plea of investment reprisal reduces the state's international responsibility according to the degree to which its response was provoked by the investor's misconduct.

Because of its flexibility, investment reprisal is an apt tool to strike the balance between holding the state accountable for its misconduct, while simultaneously sanctioning the investor's misconduct. This tool, however, is being improperly used at present. Starting from the erroneous foundation that it is possible to accurately value the degree to which an investor's misconduct causes the state's response, it has been used in an arbitrary fashion. The proper way to use this tool is to apportion to the investor a percentage of the international responsibility reflecting the harm that its misconduct causes. Coming back to the second question posed in section I on how arbitral tribunals can strike a better balance, adopting this more objective approach counts as the main recommendation.