Chapter 7.
Indirect Obligations in Investment Law Practice

The concept of indirect obligations has been laid out in Chapter 6. Chapter 7 will now show that they already exist in many forms in investment law practice. To that end, it will analyse relevant IIAs, investment arbitration awards and scholarly writing.

As seen, 'indirect obligations' are not yet established as a term in investment law. Consequently, this Chapter will first focus on identifying arbitral jurisprudence and IIAs which examine investors' conduct in some way – instead of only concentrating on a potential wrongdoing by the host state. Then, it will assess if the manner in which tribunals and IIAs examined such conduct functionally amounts to an indirect obligation: the automatic deprival of protection. In doing so, it will distinguish such instances from cases in which investor misconduct only constitutes a balancing criterion – hence not giving rise to such a stringent sanction.

The analysis will follow three doctrinal categories. First, it will address jurisdiction and admissibility requirements in international investment arbitration. They bring about indirect obligations which foreclose access to arbitration in case of a breach (I.). Second, substantive investment law entails indirect obligations that deprive investors of an investor right (II.). Third, rules on compensation also imply indirect obligations. A violation thereof partly curtails a substantive investor right because the investor receives less compensation (III.). Lastly, the Chapter will separately address the role played by the clean hands doctrine. Despite the suggestion that the doctrine may function in a manner that would give rise to indirect obligations, it is submitted that the doctrine is, in fact, redundant (IV.).

I. Arbitration's jurisdiction and admissibility requirements

The analysis will begin by shedding light on indirect obligations related to the right to file an arbitration claim. Here, the sanction for non-compliance is that any claim by the investor is inadmissible or leads the tribunal to lack jurisdiction. Hence, investors forfeit the international right to an international adjudicatory procedure. They lose a right that the host state otherwise grants in the respective IIA's arbitration clause.

This section will identify three indirect obligations. There exists jurisprudence according to which tribunals only have jurisdiction under the ICSID Convention if the investment at stake contributes to the host state's development. This implies an indirect obligation with an indeterminate standard of conduct (1.). More elaborate indirect obligations are implied by the wide-spread jurisdiction requirements to comply with the host state's domestic law (2.) and with international law (3.).

1. Contribution to the host state's development

Building on the award in *Salini Costruttori S.P.A. and Italstrade S.P.A. v Morocco*, ICSID tribunals have developed the jurisdiction requirement that the investor must contribute to the host state's development (a). This requirement implies an indirect obligation (b). However, the content of the obligation itself, is relatively indeterminate. It vaguely requires the investor to positively affect the national economy and, as some tribunals have indicated, the host state's social and cultural environment (c). Overall, therefore, this jurisprudence constitutes an example of an indirect obligation which is yet to be further concretised.

a) The Salini jurisprudence

The requirement to contribute to the host state's development draws on Art 25 (1) ICSID Convention. The provision stipulates: 'The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment […]'.

States have the freedom to define which rules shall govern investment arbitration proceedings. Often, they determine in an IIA that the respective rules should follow those of the ICSID Convention. If the states choose to do so, the prepondering arbitral jurisprudence understands Art 25 (1) ICSID Convention as constituting an objective jurisdiction requirement – irrespective of and in addition to the IIA's other terms.[1] The ICSID award

1 The so-called objective or double-barrelled test, supported by *Consortium R.F.C.C. v Kingdom of Morocco*, ICSID Case No. ARB/00/6, Decision on Jurisdiction (16 July 2001) para 60; *Joy Mining Machinery Limited v Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction (6 August 2004) para 50; *Helnan International Hotels A/S v Arab Republic of Egypt*, ICSID Case No. ARB/05/19, Decision

in *Salini Costruttori S.P.A. and Italstrade S.P.A. v Morocco* for the first time understood this clause to require foreign investments to make a 'contribution to the economic development of the host State of the investment'.[2]

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of the Tribunal on Objection to Jurisdiction (17 October 2006) para 77; *Víctor Pey Casado and President Allende Foundation v Republic of Chile*, ICSID Case No. ARB/98/2, Award (8 May 2008) para 232; *RSM Production Corporation v Grenada*, ICSID Case No. ARB/05/14, Award (13 March 2009) paras 235–238; *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v The Republic of Paraguay*, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction (29 May 2009) para 78; *Malaysian Historical Salvors SDN, BHD v The Government of Malaysia*, ICSID Case No. ARB/05/10, Award on Jurisdiction (17 May 2007) paras 65–68; *Saba Fakes v Republic of Turkey*, ICSID Case No. ARB/07/20, Award (14 July 2010) para 108; *Global Trading Resource Corp. and Globex International, Inc. v Ukraine*, ICSID Case No. ARB/09/11, Award (1 December 2010) paras 44–45; see also *Ceskoslovenska Obchodni Banka, A.S. v The Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction (24 May 1999) para 68 and *Saba Fakes v Turkey* (n 1) para 108 which both *in abstracto* confirm the objective nature of Art 25 (1) ICSID Convention but consider the specific consent of the Parties to be an important element in interpreting the provision, thereby blurring a clear distinction between an objective and a subjective approach. From the literature in favour of the objective approach see Jan A Bischoff and Richard Happ, 'The Scope of Application of International Investment Agreements' in Marc Bungenberg and others (eds), *International Investment Law* (Nomos 2015) para 31; Christoph Schreuer, *The ICSID Convention: A Commentary* (2nd edn, Cambridge University Press 2009) paras 122–123. The contrary subjective approach argues that Art 25 (1) ICSID Convention does not bring about any restrictions other than those agreed upon by the Parties in the relevant IIA. This view is supported for example by *Fraport AG Frankfurt Airport Services Worldwide v The Republic of Philippines (Fraport I)*, ICSID Case No. ARB/03/25, Award (16 August 2007) para 305; *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008) paras 312–318; *Pantechniki S.A. Contractors & Engineers (Greece) v Republic of Albania*, ICSID Case No. ARB/07/21, Award (30 July 2009) paras 41–47; *Malaysian Historical Salvors SDN BHD v The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment (16 April 2009) paras 62–74. In addition, some tribunals do not undertake a separate analysis of Art 25 (1) ICSID Convention and thus appear to follow the subjective approach, see for example *PSEG Global Inc. The North American Coal Corporation, and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v Republic of Turkey*, ICSID Case No. ARB/02/5, Decision on Jurisdiction (4 June 2004) paras 79–105, however, see *MHS v Malaysia*, Award on Jurisdiction (n 1) paras 119–122 arguing that in *PSEG v Turkey* the *Salini*-test was so clearly fulfilled that a separate analysis was not warranted.

2 *Salini Costruttori S.P.A. and Italstrade S.P.A. v Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (23 July 2001) para 52; in the same direction already *Ceskoslovenska v The Slovak Republic*, Decision of the Tribunal on Objections to Jurisdiction (n 1) para 64 in 1999.

The main argument is a teleological one: States had created ICSID to foster development by attracting foreign investment, willing to grant protection only if investors actually contributed to that end. This argument is supported by the ICSID Convention's preamble. In its first paragraph it explicitly highlights the 'need for international cooperation for economic development, and the role of private international investment therein'.[3] Other tribunals have followed the same approach[4] although it remains controversial.[5]

3 Similarly, the Report of the Executive Directors of the IBRD on ICSID reveals that the Convention's object and purpose is to 'strengthen the partnership between countries in the cause of economic development', see IBRD 'Report of the Executive Directors on the Convention of the Settlement of Investment Disputes Between States and Nationals of Other States' ICSID/15/Rev.1, 35–49 (18 March 1965) para 9.

4 *Mr. Patrick Mitchell v Democratic Republic of the Congo*, ICSID Case No. ARB/99/7, Decision on the Stay of Enforcement of the Award (9 February 2004) paras 28–31; *Jan de Nul N.V. and Dreging International N.V. v Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Decision on Jurisdiction (16 June 2006) para 91; *Saipem S.p.A. v The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures (21 March 2007) para 99; *Ioannis Kardassopoulos v The Republic of Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction (6 July 2007) para 116; *Helnan International Hotels v Egypt* (n 1) para 77; *Malaysian Historical Salvors SDN BHD v The Government of Malaysia*, ICSID Case No. ARB/05/10, Dissenting Opinion of Judge Mohamed Shahabuddeen (19 February 2009) paras 17–18; *Millicom International Operations B.V. and Sentel GSM S.A. v The Republic of Senegal*, ICSID Case No. ARB/08/20, Decision on Jurisdiction of the Arbitral Tribunal (16 July 2010) para 80, finding all four criteria to be fulfilled without commenting on the relevance of each of them; sceptical on the future relevance are Antonio Parra, 'The Convention and Centre for Settlement of Investment Disputes' (2014) 374 Recueil des Cours 313, 342; Emmanuel Gaillard and Yas Banifatemi, 'The Long March Towards a Jurisprudence Constante on the Notion of Investment: Salini v. Morocco, ICSID Case No. ARB/00/4' in Mairée Uran Bidegain and others (eds), *Building International Investment Law: The First 50 Years of ICSID* (ICSID, Wolters Kluwer 2016) 119.

5 Other tribunals have rejected the criterion, for example because it was impossible to ascertain that a contribution to the host state's development was a consequence, not a requirement of investment, see *Saba Fakes v Turkey* (n 1) para 111; *Alpha Projektholding GmbH v Ukraine*, ICSID Case No. ARB/07/16, Award (8 November 2010) para 312; *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction (27 September 2012) para 220; *Electrabel S.A. v Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability (30 November 2012) para 5.43; *KT Asia Investment Group B.V. v Republic of Kazakhstan*, ICSID Case No. ARB/09/8, Award (17 October 2013) para 171.

b) Contribution to development as an indirect obligation

The requirement to contribute to the host state's development implies an indirect obligation as defined in Chapter 6. It entails the behavioural expectation that investors must contribute to the host state's development. If they do not act accordingly, they suffer the sanction of being precluded from filing an ICSID arbitration claim. They lose their procedural protection against any adverse host state action.

It is also an indirect obligation that relates to the public interest because it considers how the investment benefits society. For example, in the *Salini* award, the claimants constructed a part of a highway between the Moroccan cities Rabat and Fès. The Tribunal affirmed the contribution to Morocco's development because the construction of infrastructure was a public task. To build a highway served the public. Besides, the transfer of construction expertise to Morocco was also beneficial.[6]

This shows that the requirement tests the foreign investment's role and value for society. In turn, investors must make sure that they contribute to the host state's development to safeguard their right to file an ICSID claim. Incidentally, this may serve the public interest as investors might behave more public interest-friendly for their own sake.

Furthermore, the criterion also operates on the level of international law. The right to file an ICSID claim against the host state follows from the IIA's arbitration clause. Thus, the *Salini* requirement potentially holds a negative consequence with regard to an international right. What is more, the standard of 'contribution to development' itself is international in character. It follows from Art 25 (1) ICSID Convention, an international treaty.

c) Vague content of the obligation

However, the content of this indirect obligation is relatively indeterminate. As seen, the Tribunal in the *Salini* award only laid out why the investment at hand contributed to Morocco's development. It did not

6 *Salini v Morocco* (n 2) para 57; but see the critical remark that the award actually showed a very limited effective transfer of know-how by Farouk Yala, 'The Notion of "Investment" in ICSID Case Law: A Drifting Jurisdictional Requirement? Some "Un-Conventional" Thoughts on Salini, SGS and Mihaly' (2005) 22(2) Journal of International Arbitration 105, 111.

develop an abstract test to assess the investment – in other words, what conduct exactly is to be expected from the investor to meet the jurisdiction threshold. Other awards following *Salini* also remained ambiguous in this regard. Some added that the contribution must be 'significant'[7] – apparently setting a form of minimum threshold.

Yet, one can discern lines of cases that, at least to some extent, outline a material scope of expected conduct: some hold that investors must have a general positive impact on the host state's national economy (1), while others also indicate that other forms of the public interest might be relevant as well (2).

(1) The economy as a public good

The *Salini* award already explicitly required a 'contribution to the *economic* development'.[8] Similarly, the Tribunal in *GEA v Ukraine* confirmed that the claimant contributed to Ukraine's development

> […] in the form of over one million metric tons of diesel and naphtha, catalysts and other materials, delivered to Ukraine as part of a broad economic operation, as well as the contribution of the Claimant's know-how on logistics, marketing, and the mobilisation of repairs and services.[9]

In the same vein, the Tribunal in *Toto Costruzioni Generali SpA v Lebanon* considered that the construction of a part of a highway between Beirut and Damascus advanced 'Lebanon's position as a transit country for goods from and to Middle East countries'[10] and thus contributed to Lebanon's economy.

The Tribunal in *Malaysian Historical Salvors v Malaysia* took a rather strict approach and construed the requirement to be met only in case of the investment having an impact on the economy and to be rejected when the economy is not affected. The claimant performed marine salvage services to Malaysia for a ship sunken off Malaysia's coast to enable Malaysia

7 See for example *Joy Mining Machinery v Egypt* (n 1) para 53; *MHS v Malaysia*, Award on Jurisdiction (n 1) para 138.

8 *Salini v Morocco* (n 2) para 52 (emphasis added).

9 *GEA Group Aktiengesellschaft v Ukraine*, ICSID Case No. ARB/08/16, Award (31 March 2011) para 52.

10 *Toto Costruzioni Generali S.P.A. v Republic of Lebanon*, ICSID Case No. ARB/07/12, Decision on Jurisdiction (11 September 2009) para 86 lit d).

to recover Chinese porcelain. The Tribunal rejected its jurisdiction. It argued that the benefits of the claimant's activities were merely cultural and historical in nature, lacking any economic impact.[11]

All these awards indicate that the investor's conduct must, in some way, be beneficial to the host state's economy. This line of argument conforms with the concept of an indirect obligation: A strong national economy constitutes a public good. Thus, the requirement expresses that foreign investments should not only serve the investor's financial interests but rather, they should overall strengthen national economy to the benefit of everyone. However, in the cases mentioned above, the Tribunals appear to have applied a rather broad test. Apparently, it suffices that the investment *in general* – as identifiable from the investment strategy – brings about economic advantages to the community.

(2) Other forms of the public interest

Furthermore, there are indications that the investor also should contribute to other forms of the public interest to establish ICSID jurisdiction.

Schreuer finds it possible to integrate considerations of 'development of human potential, political and social development and the protection of the local and the global environment.'[12] Similarly, others propose to read the concept of sustainable development into the notion of 'development'.[13]

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11 *MHS v Malaysia*, Award on Jurisdiction (n 1) paras 113, 138. Later, the Ad-Hoc Committee in *MHS v Malaysia*, Decision on the Application for Annulment (n 1) paras 77–81 annulled the award, rejecting the requirement of contribution to the host state's development altogether.

12 Schreuer, *ICSID* (n 1) Art 25 para 74. Such an interpretation is also supported by Martin Endicott, 'The Definition of Investment in ICSID Arbitration: Development Lessons for the WTO?' in Marie-Claire Cordonier Segger and Markus W Gehring (eds), *Sustainable Development in World Trade Law* (Kluwer Law International 2005) 390–391; Marek Jeżweski, 'Development Considerations in Defining Investment' in Marie-Claire Cordonier Segger, Markus W Gehring and Andrew P Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer Law International 2011) 216; for a contrary view see Sven L E Johannsen, *Der Investitionsbegriff nach Art. 25 Abs. 1 der ICSID-Konvention* (Martin-Luther-Universität Halle-Wittenberg Institut für Wirtschaftsrecht 2009) 21–22.

13 Supported for example by Diane A Desierto, 'Development as an International Right: Investment in the New Trade-Based IIAs' (2011) 3(2) Trade, Law and Development 296, 298; Diane A Desierto, 'Deciding International Investment

In this direction, the Tribunal in *RSM Production Corporation v Grenada* required 'a contribution to the economic and *social* development of the host state'.[14] This indicates that the investment must do more than benefit the respective national economy. For example, one could imagine that strengthening employment could qualify as a social contribution. However, when the Tribunal applied its definition to the facts of the case, it emphasised the economic impact without elaborating on the social dimension. It held that the oil exploration at stake 'was in Grenada's public interest to ascertain whether the country had commercially viable resources in offshore petroleum.'[15]

In *Víctor Pey Casado and President Allene Foundation v Republic of Chile*, the Tribunal considered other forms of the public interest more explicitly. The claimant was the publisher and owner of the newspaper 'El Clarín'. After Pinochet came into power, the government confiscated the newspaper.[16] The Tribunal affirmed that the investment contributed without doubt to Chile's economic, social and cultural progression ('[…] contribuyó sin duda alguna al progreso económico, social y cultural del país'[17]). This decision vaguely expressed that it was relevant, in the Tribunal's view, how the investor's conduct affected social and cultural conditions in Chile. It remained unclear if this contribution was an alternative requirement in relation to a support of the national economy – or if ICSID

Agreement Applicability: The Development Argument in Investment' in Freya Baetens (ed), *Investment Law Within International Law: Integrationist Perspectives* (Cambridge University Press 2013) 253; Jeżweski (n 12) 235; for a sceptical perspective see Stephan W Schill, 'Investitionsschutzrecht als Entwicklungsvölkerrecht' (2012) 72(2) Zeitschrift für ausländisches öffentliches Recht und Völkerrecht 261, 287 who argues that the host state has sufficient means to exclude unwanted investments through its domestic law; Julian Scheu, *Systematische Berücksichtigung von Menschenrechten in Investitionsschiedsverfahren* (Nomos 2017) 303 who considers that qualitative elements of an investment such as duration and risk lead to a presumption that the investment is favourable for the host state's development. Generally on the concept of sustainable development see only UNGA 'Rio Declaration on Environment and Development' UN Doc A/CONF.151/26 (Vol. I) (12 August 1992); Ulrich Beyerlin, 'Sustainable Development' in Anne Peters (ed), *Max Planck Encyclopedia of Public International Law* (October 2013) para 11.

14 *RSM v Grenada* (n 1) para 240 (emphasis added).

15 ibid 245 (emphasis added).

16 *Víctor Pey Casado and President Allende Foundation v Chile* (n 1) paras 56–80.

17 ibid 234. This finding is notable even though the Tribunal rejected the *Salini* requirement and considered it to be fulfilled only as a subsidiary argument.

tribunals only had jurisdiction if investors in some form also promoted the host state's society and culture.

2. Compliance with host state's domestic law before admission

A more concrete indirect obligation follows from the jurisdiction requirement that investors must comply with the host state's domestic law.

The requirement is established in arbitral jurisprudence even without explicit basis in the applicable IIA (a). It implies an indirect obligation. If investors do not comply, they lose the right to file an investment arbitration claim (b). This indirect obligation's content can potentially relate to the protection of all forms of the public interest – depending on the purpose of the respective domestic provision. Yet, investment law doctrine modifies the underlying domestic norm by adding certain qualifications (c).

a) Compliance as a jurisdiction requirement

There are explicit and implicit bases for the requirement of compliance with domestic law – sometimes also coined the 'legality requirement'. Many IIAs contain a clause which define that only investments which comply with the host state's domestic law receive protection.[18] This type of clause determines not only the substantive scope of investor rights but also serves as a basis for tribunals to accept or reject jurisdiction for arbitral claims. Even without an explicit clause, the majority of tribunals interpret IIAs as implying such a requirement. The main argument is a teleological interpretation of IIAs: States would not intend to provide investment protection for investments which contravene their domestic law.[19]

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18 For other clauses that require compliance with host state law see for example on market access Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (2nd edn, Oxford University Press 2012) 88–90.

19 See *Salini v Morocco* (n 2) para 46; see also *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award (27 August 2008) paras 138–139; *SAUR International S.A. v Republic of Argentina*, ICSID Case No. ARB/04/4, Decision on Jurisdiction and Liability (6 June 2012) para 308; *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v Republic of Albania*, ICSID Case No. ARB/11/24, Award (30 March 2015) paras 293, 359–360. There is also a historical argument based on the *travaux préparatoires*, see *Inceysa Vallisoletana, S.L. v Republic of El*

In applying the legality requirement, most tribunals make a temporal distinction. Only compliance until the investment is admitted to and established in the host state is a question of jurisdiction.[20] In contrast, non-compliance after admission is a matter for the merits.[21] Only few tribunals have rejected such a temporal differentiation.[22] Consequently, this Section will only address legality at the time of admission.

Salvador, ICSID Case No. ARB/03/26, Award (2 August 2006) paras 192–195 and the consideration that the legality requirement follows from the need for objective protection of the international investment protection system or is even a general principle of law, see *Gustav FW Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No. ARB/07/24, Award (18 June 2010) paras 123–124; furthermore, it was considered to follow from Art 25 (1) ICSID Convention by *Phoenix Action, Ltd. v The Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009) para 113; for a contrary result that rejects a requirement of legality because the applicable IIA's wording indicated that there had to be an express basis for such a requirement which was absent in the treaty at hand see *Bear Creek Mining Corporation v Republic of Perú*, ICSID Case No. ARB/14/21, Award (30 November 2017) paras 319–322, 335. The Tribunal in *Blusun S.A, Jean-Pierre Lecorcier and Michael Stein v Italian Republic*, ICSID Case No. ARB/14/3, Award (27 December 2016) para 264 deduced the legality requirement from the principle of international public order – a position which does seem to conflate the levels of domestic and international law.

20 *Fraport v Philippines (Fraport I)*, Award (n 1) paras 334–340, 401; *Inceysa v El Salvador* (n 19) paras 142–145; *Saba Fakes v Turkey* (n 1) paras 112–114; Stephan W Schill, 'Illegal Investments in Investment Treaty Arbitration' (2012) 11(2) The Law & Practice of International Courts and Tribunals 281, 307–308; Nathalie Bernasconi-Osterwalder, 'Inclusion of Investor Obligations and Corporate Accountability Provisions in Investment Agreements' in Julien Chaisse, Leïla Choukroune and Sufian Jusoh (eds), *Handbook of International Investment Law and Policy* (Springer 2021) 473; see also the overview by Katharina Diel-Gligor and Rudolf Hennecke, 'Investment in Accordance with the Law' in Marc Bungenberg and others (eds), *International Investment Law* (Nomos 2015) paras 11–15.

21 It belongs to the requirements of investor rights according to *Hamester v Ghana* (n 19) para 129 or to the quantum phase as found by *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No. AA 227, Final Award (18 July 2014) paras 1354–1355; for a criticism see for example Patrick Dumberry, 'State of Confusion: The Doctrine of "Clean Hands" in Investment Arbitration After the Yukos Award' (2016) 17(2) Journal of World Investment & Trade 229, 242–245.

22 For example *Vladimir Berschader and Moše Berschader v The Russian Federation*, SCC Case No 080/2004, Award (21 April 2006) para 111 which regarded compliance with domestic law at the time of the investment's admission as a question of the merits of the case; *Mamidoil v Albania* (n 19) paras 289–290 which dealt with domestic law compliance both on the stage of jurisdiction and on the merits. For an analysis of this question see Ursula Kriebaum, 'Investment Arbitration –

b) Compliance as an established indirect obligation

The legality requirement constitutes an indirect obligation. Domestic rules serve as the implied standard of conduct. If investors violate a domestic rule before the investment is admitted to the host state, the tribunal will reject its jurisdiction, depriving the investors of their right to file an arbitral claim. Many domestic rules set public interest standards. By referring to these norms, the legality requirement incites public interest-friendly behaviour: Investors will avoid violating any such rules – and thus harming the public interest – in order to qualify for investment arbitration. Similarly, UNCTAD understands the legality requirement as a policy option to bring about investor obligations and responsibilities as a way to '[e]stablish sanctions' in order to 'promote compliance by investors with domestic […] norms'.[23]

For example, in *Fraport v Philippines (Fraport I)*, the respondent argued that the investor had circumvented domestic law at the investment's admission. It contended that the investor did not fulfil the constitutional requirement under which foreign investors may only hold up to 40 percent of shares of a Philippian company. To undermine this rule, the investor had concluded covert strawmen agreements in violation of a Philippian Anti Dummy Law.[24] The Tribunal affirmed that '[r]espect for the integrity of the law of the host state is also a critical part of development and a concern of international investment law'.[25] It dismissed a violation only

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Illegal Investments' in Christian Klausegger and others (eds), *Austrian Yearbook on International Arbitration* (Stämpfli Verlag 2010) 330–334; Schill, 'Illegal' (n 20) 288–291.

23 UNCTAD 'Investment Policy Framework for Sustainable Development' UNCTAD/DIAE/PCB/2015/5 (2015), 109; see also Barnali Choudhury, 'Investor Obligations for Human Rights' (2020) 35(1–2) ICSID Review 82, 96–97 who considers this jurisdictional requirement an entry point for human rights obligations of investors.

24 *Fraport v Philippines (Fraport I)*, Award (n 1) paras 281–287; Schill, 'Illegal' (n 20) 287.

25 *Fraport v Philippines (Fraport I)*, Award (n 1) para 402. The award was later annulled because of a serious departure from a fundamental rule of procedure pursuant to Art 52 (1) (d) ICSID Convention because the claimant was not given sufficient opportunity to be heard in the proceedings. Yet, the Ad-hoc Committee did not find an annulment ground in the way the Tribunal had dealt with the criterion of compliance with domestic law, see *Fraport AG Frankfurt Airport Services Worldwide v Republic of Philippines*, ICSID Case No. ARB/03/25, Decision on the Application for Annulment of Fraport AG Frankfurt Airport Services

because any such adverse conduct by the investor could not be proven. This shows that the Tribunal understood the Anti Dummy obligation as a means to protect the Philippian rule of law. Investors should abide by the rule that imposes a maximum of shares held. Strawmen agreements attempt to circumvent this rule through non-transparent legal constructions and thus stand in conflict with the rule of law. Therefore, foreclosing a non-compliant investor from investment arbitration qualifies as a sanction for misconduct towards the rule of law – which forms a public good and part of the public interest. The Tribunal was aware of this public interest dimension as it highlighted the concern for the 'integrity' of Philippian law. Other tribunals and scholars have also affirmed the purpose to protect the public interest regarding the obligation to comply with domestic law.[26]

Interestingly, tribunals and scholars are particularly aware of this requirement's sanctioning character when it comes to domestic anti-corruption obligations. It is highly controversial if jurisdiction should be foreclosed if the host state was complicit in the corruption. There is a strong view that investors should not be able to resort to an arbitral tribunal in this case either. Proponents argue that they should suffer the negative consequence for their misconduct.[27] They hope that investors will pre-emp-

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Worldwide (23 December 2010) paras 112, 244–245; Schill, 'Illegal' (n 20) 298–299 and fn 56.

26 *Plama v Bulgaria*, Award (n 19) paras 139, 143; *Fraport v Philippines (Fraport I)*, Award (n 1) para 402; *Alasdair Ross Anderson et al v Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award (19 May 2010) para 53; Jarrod Hepburn, *Domestic Law in International Investment Arbitration* (Oxford University Press 2017) 157.

27 In favour of such an approach are for example *Fraport v Philippines (Fraport I)*, Award (n 1) para 346; *Railroad Development Corporation (RDC) v Republic of Guatemala*, ICSID Case No. ARB/07/23, Second Decision on Objections to Jurisdiction (18 May 2010) para 146; Hepburn (n 26) 157–158; see also Christina Knahr, 'Investments "In Accordance with Host State Law"' (2007) 4(5) Transnational Dispute Management 1, 16–17 who, however, does not connect this requirement with the furthering of the host state's rule of law. Notwithstanding, most tribunals held that the state's complicity exculpates the investor's breach and reopens access to investment arbitration, see *Swembalt AB, Sweden v The Republic of Latvia*, Decision (UNCITRAL, 23 October 2000) paras 33–34; *Tecnicas Medioambientales Tecmed S.A. v The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003) para 149; *Tokios Tokelės v Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 April 2004) para 86; *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary*, ICSID Case No. ARB/03/16, Award (2 October 2006) paras 456, 474; *Ioannis Kardassopoulos v Georgia* (n 4) paras 190–194; *Fraport v Philippines (Fraport I)*,

tively abstain from corruption, deterred by this eventual consequence on their investment protection. This effect of imposing a sanction precisely reflects the character of an indirect obligation.

This indirect obligation is of an international legal character for two reasons. First, the legality requirement follows from an interpretation of the IIA and its arbitration clause – hence, from an international treaty. And second, its violation has an effect on the international procedural right to file an investment arbitration claim.

Considering domestic and international law, the respective domestic obligation operates in two different manners. It, of course, remains an enforceable, directly applicable rule in the domestic legal system. In the above-mentioned example, the Philippines can enforce the respective Anti Dummy Law through domestic institutions and processes against the investor. At the same time, the obligation forms part of the jurisdiction requirements of investment arbitration – hence, appears on the level of international law in this regard. As a matter of international investment arbitration, investors are free to choose whether to comply but if they do not comply, they suffer the consequence of losing access to investment arbitration. Therefore, the legality requirement is an example of the dual character of the same rule as a (domestic) direct and an (international) indirect obligation as pointed out in Chapter 6.VI.

Award (n 1) para 346; *Desert Line Projects LLC v The Republic of Yemen*, ICSID Case No. ARB/05/17, Award (6 February 2008) para 120; *Inmaris Perestroika Sailing Maritime Services GmbH and Others v Ukraine*, ICSID Case No. ARB/08/8, Decision on Jurisdiction (8 March 2010) para 140; *RDC v Guatemala* (n 27) paras 139–147; *Alpha Projektholding v Ukraine* (n 5) para 302; *Quiborax v Bolivia*, Decision on Jurisdiction (n 5) para 257; Kriebaum, 'Investment' (n 22) 325–329; Schill, 'Illegal' (n 20) 303. Generally on corruption and investment law see the overview by Ralph A Lorz and Manuel Busch, 'Investment in Accordance with the Law – Specifically Corruption' in Marc Bungenberg and others (eds), *International Investment Law* (Nomos 2015) para 26; for in-depth analyses on the consequences of corruption see for example Andrea J Menaker, 'The Determinative Impact of Fraud and Corruption on Investment Arbitrations' (2010) 25(1) ICSID Review 67, 75; Stephan Wilske, 'Sanctions for Unethical and Illegal Behavior in International Arbitration: A Double-Edged Sword?' (2010) 3 Contemporary Asia Arbitration Journal 211, 220; Tamar Meshel, 'Use and Misuse of the Corruption Defence in International Investment Arbitration' (2013) 30(3) Journal of International Arbitration 267, 272–274, 279–281; Yarik Kryvoi, 'Economic Crimes in International Investment Law' (2018) 67(3) International & Comparative Law Quarterly 577.

c) Content of the obligation

Indirect obligations implied by the legality requirement have a well-defined content. Domestic rules spell out the expected behaviour for establishing jurisdiction. Tribunals and investors can resort to domestic jurisprudence to concretise the meaning of domestic law. So far, most tribunals and scholars concentrated on cases of fraud, corruption and misrepresentation by the investor.[28] However, in principle, it is possible that the indirect obligation can cover domestic obligations which protect very different facets of the public interest: for example, domestic human rights, labour standard or environmental obligations.[29] In the same vein,

28 See the detailed study on corruption as a defence against investment claims by Alexander Bothe, *Die 'Corruption Defence' des Gaststaats in internationalen Investitionsschiedsverfahren* (Nomos 2021); see also Martin Jarrett, Sergio Puig and Steven R Ratner, 'Towards Greater Investor Accountability: Indirect Actions, Direct Actions by States and Direct Actions by Individuals' (2021) Journal of International Dispute Settlement 1, 6, advance article version ‹https://doi.org/10.1093/jnlids/idab035› accessed 7 December 2021.

29 See Christoph Schreuer and Ursula Kriebaum, 'From Individual to Community Interest in International Investment Law' in Ulrich Fastenrath and others (eds), *From Bilateralism to Community Interest: Essays in Honour of Judge Bruno Simma* (Oxford University Press 2011) 1095 who argue that applying host state law allows tribunals to take account of environmental concerns and human rights; Patrick Dumberry and Gabrielle Dumas-Aubin, 'When and How Allegations of Human Rights Violations Can Be Raised in Investor-State Arbitration' (2012) 13 Journal of World Investment & Trade 349, 365 advocating that tribunals should consider breaches against domestic human rights as a matter of admissibility; Christian Tietje, *Individualrechte im Menschenrechts- und Investitionsschutzbereich – Kohärenz von Staaten- und Unternehmensverantwortung?* (Martin-Luther-Universität Halle-Wittenberg 2012) 19 who claims that tribunals must consider corporate human rights breaches in the tradition of the jurisprudence on the abuse of investor rights; Diane A Desierto, 'Conflict of Treaties, Interpretation, and Decision-Making on Human Rights and Investment During Economic Crises' (2013) 10(1) Transnational Dispute Management 1, 80–81 who argues that through the host state's law, an ICESCR-sensitive interpretation of IIAs could be possible; Dominik Kneer, *Investitionsschutz und Menschenrechte: Eine Untersuchung zum Einfluss menschenrechtlicher Standards auf die Investitionssicherung* (Nomos 2013) 146–147 who considers that breaches of domestic human rights could make investment claims inadmissible; specifically on environmental protection see Jorge E Viñuales, *Foreign Investment and the Environment in International Law* (Cambridge University Press 2012) 96–100 who considers arbitral case-law on domestic environmental law as a possible preliminary objection against investment claims; Jeff Sullivan and Valeriya Kirsey, 'Environmental Policies: A Shield or a Sword in Investment Arbitration?' (2017) 18(1) Journal of World Investment & Trade 100,

Cremades suggested in his Dissenting Opinion in *Fraport v Philippines (Fraport I)* that ownership prohibitions under domestic environmental law could constitute relevant domestic obligations.[30] Due to this potential, UNCTAD understands the legality requirement as an approach for a more sustainable investment law.[31]

Notwithstanding, any reference to domestic law must be subject to some limits. Investment law cannot blindly adopt domestic law as the relevant standard. Otherwise, it would be in the host state's hands alone to decide on the investor's access to arbitration – circumventing the customary principle that a state cannot invoke its national law to justify breaches of international law.[32] This is reflected in arbitral jurisprudence. Tribunals add certain qualifications to the requirement to comply with domestic law. For example, tribunals have limited the requirement to rules which specifically regulate the admission of foreign investment.[33] Others have required a certain minimum intensity regarding the violation.[34] Again, a

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118–129 on the requirements for breaches of domestic environmental law to lead to an inadmissibility of investment claims.

30 *Fraport AG Frankfurt Airport Services Worldwide v The Republic of Philippines (Fraport I)*, ICSID Case No. ARB/03/25, Dissenting Opinion of Mr Bernardo Cremades (16 August 2007) paras 10–12.

31 UNCTAD 'IPFSD' (n 23) 109.

32 Enshrined in Art 27 VCLT and Art 32 of the ILC Articles on the Responsibility of States for Internationally Wrongful Acts; also supported by Jarrett, Puig and Ratner (n 28) 9; see in detail Hepburn (n 26) 15, 193–197.

33 For example, this view excluded regulation on the telecommunication sector and competition law from the scope of the legality requirement because it did not exclusively regulate the admission of foreign investors but more generally the economy, see *Saba Fakes v Turkey* (n 1) paras 119–120; on this view see further *Inceysa v El Salvador* (n 19) paras 249–257; *Fraport v Philippines (Fraport I)*, Dissenting Opinion of Mr Bernardo Cremades (n 30) para 12; Hepburn (n 26) 148; *Álvarez y Marín Corporación S.A. and Others v República de Panamá*, ICSID Case No. ARB/15/14, Laudo (12 October 2018) para 149. However, the majority of tribunals consider all types of obligations covered, see for example *Fraport v Philippines (Fraport I)*, Award (n 1) paras 339–343, 401–403; *Plama v Bulgaria*, Award (n 19) paras 133–135; *Anderson v Costa Rica* (n 26) paras 51–59; *Hamester v Ghana* (n 19) paras 129–135; Cameron A Miles, 'Corruption, Jurisdiction and Admissibility in International Investment Claims' (2012) 3(2) Journal of International Dispute Settlement 329, 346–347; Hepburn (n 26) 148–151.

34 For the exclusion of *de minimis*-violations see *Tokios Tokelės v Ukraine* (n 27) para 85; *Alpha Projektholding v Ukraine* (n 5) para 297; see further Schill, 'Illegal' (n 20) 293; for a requirement that the investor must have violated a fundamental domestic legal principle see *Consorzio Groupement L.E.S.I.-DIPENTA v People's Democratic Republic of Algeria*, ICSID Case No. ARB/03/08, Award (10 January

number of tribunals have excluded violations in good faith or without negligence.[35] What is more, if investors contend that the domestic obligation in question violates an investor right, the tribunal must deal with the alleged violation at the merits stage. Only then it can inquire if the state itself has violated the IIA through said domestic obligation.[36]

For example, the investor could claim that the admission requirement to obtain an environmental permit violates the right to FET. In this case, tribunals cannot reject jurisdiction on the grounds that the investor did not comply with this domestic admission requirement. Otherwise, the host state could arbitrarily shield itself against a potentially legitimate claim. Instead, the tribunal has to decide on the permit requirement at the merits stage.

These reservations show that the indirect obligation to comply with domestic law sets an autonomous standard in international law. It modifies the domestic obligation on which it builds. These modifications embody a rudimentary balancing between the investors' interests and the public interest pursued by the domestic rule.[37]

The recent ICSID award in *Cortec v Kenya* confirms how the legality requirement connects to the protection of the public interest and sets an autonomous international standard building on domestic law. The claimants were engaged in a mining project at Mrima Hill in Kenya which

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2005) para II.24 (iii); *L.E.S.I. S.p.A. and ASTALDI S.p.A. v People's Democratic Republic of Algeria*, ICSID Case No. ARB/05/3, Decision (12 July 2006) para 83 (iii); *Desert Line Projects v Yemen* (n 27) para 104; *Rumeli Telekom A.S. and Telsim Mobil Telekomikasyon Hizmetleri A.S. v Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award (29 July 2008) para 319; for a requirement that the violated norm must be relevant in the domestic legal system and that the breach was intentional, see *Álvarez y Marín Corporación v Panamá* (n 33) paras 151–154.

35 For the exclusion of good faith violations see *Fraport v Philippines (Fraport I)*, Award (n 1) paras 396–398, 401, 403; similarly *Desert Line Projects v Yemen* (n 27) paras 116–117; see further Kriebaum, 'Investment' (n 22) 307, 324; for a contrary approach see *Anderson v Costa Rica* (n 26) para 52 where the Tribunal declared the investor's knowledge or intentions irrelevant for the question of compliance with host state law. For the requirement of actions against due diligence see *Anderson v Costa Rica* (n 26) paras 52, 58.

36 *Mr. Franck Charles Arif v Republic of Moldova*, ICSID Case No. ARB/11/23, Award (8 April 2013) paras 375–376; *Yukos v Russia*, Final Award (n 21) para 1355.

37 Similarly Stephanie B Leinhardt, 'Some Thoughts on Foreign Investors' Responsibilities to Respect Human Rights' (2013) 10(1) Transnational Dispute Management 1, 19–20; Diane A Desierto, *Public Policy in International Economic Law: The ICESCR in Trade, Finance, and Investment* (Oxford University Press 2015) 324–325.

the government had given special protected status as a forest reserve, nature reserve and national monument.[38] The Tribunal denied jurisdiction because the claimants had not complied with regulation on the forest and nature reserve and had failed to obtain an environmental impact assessment license before establishing the investment.[39] To reach this verdict, the Tribunal did not simply apply Kenyan law. Rather, building on the ICSID award in *Kim v Uzbekistan*[40] the tribunal made the denying of investment protection dependent on whether this was a 'proportional response' to breaching a domestic law resulting 'in a compromise of a correspondingly significant interest of the Host State'.[41] Importantly for the present context, the proportionality test consists of three steps. The second requires the Tribunal to 'assess the seriousness of the investor's conduct', including the investor's intent, exercise of due diligence and subsequent conduct.[42]

Applying this test, the Tribunal in *Cortec v Kenya* considered that it was 'difficult to overstate the importance of environmental protection in areas, such as Mrima Hill, of special vulnerability'. The Kenyan environmental regulations were 'of fundamental importance in an environmentally vulnerable area faced with a project to remove and at least partially process 130 million tonnes of Mrima Hill.'[43] It held that the claimants had 'showed serious disrespect for the fundamental public policies of the host country in relation to the environment and resource development.'[44] This shows that the Tribunal *autonomously* evaluated the domestic environmental rules and measured the investors' mining activities against the importance of environmental protection, applying a (rather vague) international proportionality test. It is important to point out that the referenced award of *Kim v Uzbekistan* dealt with alleged corruption by the investors, a category much better established in investment jurisprudence[45] – transferred

38 *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) paras 1, 5.

39 ibid 365.

40 *Vladislav Kim and Others v Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction (8 March 2017) paras 404–409.

41 ibid 413; *Cortec Mining v Kenya* (n 38) para 315.

42 *Kim v Uzbekistan* (n 40) para 407.

43 *Cortec Mining v Kenya* (n 38) paras 345–346.

44 ibid 349.

45 cf Choudhury, 'Investor' (n 23) 96–99 on the distinction between jurisdiction, requiring compliance with domestic law, and admissibility which may be rejected if the claim itself is defective in case of corruption or fraud.

in *Cortec v Kenya* to environmental issues. It appears possible to generalise this line of argument and to apply it, for example, to domestic human rights obligations.[46]

3. Compliance with international law

At times, tribunals also require investors to comply with certain rules of international law as a precondition for the admissibility of investor claims or for the respective tribunal's jurisdiction. This jurisprudence implies indirect obligations as well.

In the following Section, the analysis will demonstrate three different approaches to such indirect obligations in investment practice. Recently, states have introduced clauses into new IIAs that explicitly demand such compliance (a). Furthermore, one can find them – in less determinate forms – in arbitral jurisprudence as tribunals have required investors to comply with the *ordre public international* (b) and fundamental rules of human rights protection (c).

a) New IIA clauses with indirect obligations

New IIAs make arbitral tribunal's jurisdiction expressly dependent on compliance with international law. These clauses illustrate very clearly the presence of a new indirect obligation with the purpose to protect the rule of law.

For example, Art 13.4 of the India Model BIT stipulates:

> An investor may not submit a claim to arbitration under this Chapter if the investment has been made through fraudulent misrepresentation, concealment, corruption, money laundering or conduct amounting to an abuse of process or similar illegal mechanisms.

Art 13.4 must be understood to impose an *international* standard of conduct. The norm does not refer to domestic law. What is more, Art 11 enshrines a separate obligation to comply with domestic law – hence, Art 13.4 would have been superfluous if it solely built on domestic law. Thus, it establishes an autonomous rule that tribunals will have to concretise further. In this regard, the IIA's clause is no different compared to

46 ibid, 97.

domestic laws which use general terms to comprehensively cover different situations.

Furthermore, the clause does not constitute a direct obligation because it does not stipulate that the host state can demand compliant behaviour. Instead, it only accords the negative consequence that the investor loses the right to submit a claim to arbitration – hence, establishing an indirect obligation.

In a very interesting, complex manner, Art 18 (1) ECOWAS Investment Rules establishes an indirect obligation by stipulating:

> Where it is established by a court of competent jurisdiction of the host State that an investor has breached Article 13 of this Supplementary Act, the investor shall not be entitled to initiate any dispute settlement process established under this Supplementary Act. A host or home State may raise this as an objection to jurisdiction in any dispute under this Supplementary Act.

Art 13 ECOWAS Investment Rules determines:

> Investors and their investments shall prior to the establishment of an investment or afterwards, refrain from involving themselves in corrupt practices as defined in Article 30 of this supplementary Act.

In turn, Art 30 ECOWAS Investment Rules provides:

> Member States shall consider as criminal the following offences and investigate, prosecute and punish the said offences with appropriate sanctions
> (a) the offering […] of any pecuniary or other nature […] to any public official of the host State […] in order that the official […] act[s] or refrain[s] from acting in relation to the […] investment […].

Art 30 imposes an international obligation on the IIA's state parties to combat corruption. Art 13 is an example of a direct obligation created by diverting this state obligation to investors as discussed above in Chapter 3.II.2. To recall, it is a technique of creating an obligation directly applicable to the investor by referring to the content of a state's obligation. Here, Art 13 orders the investor to refrain from the very acts of corruption the member states are obliged to prosecute by Art 30. On this basis, member states can demand compliance and demand compensation from the investor in case of a breach as a matter of international law.

Art 18 builds on this net of obligations. It draws on the same behavioural standard, the anti-corruption norm. In case of a breach that has been

established by a court of competent jurisdiction of the host state, it accords another, different sanction: The investor can no longer initiate any dispute settlement envisaged in the ECOWAS Investment Rules. Consequently, the (diverted) anti-corruption standard also operates as an indirect obligation taking away the investor's right to file a claim.

This indirect obligation is purely international in character: The anti-corruption standard itself is part of international law as seen. The obligation's source is an international treaty: the ECOWAS Investment Rules. And the sanction therein affects the right to initiate dispute settlement procedures. Even though Art 33 also envisages national courts as relevant fora in this context, it includes access to the ECOWAS Court of Justice in case of doubt – hereby allowing for an international dispute settlement procedure.

Therefore, the ECOWAS Investment Rules illustrate well how investment practice can combine direct and indirect obligations. Here, one anti-corruption standard defines the content of three obligations: the international obligation of the ECOWAS member states, a direct and an indirect obligation of investors. It demonstrates how the same norm can have a dual (or even, if the state is included: threefold) character as part of different types of obligations. By this combination, the ECOWAS Investment Rules aim at combatting and sanctioning corruption by investors in a particularly comprehensive manner.

b) Ordre public international as an indirect obligation

Apart from these new IIAs, indirect obligations to comply with international law as a jurisdiction or admissibility requirement also exist in arbitral jurisprudence. They are much more established than the relatively few IIA clauses presented above – yet, they are also less determinate in content. This section will address the indirect obligation to comply with the *ordre public international*.

The *ordre public international* or transnational public policy is a term borrowed from private international law and commercial arbitration. The ILA defined it as a concept 'of universal application, comprising fundamental rules of natural law, principles of universal justice, *jus cogens* in public international law, and the general principles of morality accepted

by what are referred to as "civilized nations"'.[47] Although this definition resembles the concept of *ius cogens*, the two must be distinguished from each other. An important exemplary rule that most consider enjoying the status of *ordre public international* but not of *ius cogens* is the prohibition of corruption.[48] While it remains controversial if the concept should be applied to investment treaty arbitration and if it is even recognised in commercial arbitration,[49] investment tribunals have relied on the concept in investment treaty arbitration.

Investment tribunals have rejected jurisdiction for investor claims if the investor violated norms covered by the *ordre public international*. Claims that stand against the international consensus that the principle embodies should not be entertained. Sometimes, tribunals also cite the principle of good faith in addition.[50]

These norms operate as indirect obligations: In the words of the Tribunal in *World Duty Free v Kenya*, they constitute 'norms of conduct'[51]. In

47 Audley Sheppard, 'Interim ILA Report on Public Policy as a Bar to Enforcement of International Arbitral Awards' (2003) 19(2) Arbitration International 217, 220; Eric de Brabandere, 'The (Ir)Relevance of Transnational Public Policy in Investment Treaty Arbitration – a Reply to Jean-Michel Marcoux' (2020) 21(6) Journal of World Investment & Trade 847, 852. The concept must be distinguished from the *ordre public* in the domestic law of conflict. There, it is a principle by which a state bars the application of foreign domestic law and the recognition and enforcement of foreign arbitral awards due to prepondering public interest concerns. Sometimes, the term 'international *ordre public*' is used for rules which harmonise this domestic *ordre public* between different states, for example under Art V (2) New York Convention and Art 36 UNCITRAL 'Model Law on International Commercial Arbitration 1985 (With Amendments as Adopted in 2006)' UN Doc A/40/17, Annex I and UN Doc A/61/17, Annex I. On this distinction see Régis Bismuth, 'Customary Principles Regarding Public Contracts Concluded with Foreigners' in Mathias Audit and Stephan W Schill (eds), *Transnational Law of Public Contracts* (Bruylant 2016) 331; see generally on the concept *of ordre public* Martin Gebauer, 'Ordre Public (Public Policy)' in Anne Peters (ed), *Max Planck Encyclopedia of Public International Law* (May 2007) paras 1–3.

48 Bismuth (n 47) 330.

49 For a criticism that the principle is not fully established in commercial arbitration and that it should not apply to investment treaty arbitration because it is superfluous, given that investment treaties are based on public international law (rather than private autonomy) and the legality requirement already covers all the relevant constellations, see Brabandere, 'Transnational' (n 47) 852–865.

50 *Plama v Bulgaria*, Award (n 19) paras 143–144.

51 *World Duty Free Company Limited v Republic of Kenya*, ICSID Case No. ARB/00/7, Award (4 October 2006) para 139; cf Jorge E. Viñuales, 'Investor Diligence in Investment Arbitration: Sources and Arguments' (2017) 32(2) ICSID Review 346,

case of a breach, tribunals accord a sanction to the investor's procedural right to file an investment claim. So far, investment tribunals have only applied this obligation in relation to anti-corruption and anti-fraud rules. This indirect obligation addresses how the investor's conduct affects the host state's rule of law.

For example, in *Plama Consortium v Bulgaria*, the ICSID Tribunal found that the investor had fraudulently misrepresented its shareholders. It held that this conduct violated not only Bulgarian law but also the *ordre public international*.[52] The Tribunal stated that this violation foreclosed the investor from *substantive* protection under the ECT.[53] However, it also appeared to accord a procedural consequence. The Tribunal found that 'a contract obtained by wrongful means should not be enforced by a tribunal'[54] and that it 'cannot lend its support to Claimant's request'.[55] This points to an inadmissibility of the 'improper' claim.

Interestingly, the Tribunal was aware that this sanction incidentally serves the public interest. To support its argument, it invoked the purpose of the applicable ECT to further the host state's rule of law by holding:

> In accordance with the introductory note to the ECT '[t]he fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues […]'. Consequently, the ECT should be interpreted in a manner consistent with the aim of encouraging respect for the rule of law.[56]

However, the content of this indirect obligation is relatively indeterminate. It is unclear which other facets of the public interest it may cover.[57] The award in *Inceysa v El Salvador* illustrates this well. It defined the international public policy rather vaguely as 'a series of fundamental principles that constitute the very essence of the State'.[58] There is no jurisprudence if basic standards of environmental protection would qualify as such fundamental principles, for example. Even the existing practice on fraud and

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360 who considers this constellation to be an 'entry point' for norms on 'investor diligence'.

52 *Plama v Bulgaria*, Award (n 19) paras 141–142.

53 ibid 139.

54 ibid 143.

55 ibid 146.

56 ibid 139.

57 Choudhury, 'Investor' (n 23) 99 suggests that breaches of human rights could be considered contrary to international public policy.

58 *Inceysa v El Salvador* (n 19) para 245.

corruption does not elaborate on what conduct tribunals require from investors in abstract. Instead, they decide if the investor committed fraud in the specific circumstances of the case.[59] The open character of the *ordre public international* has led to scholarly suggestions that the concept could serve 'as a vehicle to impose human rights obligations in international investment arbitration'.[60]

An interesting attempt to concretise this indirect obligation can be found in *World Duty Free v Kenya*.[61] The Tribunal attempted to define more closely how the *ordre public international* protects the rule of law against corruption. To that end, it referred to state practice by arguing that 'most, if not all, countries penalise bribery'.[62] It went even further and considered international anti-bribery conventions such as the 1996 Inter-American Convention against Corruption,[63] the 1997 OECD Anti-Bribery Convention, the 1999 Criminal Law Convention on Corruption,[64] the 1999 Civil Law Convention on Corruption,[65] the 2003 Additional Protocol to the Criminal Law Convention on Corruption,[66] the 2003 African Union Convention on Preventing and Combating Corruption[67] and the 2003 UN Convention against Corruption. It also cited the non-binding

59 See also for example *Phoenix v Czech Republic* (n 19) paras 111–113.

60 Jean-Michel Marcoux, 'Transnational Public Policy as a Vehicle to Impose Human Rights Obligations in International Investment Arbitration' (2020) 21(6) Journal of World Investment & Trade 809; opposed by Brabandere, 'Transnational' (n 47).

61 While it is an investment contract arbitration that in the relevant part elaborates on the merits of the claim, it was however used as authority by the investment treaty arbitration award in *Plama Consortium v Bulgaria* for questions of jurisdiction and admissibility, see *Plama v Bulgaria*, Award (n 19) para 142 and Schill, 'Illegal' (n 20) 317.

62 *World Duty Free v Kenya* (n 51) para 142.

63 Inter-American Convention against Corruption (adopted 29 March 1996, entered into force 6 March 1997) 35 ILM 724 (Inter-American Anti-Corruption Convention).

64 Criminal Law Convention on Corruption (adopted 27 January 1999, entered into force 1 July 2002) 2216 UNTS 225 (Criminal Law Convention on Corruption).

65 Civil Law Convention on Corruption (adopted 4 November 1999, entered into force 1 November 2003) 2246 UNTS 3 (Civil Law Convention on Corruption).

66 Additional Protocol to the Criminal Law Convention on Corruption (adopted 15 May 2003, entered into force 1 February 2005) 2466 UNTS 168 (Criminal Law Convention on Corruption AP).

67 African Union Convention on Preventing and Combating Corruption (adopted 11 July 2003, entered into force 5 August 2006) 2860 UNTS 113 (AU Anti-Corruption Convention).

1996 UN General Assembly Declaration against Corruption and Bribery in International Commercial Transactions.[68]

Interestingly, then, the Tribunal explicitly held that these conventions only bind their state parties.[69] Notwithstanding, it continued by finding that the conventions

> […] have shown [States'] common will to fight corruption, not only through national legislation, as they did before, but also through international cooperation. In doing so, States not only reached a new stage in the fight against corruption, but also solidly confirmed their prior condemnation of it.[70]

It seems that the Tribunal found it possible to define the indirect obligation's content by reference to international obligations of states. Apparently, the anti-bribery conventions evidenced a universal consensus which also applied to investors. This technique resembles the diverting of state obligations to direct obligations encountered in Chapter 3.II – with the difference that, here, the Tribunal turned them into an indirect obligation.

c) Fundamental rules of human rights protection as indirect obligations

Fundamental rules of human rights protection form the standard for another indirect obligation. Tribunals have found that if investors breach them, they have no jurisdiction.

The Tribunal in *Phoenix v Czech Republic* referred to this argument in an *obiter dictum*. In the process of establishing its jurisdiction, the Tribunal elaborated that both the ICSID Convention and the BIT at stake were subject to international law. For this reason, they had to be interpreted according to Art 31 VCLT. It held that this included the giving of due regard to general principles of law. To support this finding, it pointed to the WTO Appellate Body's report in *US—Gasoline* in which the Appellate Body found that the GATT 'is not to be read in clinical isolation from pu-

68 UNGA 'United Nations Declaration Against Corruption and Bribery in International Commercial Transactions' UN Doc A/RES/51/191 (21 February 1997); the Tribunal cited the above-mentioned treaties and this declaration in *World Duty Free v Kenya* (n 51) paras 143–145.

69 *World Duty Free v Kenya* (n 51) para 146.

70 ibid.

blic international law'[71], a passage that the Tribunal quoted in its award.[72] The Tribunal went on to find that the ICSID Convention and the BIT

> […] cannot be read and interpreted in isolation from public international law, and its general principles. To take an extreme example, nobody would suggest that ICSID protection should be granted to investments made in violation of the most fundamental rules of protection of human rights, like investments in pursuance of torture or genocide or in support of slavery or trafficking of human organs.[73]

The Tribunal precisely described the functioning of an indirect obligation. It did not hold that the respondent could enforce these human rights norms against investors through investment arbitration. Instead, it elaborated on a sanction for non-compliance within investment arbitration: that tribunals could not grant ICSID protection. Consequently, violation of these international human rights norms has a negative consequence on investors' right to file an ICSID claim.

On the one hand, the award partly lays down a concrete standard of conduct. The listed examples of fundamental human rights violations are well-established prohibitions. Other international instruments concretise them, such as the Convention on the Prevention and Punishment of the Crime of Genocide[74]. On the other hand, aside from these examples, the notion of 'fundamental rules of protection of human rights' is fairly indeterminate. Notably, it does not seem possible to equate it with *ius cogens*. This follows from the presented example of trafficking of human organs. It is not accepted to have the status of *ius cogens* which reflects that, seemingly, the Tribunal did not have a reference to *ius cogens* in mind.

In contrast, the Tribunal's award in *EDF et al. v Argentina* favours such a resort to *ius cogens* as it affirmed that '[i]t is common ground that the Tribunal should be sensitive to international *jus cogens* norms, including

71 WTO, *United States—Standards for Reformulated and Conventional Gasoline* (29 April 1996) WT/DS2/AB/R.

72 *Phoenix v Czech Republic* (n 19) paras 74–77.

73 ibid 78.

74 Convention on the Prevention and Punishment of the Crime of Genocide (adopted 9 December 1948, entered into force 12 January 1951) 78 UNTS 278 (Genocide Convention).

basic principles of human rights'.[75] However, there, the Tribunal did not elaborate on the consequences of such sensitivity.

4. Interim conclusion

Section I has shown that indirect obligations are established in investment practice within investment arbitration's jurisdiction and admissibility requirements. They follow from explicit IIA clauses and from arbitral jurisprudence. Fitting the concept of indirect obligations, they imply standards of conduct and sanction non-compliance by forfeiting investor's procedural right to file an arbitral claim. The content of these standards draws on international and domestic law. Yet, they vary in how determinate they formulate the expected behaviour. For example, the requirement to contribute to the host state's development is particularly vague. In contrast, compliance with the host state's domestic law draws on concrete norms because, for example, aside from being part of the black letter law, domestic courts in most cases will have clarified their meaning.

The encountered indirect obligations examined the investor's conduct towards very different facets of the public interest. They included, for example, human rights, the rule of law, the host state's economy as well as a favourable social and cultural environment. Where domestic law defines indirect obligations' content, they can potentially cover any aspect of the public interest.

As these indirect obligations operate on the level of jurisdiction and a claim's admissibility, their sanction is relatively strong. They already hinder the tribunal from addressing the substantive matter of a dispute at the merits stage. It is apparent that the encountered indirect obligations appear to address this issue by requiring a *qualified* violation: either the indirect obligation relates to a fundamental rule,[76] or the breach must

75 *EDF International S.A. SAUR International S.A. and León Participaciones Argentinas S.A. v Argentine Republic*, ICSID Case No. ARB/03/23, Award (11 June 2012) para 909.

76 Most clearly indicated by the requirements to comply with the international *ordre public* and fundamental human rights, see Chapter 7.I.3.b) and Chapter 7.I.3.c); cf Matthew A.J. Levine, 'Emerging Practice on Investor Diligence: Jurisdiction, Admissibility, Merits' in Julien Chaisse, Leïla Choukroune and Sufian Jusoh (eds), *Handbook of International Investment Law and Policy* (Springer 2021) 1087–1088.

exceed a certain intensity,[77] or it has to constitute a *prima facie* violation.[78] It, thus, appears that the encountered indirect obligations serve to filter graver forms of investor misconduct towards the public interest. In doing so, they incidentally serve the public interest, because there is an incentive for investors to comply for their own stake. Otherwise, they will not even be heard with their substantive arguments before an arbitral tribunal.

II. Substantive requirements of investor rights

After studying jurisdiction and admissibility requirements, the analysis will now turn to investor rights' substantive requirements. This Section will show that, increasingly, tribunals and IIAs include standards for the investor's conduct in the analysis of investor rights. In most instances, tribunals have considered misconduct towards the public interest only as a balancing criterion amongst others – hence without giving rise to an indirect obligation as understood here. However, this development is notable, too. It is evidence of a tendency to make investor rights dependent on proper investor behaviour, contributing to an overall trend towards indirect obligations. What is more, in some important cases, indirect obligations can be seen to have already emerged.

This Section will present these findings alongside the different approaches that have been used to address investors' misconduct.

It will start with approaches which only consider investor misconduct as a balancing criterion: by a changing understanding of what constitutes legitimate expectations of investors (1.), through the principle of proportionality (2.) and by interpreting investor rights in the light of soft law (3.). In the next step, the analysis will turn to cases in which indirect obligations have already arisen. Namely, indirect obligations can appear in rare instances in which tribunals interpret investor rights in the light of host states' international obligations (4.). Finally, the requirement to comply with the host state's domestic law after the investment's admission implies broadly established indirect obligations already today (5.).

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77 See for example the qualifications for a breach of domestic law elaborated in Chapter 7.I.2.c).

78 For example, because the requirement of contribution to the host state's development only considers the strategic field and character of the investment, not concrete actions, see Chapter 7.I.1.c).

Excluded from this Section's scope are rules on compensation which will find separate attention in the subsequent Section III.

1. Investors' legitimate expectations

One could consider the notion of investors' 'legitimate expectations' as a possible basis for an indirect obligation. It forms part of important rights such as the right to FET. Because, by its nature, the criterion entails the taking of the investor's perspective,[79] it deserves specific attention.

This section will first lay out in which regard legitimate expectations form an established requirement especially of the right to FET and the protection against expropriation (a). Still, so far, investment practice has not applied it in a manner implying an indirect obligation as understood here. A standard of conduct that automatically deprives the investor of an investor right in case of a breach is missing. Instead, tribunals have used it to consider investors' misconduct towards the public interest as only one amongst other balancing criteria (b). Yet, there is an increasing tendency to give the criterion a more concrete content – hence, intimating a potential development of indirect obligations in the future (c).

79 cf *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v The Argentine Republic*, ICSID Case No. ARB/07/26, Award (8 December 2016) para 615: 'The next step is therefore to determine the scope of events, acts or omissions on part of the host State that are not triggering an investor's right for protection under the fair and equitable treatment standard and that it has to expect to be faced with. This is why the interpretation of this standard is usually focusing on the legitimate expectations of the investor […]. While the Tribunal understands Respondent's objection that Article IV of the BIT does not allow an extensive interpretation covering the "legitimate expectations" of the investor, the argument is simply subject to the understanding and meaning of the term "legitimate."'

a) Relevant requirements of investor rights

Most IIAs consider if the investor has legitimate expectations as part of the right to FET[80] and the protection against indirect expropriation.[81]

The right to FET developed out of the customary minimum standard of treatment of aliens. The correct definition of this right is highly controversial.[82] For example, the UNCITRAL Tribunal in *Saluka v Czech Republic* found state action that is 'manifestly inconsistent, non-transparent, unreasonable (i.e. unrelated to some rational policy) or discriminatory (i.e. based on unjustifiable distinctions)'[83] to violate the right to FET. The protection against (direct) expropriation originally limited the host state's capacity to transfer control of investors' property to itself. But many IIAs and tribunals have acknowledged that investors also receive protection against

80 See for example *Saluka Investments BV v The Czech Republic*, Partial Award (UNCITRAL, 17 March 2006) para 302; Fulvio M Palombino, *Fair and Equitable Treatment and the Fabric of General Principles* (T.M.C. Asser Press 2018) 85–119.

81 See for example *Metalclad Corporation v The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000) para 103; *Tecmed v Mexico* (n 27) para 149; Ursula Kriebaum, 'Expropriation' in Marc Bungenberg and others (eds), *International Investment Law* (Nomos 2015) paras 174–186; from the international treaty practice see for example the definition of indirect expropriation in Annex 8-A of Comprehensive Economic and Trade Agreement (adopted 30 October 2016) ‹https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3593/download› accessed 7 December 2021 (CETA) which stipulates in no 2 (c) as one criterion: 'the extent to which a measure or series of measures interferes with distinct, reasonable investment-backed expectations'.

82 For a comprehensive analysis of the right to FET see for example Christoph Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6(3) Journal of World Investment & Trade 357; see also the monographs by Mārtiņš Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (Oxford University Press 2013); Palombino (n 80); Teerawat Wongkaew, *Protection of Legitimate Expectations in Investment Treaty Arbitration* (Cambridge University Press 2019).

83 *Saluka v Czech Republic*, Partial Award (n 80) para 309. For an alternative, expansive definition, see *Tecmed v Mexico* (n 27) para 154 which interpreted the right to FET as demanding from the state to act 'in a consistent manner, free from ambiguity and totally transparently in its relationship with the foreign investor'; cf the definition of the customary minimum standard for the treatment of aliens in *L.F.H. Neer and Pauline Neer (U.S.A.) v United Mexican States* (Decision) (1926) 4 Reports of International Arbitral Awards 60, 65 which held that a 'treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.'

indirect expropriations. These are measures by the host state that have an effect tantamount to a direct expropriation by devaluating the investment's worth.[84]

The right to FET and the protection against indirect expropriation are both rather indeterminate in scope. Considering investors' legitimate expectations is a way of giving these rights a more defined content. IIAs of the newest generation even explicitly mention legitimate expectations as a criterion limiting these rights.[85] The teleological argument is that investors only deserve these rights if they could legitimately expect no interference by the state. IIAs protect investors' trust in a stable legislative framework and business environment at the time of the investment. Drastic, unpredictable changes which seriously affect the investment can constitute a breach of these rights.[86]

b) Consideration of investor misconduct

Tribunals have considered the investor's misconduct in assessing if the investor's expectations to be protected against the host state are *legitimate*. One can identify that tribunals are increasingly willing to take account of the way the investor behaves towards the public interest.

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84 See generally on expropriation Dolzer and Schreuer (n 18) 98–129 with further references. The details are highly controversial, see for example Dolzer and Schreuer (n 18) 120–123; Jeswald W Salacuse, *The Law of Investment Treaties* (3rd edn, Oxford University Press 2021) 395–423; for an in-depth analysis see for example Sebastián López Escarcena, *Indirect Expropriation in International Law* (Edward Elgar Publishing 2014); from the case law see in particular *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016) paras 287–307.

85 See for example Art 8.10 CETA which mentions the legitimate expectations of investors that accrue from a specific representation that the host state made to them.

86 For more details on legitimate expectations as an argument in the analysis of the right to FET see for example *CMS Gas Transmission Company v The Argentine Republic*, ICSID Case No. ARB/01/8, Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic (25 September 2007) paras 274–276; *LG&E Energy Corp. LG&E Capital Corp. and LG&E International, Inc. v Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (3 October 2006) paras 124–133; Schreuer, *ICSID* (n 1) Art 42 para 132; on indirect expropriation see *Tecmed v Mexico* (n 27) para 149; *Azurix Corp. v The Argentine Republic*, ICSID Case No. ARB/01/12, Award (14 July 2006) paras 316–322; Dolzer and Schreuer (n 18) 115–117.

This was not always the case. Originally, tribunals have understood the criterion as a way of distributing risks between the state and the investor. For example, the Tribunal in *Maffezzini v Spain* pointedly held that 'BITs are not an insurance against business risk'[87] – a definition that appears to examine the investor's economic decisions. This way of arguing follows a private law paradigm. It is disinclined to assess the investor's role in the host state's society more holistically.

Yet, the normative value judgment to determine what is 'legitimate' is free to consider the investor's conduct towards the public interest. In *Muchlinski*'s words: '[t]he fairness of such regulatory conduct towards investors cannot be judged without also assessing the conduct of investors towards the community on behalf of which the State may act.'[88]

Some tribunals, for example the UNCITRAL award in *Methanex v USA*, have interpreted investor rights in this manner. The claimant in this case produced methanol. A Californian ban on methanol-based fuel additives negatively affected its investment. The Tribunal rejected that the Californian ban constituted an expropriation or a violation of the right to FET. It argued *inter alia* that California was known for its environmentally-friendly policy. The investor decided to enter the market despite knowing this fact. Thus, in the absence of specific representations, the foreign investor had to bear the risk that followed from the Californian regulatory environment.[89] The Tribunal in *Unglaube v Costa Rica*, interpreting the right to FET, observed that the claimants, engaging in tourism services

87 *Emilio Agustín Maffezini v The Kingdom of Spain*, ICSID Case No. ARB/97/7, Award (13 November 2000) para 64; see also Jorge E Viñuales, 'The Environmental Regulation of Foreign Investment Schemes Under International Law' in Pierre-Marie Dupuy and Jorge E Viñuales (eds), *Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards* (Cambridge University Press 2013) 299 who elaborates on arbitral tribunals which have interpreted the right FET as allocating regulatory (rather than economic) risks between investors and the host state.

88 Peter Muchlinski, '"Caveat Investor"? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard' (2006) 55(3) International & Comparative Law Quarterly 527, 534; this necessity to analyse investors' conduct is affirmed for example by Kneer (n 29) 280; Roland Kläger, '"Fair and Equitable Treatment" and Sustainable Development' in Marie-Claire Cordonier Segger, Markus W Gehring and Andrew P Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer Law International 2011) 255; specifically on environmental protection see Viñuales, 'Environmental' (n 87) 297–301.

89 *Methanex Corporation v United States of America*, Final Award of the Tribunal on Jurisdiction and Merits (UNCITRAL, 3 August 2005) Part IV Chapter D paras 9–10.

in an environmentally sensitive area, 'were, of course, required, as part of their due diligence, to become familiar with Costa Rican law and procedure.'[90] The use of the term 'due diligence' very openly expresses behavioural expectations towards the investors as to environmental protection.[91] Other tribunals have concretised the notion of legitimate expectations in a similar manner[92] in spite of remaining criticism.[93]

Herein, the tribunals departed from an exclusive focus on the host state's measure. Instead, they considered the interests at stake through the investor's eyes. Implicitly, they gave weight to the fact that investors must, to a certain degree, conform with public interest policy established in the host state. In the example of *Methanex v USA*, the Tribunal subtly expressed that the claimant must take Californian societal preferences as they are. By investing in an environmentally-friendly state, the claimant had to conform with these policies to some degree. Therefore, this provides evidence that investment law expects proper conduct towards public goods and individual rights of others – here, as defined by Californian policy.

c) A lacking character as an indirect obligation

However, this observation also shows that the notion of legitimate expectations does not imply an indirect obligation. They do not pronounce a

90 *Marion Unglaube and Reinhard Unglaube v Republic of Costa Rica*, ICSID Case No. ARB/08/1, ARB/09/20, Award (16 May 2012) para 258.

91 Jorge E Viñuales, 'Foreign Investment and the Environment in International Law: Current Trends' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar Publishing 2019) 30 identifies 'a mindset more attuned to the current understanding of environmental protection needs' herein.

92 See for example *S.D. Myers, Inc. v Government of Canada*, Partial Award (UNCITRAL, 13 November 2000) para 263; *Saluka v Czech Republic*, Partial Award (n 80) para 305; *Charanne and Construction Investments v The Kingdom of Spain*, SCC Case No V 062/2012, Award (21 January 2016) para 505; supported by Ioana Knoll-Tudor, 'The Fair and Equitable Treatment Standard and Human Rights Norms' in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann and Francesco Francioni (eds), *Human Rights in International Investment Law and Arbitration* (Oxford University Press 2009) 326; Viñuales, 'Diligence' (n 51) 362–363; further on the relevance of the police powers doctrine Viñuales, 'Environmental' (n 87) 301–304.

93 Some criticise this jurisprudence because it relied too exclusively on the host state's regulatory intentions in assessing the police powers doctrine. See for example *Methanex v USA* (n 89) Part IV Chapter D para 7; see also Kriebaum, 'Expropriation' (n 81) paras 155–161 with further references.

certain standard of conduct. There is no automatic sanction in the form of forfeiting an investor right. Instead, legitimate expectations only constitute a requirement to consider the investor's misconduct as a balancing criterion amongst others. Vaguely, tribunals give an undefined weight to these actions. For example, in *Methanex v USA*, it remains elusive up to which point the tribunal would have expected the investor to integrate into the Californian environmentally-friendly regulatory framework.

Nevertheless, the criterion of legitimate expectations increasingly forms a focal point for interpreting investor rights mindful of the investors' conduct. Seemingly, there exists a need to worsen investors' positions under an IIA when they impair the public interest. This reinterpretation points in the same direction as indirect obligations: to make investment protection in some way dependent on proper investor behaviour.

Apart from scholarly suggestions,[94] the award in *Urbaser v Argentina* strongly indicates such tendencies. The claimant undertook water and sewage services in Argentina and contended that Argentina violated the right to FET. Further details of the case have been laid out above.[95] The Tribunal elaborated in detail on the interpretation of the right to FET in Art IV of the Spain-Argentina BIT. It is worth quoting the Tribunal's reasoning at length:

> The investor's expectations, and their importance in the particular case, are usually measured on the basis of the contractual commitments undertaken. However, these contractual rights should not be considered in isolation. They are placed in a legal frame-work embracing the rights and obligations of the host State and of its authorities, subject to the protections provided in the BIT. […]
>
> Moreover, the host State is bound by obligations under international and constitutional laws. Therefore, the host State is legitimately expected to act in furtherance of rules of law of a fundamental character. The scope of such rules is broad. […]

94 See for example Muchlinski (n 88) 550–551 who argues that investors must be aware of the regulatory environment and must foresee any likely regulatory change; Stephan W Schill, Christian J Tams and Rainer Hofmann, 'International Investment Law and Development: Friends or Foes?' in Christian J Tams, Rainer Hofmann and Stephan W Schill (eds), *International Investment Law and Development: Bridging the Gap* (Edward Elgar Publishing 2015) 26 who observe that 'in a rudimentary manner […] expectations of foreign investors need to be considered relative to the state of development of the host country.'

95 See Chapter 3.I.2.

> This means that the investor's interests are not to be identified as separate and distinct from the legal framework into which they have been placed upon entering into the investment. […] In the instant case, this obligation relates to the Government's responsibilities under the Federal Constitution to ensure the population's health and access to water and to take all measures required to that effect. […] When measures had been taken that have as their purpose and effect to implement such fundamental rights protected under the Constitution, they cannot hurt the fair and equitable treatment standard because their occurrence must have been deemed to be accepted by the investor when entering into the investment and the Concession Contract. In short, they were expected to be part of the investment's legal framework.[96]

It is striking how the Tribunal intertwined the investor's legitimate expectations with domestic and international obligations of the host state. It explicitly highlighted the investor's decision to invest in a state which is subject to certain obligations to protect the public interest – here, to ensure the right to health and access to water. The Tribunal almost appeared to extend these obligations to the investor by highlighting that it 'accepted' them.

Yet, it still only considered the investor's conduct as one balancing aspect among others in the analysis. For example, it also examined the host state's intentions and actions more closely.[97] This shows that the investor did not automatically forfeit the right to FET as a strict legal consequence of impairing the right to water. However, the award evidences an attempt to connect the definition of legitimate expectations with legal norms. Herein, it at least foreshadows a concept of the right to FET that could imply an indirect obligation in the future.

One can also identify a desire for giving weight to investors' misconduct in the most recent generation of IIAs. For example, Art X.11 CETA stipulates that one must assess the question whether a certain measure constitutes an expropriation on a case-by-case basis. To that end, one must *inter alia* consider '2. […] the extent to which the measure or series of measures interferes with *distinct*, *reasonable* investment-backed expectations; […]'

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96 *Urbaser v Argentina*, Award (n 79) paras 619, 621–622.

97 Patrick Abel, 'Counterclaims Based on International Human Rights Obligations of Investors in International Investment Arbitration: Fallacies and Potentials of the 2016 ICSID Urbaser v. Argentina Award' [2018] Brill Open Law 1, paras 624–625.

(emphasis added). What is more, the qualifying criterion of 'reasonableness' was even read into IIAs that do not contain such explicit language by investment tribunals.[98] To determine what is distinct and reasonable, the CETA Investment Court could develop a standard of conduct. If sufficiently determinate, it could constitute an indirect obligation by defining certain investor misconduct as always being unreasonable – hence depriving the investor of the right to protection against expropriation.

2. Proportionality

Furthermore, investment tribunals have examined how the investor behaves towards the public interest through the proportionality principle. It is established as a requirement especially of the right to FET and the protection against expropriation (a). Tribunals have increasingly applied it in a manner that considers investors' misconduct as a balancing criterion in the analysis. This includes, for example, their impact on human rights and the environment (b). However, the principle does not give rise to an indirect obligation. It does not establish an automatism between the breach of a certain standard of conduct and the loss of an investor right. Similar to the changing role of legitimate expectations, it is part of broader dynamics: to make investor rights dependent on proper investor conduct (c).

a) The proportionality principle in investment law

The principle of proportionality is established in various areas of international law.[99] In its most advanced form, it entails four sub-principles: The state must pursue a legitimate goal. The means applied must be suitable to achieve this goal. Furthermore, they must be necessary in the sense that there cannot be a less intrusive but equally effective alternative available.

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98 For example in *Waste Management, Inc. v United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award (30 April 2004) para 98; *Duke Energy Electroquil Partners & Electroquil S.A. v Republic of Ecuador*, ICSID Case No. ARB/04/19, Award (18 August 2008) para 340; *Plama v Bulgaria*, Award (n 19) para 219; *Chemtura Corporation v Government of Canada*, Award (UNCITRAL, 2 August 2010) para 149.

99 Some even consider it a general principle of law, for example Emily Crawford, 'Proportionality' in Anne Peters (ed), *Max Planck Encyclopedia of Public International Law* (May 2011) para 1.

Finally, the measure must be appropriate to the objective sought and to the right interfered with (proportionality *stricto sensu*).[100] The last element requires a weighing and balancing of all interests and rights involved on a case-by-case basis.

Many investment tribunals have applied the principle especially as part of the right to FET and the protection against indirect expropriation.[101] This means, to determine if the host state breached these rights, they have balanced the investor's economic interests against the rights and interests the host state pursued. Only where the state acted disproportionately, they affirmed a violation. Sometimes, the principle is also an element of clauses which exclude certain types of foreign investment from the IIA's scope of protection (so called exception clauses) and which safeguard the host state's right to regulate (right to regulate clauses). Both constitute new types of clauses which feature in the most recent generation of IIAs.[102]

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100 Supported i.e. by ibid, paras 1–2. Not every branch of international law applies all of these steps, cf Thomas Cottier and others, 'The Principle of Proportionality in International Law: Foundations and Variations' (2017) 18(4) Journal of World Investment & Trade 628, 630.

101 Sometimes this jurisprudence is also coined the police powers-doctrine. Essentially, it entails a weighing and balancing between all interests affected by the host state measure and thus constitutes a form of proportionality test, see *Tecmed v Mexico* (n 27) para 119; *Saluka v Czech Republic*, Partial Award (n 80) para 306; *Azurix v Argentina* (n 86) paras 311–312; *LG&E v Argentina*, Decision on Liability (n 86) para 194; *BG Group Plc. v Republic of Argentina*, Final Award (UNCITRAL, 24 December 2007) para 298; *Biwater Gauff v Tanzania* (n 1) paras 503, 515, 519; *Occidental Petroleum Corporation and Occidental Exploration and Production Company v Republic of Ecuador*, ICSID Case No. ARB/06/11, Award (5 October 2012) paras 404–409; Kriebaum, 'Expropriation' (n 81) para 173; Cottier and others (n 100) 657–659. The application of the principle of proportionality is for example supported by Benedict Kingsbury and Stephan W Schill, 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 75–85; Andreas Kulick, *Global Public Interest in International Investment Law* (Cambridge University Press 2012) 225–341. For the alternative approach of the 'sole effects' doctrine which only considers the host state's impact on the investment to the exclusion of other criteria, see for example *Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Award (6 February 2007) para 270; and the contrary approach of only requiring that the host state followed a legitimate purpose, see *Methanex v USA* (n 89) Part IV, Chapter D, para 7; see also Kriebaum, 'Expropriation' (n 81) paras 132, 155–161 with further references.

102 For an analysis of the proportionality principle as part of these new clauses see Jasper Krommendijk and John Morijn, '"Proportional" by What Measure(s)?

b) Consideration of investor misconduct

Increasingly, tribunals have applied the principle of proportionality to consider investor misconduct.

A good example is the ICSID award in *Tecmed v Mexico*. There, the Tribunal considered if the investor had adversely affected the environment. The investor contended that Mexico had violated the right to FET and the protection against expropriation by refusing to extend a permit. This permit served to operate a landfill of hazardous industrial waste.[103] In examining if Mexico had indirectly expropriated the investment, the Tribunal engaged in a proportionality analysis. It did so by explicitly building on jurisprudence of the European Court of Human Rights on the human right to property.[104]

To that end, it cited a passage of the ECtHR's judgment in *James and Others v UK* in which the Court required 'a reasonable relationship of proportionality between the means employed and the aim sought to be realized […] The requisite balance will not be found if the person concerned has had to bear "an individual and excessive burden"'.[105]

Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration' in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann and Francesco Francioni (eds), *Human Rights in International Investment Law and Arbitration* (Oxford University Press 2009) 437–438; Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (Oxford University Press 2015) 211–252; Cottier and others (n 100) 662–665; on the role of proportionality as part of the defence of necessity under customary international law that is not pursued here any further see Bücheler (n 102) 253–300.

103 *Tecmed v Mexico* (n 27) para 41.

104 The human right to property is enshrined in Art 1 of Protocol 1 to the European Convention for the Protection of Human Rights and Fundamental Freedoms (adopted 20 March 1952, entered into force 18 May 1954) ETS 9 (ECHR Protocol No 1). The Tribunal referred to specific case law on the principle of proportionality, see *Tecmed v Mexico* (n 27) para 122 citing *Case of Mellacher and Others v Austria* App no 10522/83, 11011/84, 11070/84, ECHR Series A no 169 (European Court of Human Rights, 19 December 1989) para 48; *Case of Pressos Compania Naviera S.A. and Others v Belgium* App no 17849/91, ECHR Series A no 332 (European Court of Human Rights, 20 November 1995) para 38; *Case of Matos e Silva, Lda. and Others v Portugal* App no 15777/89, ECHR 1996-IV (European Court of Human Rights, 16 September 1996) paras 90–92.

105 *Tecmed v Mexico* (n 27) para 122 citing *Case of James and Others v The United Kingdom* App no 8793/79, ECHR Series A no 98 (European Court of Human Rights, 21 February 1986) para 50.

This passage calls for examining the investors' conduct – if they had to bear an excessive burden. Indeed, the Tribunal considered how the investor had affected the environment and the rights of others. It held that the findings

> […] do not suggest that the violations [of the permit conditions by the investor] compromise public health, impair ecological balance or protection of the environment, or that they may be the reason for a genuine social crisis. […] [The investor's] operation of the Landfill never compromised the ecological balance, the protection of the environment or the health of the people […][106]

This award shows that because the proportionality principle is about balancing all interests affected in a concrete case, the investor's conduct towards the public interest can form an important part of this analysis. Consequently, misconduct may be an attenuating balancing factor. For example, in the case of *Tecmed v Mexico*, the Tribunal not only examined how the investor affected the right to health but it also took account of the investment's environmental impact.

c) A lacking character as an indirect obligation

Some have argued that the proportionality principle could fulfil a function which resembles an indirect obligation as understood here. For example, in their studies on public law analogies, *Kingsbury* and *Schill* criticised 'that investment treaties only impose substantive obligations on host states, without matching these investors' rights with investors' obligations'[107]. They considered that the principle of proportionality could alleviate this lack of obligations.[108]

However, in the way the proportionality principle is construed, it cannot operate as an indirect obligation as understood here. As seen, the principle takes account of the investor's misconduct as one balancing criterion among others. The tribunal still has to weigh this misconduct against many other aspects of the case: for example, the gravity of the state's misconduct, the purpose of the state's measure and how likely that measure is to improve the public interest. Necessarily, the analytical result

106 *Tecmed v Mexico* (n 27) paras 124, 148.
107 Kingsbury and Schill (n 101) 76.
108 ibid.

for the same misconduct varies from case to case. For example, in one case environmental pollution caused by investors may be grave enough to justify disqualifying them from protection. In other cases, the state's misconduct may be of greater weight, and investors may receive protection despite causing pollution.

Consequently, the principle neither formulates a defined standard of conduct, nor does it automatically apply the sanction of a loss of an investor right. For example, in *Tecmed v Mexico*, it is not possible to identify a norm that, in case of the investor's non-compliance, would have automatically led the Tribunal to consider the state's behaviour to be proportional, with the result of a complete loss of protection. Rather, misconduct only 'tips the scales' of the proportionality test to the disadvantage of the investor.

Nevertheless, the very fact that tribunals apply the principle so as to consider the investor's misconduct is a remarkable development in itself – especially appreciating that its application had been contested at least for some time by a number of tribunals.[109] It brings about a change of perspective from the host state's to the investor's actions. Similar to the findings in the previous Section on legitimate expectations, it involves appreciating the investor's role in the society – hence to express behavioural expectations that the investor should treat public goods and rights of others in a positive way. Therein, it departs from a private or commercial law paradigm which would rather frame the analysis as the delineating of risks between the two parties. As seen, the recent generation of IIAs explicitly includes the proportionality principle in the treaty texts, fuelling this development even further.

3. Interpreting rights in the light of soft law

Furthermore, a number of investment tribunals have measured the investor's conduct against soft law as they applied an investor right (a). At least, these awards indicate that conformity with soft law can form a balancing criterion in determining an investor right (b). However, one would go too far to construe an indirect obligation out of soft law without explicit basis in the IIA. Therefore, the existing practice is better understood as contributing to the already-encountered dynamics in the last Sections: to

109 For alternative approaches to interpret investor rights without entailing a proportionality analysis see n 101.

give legal relevance to investors' misconduct within the analysis of investor rights (c).

a) Soft law as interpretive standards

Two arbitral awards serve as best examples of how soft law can constitute a potential basis of indirect obligations in investment practice.

The first is the 1992 ICSID award in *SPP v Egypt*, an investment contract arbitration. The claimants had concluded a contract with Egypt to build tourist facilities at the Pyramids area near Cairo and Ras El Hekma ('Pyramids Oasis'). Later, Egypt cancelled the project and declared the lands *d'utilité publique*.[110] The claimant contended that this cancellation violated Egyptian law which was applicable in the arbitration proceedings. However, Egypt argued that the cancellation was necessary to abide by the UNESCO World Heritage Convention.[111] Its Art 4 and 5 contain an international obligation of state parties to endeavour to protect cultural property.[112] The Tribunal rejected Egypt's argument. It found it decisive that at the time of the cancellation the pyramid fields had not yet been included on the World Heritage List.

The World Heritage List contains property which the states themselves consider as forming part of cultural or natural heritage in the meaning of Art 1 and 2 of the UNESCO Convention. Importantly, it has no legally binding nature. It is non-exhaustive and has only a declaratory effect.[113] What is more, Art 6 (1) stipulates that the status of world heritage is 'without prejudice to property right provided by national legislation'. Consequently, one can consider the including of certain property on the World Heritage List as non-binding soft law.

110 *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award on the Merits (20 May 1992) paras 42–65.

111 Convention Concerning the Protection of the World Cultural and Natural Heritage (adopted 16 November 1972, entered into force 17 December 1975) 1037 UNTS 151 (World Heritage Convention).

112 On the content of this obligation see Ulrich Fastenrath, 'Das UNESCO-Übereinkommen zum Schutz des Kultur- und Naturerbes der Welt und seine Wirkungen im deutschen Recht' (2016) 54(4) Archiv des Völkerrechts 382, 396–398.

113 ibid, 394–395.

However, the Tribunal found that such listing of the Pyramids Oasis would have changed the investor's legal position.[114] After a successful listing, 'a hypothetical continuation of the Claimants' activities interfering with antiquities in the area could be considered as unlawful from the international point of view'.[115] Because of this emphasis on international law, this passage of the contract arbitration award is of relevance for treaty arbitrations, too.

Similarly, the ICSID Tribunal in *Urbaser v Argentina* considered non-legal norms as part of its inquiry into whether Argentina had breached the right to FET. As shown above, the Tribunal considered if the investor had legitimate expectations and to that end examined Argentina's domestic and international obligations.[116] However, additionally it found that the 'fair and equitable treatment standard is not focused exclusively on interests and expectations of a legal nature. It does also include the actual social and economic environment of the host State'.[117] The Tribunal then concretised these non-legal considerations as including the 'universal basic human right' to guarantee basic water supply.[118] Herein, the Tribunal appears to engage in a teleological interpretation, making use of legally non-binding norms to define the FET right's content. Indeed, already the ordinary meaning of 'fair and equitable treatment' suggests that not only strict legal standards may be of interpretive relevance.

b) Consideration of investor misconduct

Both awards at the very least considered if the investor's conduct was in line with non-legal norms as a balancing criterion. As seen, in *SPP v Egypt*, the Tribunal explicitly addressed that if the investor continued to 'interfere' with protected antiquities, the company would act unlawful and lose contractual protection. In *Urbaser v Argentina*, the investor had to

114 cf Lahra Liberti, 'The Relevance of Non-Investment Treaty Obligations in Assessing Compensation' in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann and Francesco Francioni (eds), *Human Rights in International Investment Law and Arbitration* (Oxford University Press 2009) 562 pointing out the Tribunal's reasoning that a listing would have had significant consequences on the quantum of compensation.

115 *Southern Pacific Properties v Egypt* (n 110) para 154.

116 See Chapter 7.II.1.c).

117 *Urbaser v Argentina*, Award (n 79) para 623.

118 ibid 624.

align with actual societal and economic expectations. Had it not, it appears it would have worsened its legal position in the overall balancing test that the FET right entailed.

Interestingly, the tribunals gave no regard to the fact that these norms had no legal force. They still found them relevant for taking account of the investor's conduct. The awards demonstrate a desire to make investment protection to some extent dependent on conforming with these relatively vague norms. Arguably, other tribunals could rely to that end on more determinate soft law standards such as the proliferating CSR norms. Scholars have suggested that compliance with these standards could influence investor rights' interpretation as a balancing criterion.[119]

c) Soft law as a potential indirect obligation

One step further, one could consider if soft law can give rise to an indirect obligation. For example, one could argue that *legitimate* expectations of investors only arise if they comply with applicable CSR norms. Indeed,

119 See Kneer (n 29) 286 who argues that if investors have voluntarily set CSR standards, this influences how tribunals should assess their legitimate expectations as such investors must foresee that the host state might want to take similar action, however without distinguishing between a voluntary investor and a binding state approach; Leinhardt (n 37) 23–24 claims that the interpretation of legitimate expectations should also account for the moral responsibilities of investors for human rights which should not go beyond what international instruments such as the ICESCR require – however, she does not take into account that investors are not addressees of international human rights treaties; Nitish Monebhurrun, 'Mapping the Duties of Private Companies in International Investment Law' (2017) 14(2) Brazilian Journal of International Law 50, 59–61 understands CSR norms in an IIA as a means to 'enlighten' the understanding of investor rights; Catherine Kessedjian, 'Rebalancing Investors' Rights and Obligations' (2021) 22(5–6) Journal of World Investment & Trade 645, 647–649 argues that human rights and CSR norms constitute basic principles of the international community that judges and arbitrators should apply to 'complement hard law norms […], when needed, to find an adequate solution for the particular case and context at stake'; Prabhash Ranjan, 'Investor Obligations in Investment Treaties: Missing Text or a Matter of Application?' in Jean Ho and Mavluda Sattorova (eds), *Investors' International Law* (Hart 2021) 141 for whom CSR may 'reframe' the purpose of IIAs; Barnali Choudhury, 'The Role of Soft Law Corporate Responsibilities in Defining Investor Obligations in International Investment Agreements' in Jean Ho and Mavluda Sattorova (eds), *Investors' International Law* (Hart 2021) 165–168.

it has been suggested that investors could forfeit an investor right if they breached certain soft law standards.[120]

The award in *SPP v Egypt* appears to favour such an approach. It seemed ready to accept that the investor would have forfeited its right if the company had interfered with property listed in the non-binding World Heritage List. One could understand this as an indirect obligation. If investors violate a non-binding norm – here: interfering with certain property listed as protected world heritage – they lose investment protection. However, it is likely that the Tribunal mistakenly understood the World Heritage List to be legally binding. Its reasoning that the investor's actions could be 'unlawful from the international point of view', quoted above, points to such a misunderstanding.

Moreover, it is submitted that construing soft law as indirect obligations would go too far. As demonstrated in Chapter 6.II, indirect obligations constitute partly compulsory norms: they accord a sanction in the form of a loss of an investor right. In contrast, compliance with soft law is entirely voluntary. It rests on cooperation and on businesses complying with it due to consumer pressure. Without a respective explicit clause in the IIA, the interpretation of investor rights alone cannot overcome this lack of compulsory effect. Therefore, as a matter of law, it appears more compelling to consider violations of soft law as a mere balancing criterion.

Nevertheless, the presented awards and discussions are again evidence of changing dynamics in investment law. These dynamics point towards investor rights as being in some way dependent on good investor behaviour towards the public interest – here, in the form of soft law that aims to

120 See for example Roland Kläger, 'Revising Treatment Standards – Fair and Equitable Treatment in Light of Sustainable Development' in Steffen Hindelang and Markus Krajewski (eds), *Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified* (Oxford University Press 2016) 76 who considers 'the investor's conduct including the observance of universally recognized standards' such as the ILO 'Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy' adopted by the Governing Body of the International Labour Office at its 204th Session (Geneva, November 1977) and amended at its 279th (November 2000), 295th (March 2006) and 329th (March 2017) Sessions, (1978) 17 ILM 422 (16 November 1977) ‹www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---multi/documents/publication/wcms_094386.pdf› accessed 7 December 2021, the UN Human Rights Council 'Guiding Principles on Business and Human Rights Implementing the United Nations "Protect, Respect and Remedy" Framework' UN Doc HRC/RES/17/4 (2011) and CSR standards to be 'relevant in determining' a breach of the right to FET.

protect public goods such as cultural heritage and individual rights of others.

4. Interpreting rights in the light of other host state obligations

The analysis will now turn to the use of norms which do not lack a compulsory effect: international obligations of states. By interaction with them, investment law can, already today, bring about indirect obligations under certain specific circumstances.

In the last years, tribunals and scholars have increasingly interpreted investor rights in the light of public interest obligations of the states, for example under international human rights treaties (a). By and large, such interpretation only allows to consider investor misconduct as a balancing criterion without giving rise to an indirect obligation. Yet, the increasing tendency to do so is, again, notable (b). What is more, if the host state's obligation is sufficiently specific, reading investor rights in its light does bring about an indirect obligation (c).

a) Art 31 (1) and (3) (c) VCLT

Most relevant for the present purpose are the methods of contextual interpretation and systemic interpretation of an IIA in the light of other treaties as stipulated in Art 31 (1) and (3) (c) VCLT, respectively. They allow to resort to other obligations of states which protect the public interest.

Contextual interpretation means that investor rights should be understood in a manner consistent with other provisions of the same IIA.[121] More and more, IIAs contain clauses which relate to the public interest. Here one may think of IIAs with preambular language mentioning the public interest. At the time of writing, UNCTAD lists 60 IIAs that refer to sustainable development, 188 IIAs that include 'social investment aspects (e.g. human rights, labour, health, CSR, poverty reduction)' and 121 IIAs

121 See generally on contextual interpretation of IIAs August Reinisch, 'The Interpretation of International Investment Agreements' in Marc Bungenberg and others (eds), *International Investment Law* (Nomos 2015) paras 28–39.

that mention environmental aspects in their preamble and are currently in force.[122]

In addition, the recent generation of IIAs increasingly contains provisions on the protection of the public interest.[123] For example, these IIAs prohibit the lowering of public interest standards. In this regard, the 2012 US Model BIT stipulates in Art 12 (2) that the 'Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws'.[124] Such a clause was also present in NAFTA's investment protection chapter in Art 1114 (2) which states that '[t]he Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. […]'. Equally relevant are exception or right to regulate clauses of newer IIAs. They exclude investment protection under certain circumstances if the state protects the public interest.[125] For example, the investment chapter of

122 UNCTAD 'IIA Mapping Project' ‹https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping› accessed 7 December 2021; see also more specifically related to sustainable development Tarcisio Gazzini, 'Bilateral Investment Treaties and Sustainable Development' (2014) 15(5–6) Journal of World Investment & Trade 929, 941–944; Karsten Nowrot, 'How to Include Environmental Protection, Human Rights and Sustainability in International Investment Law?' (2014) 15(3/4) Journal of World Investment & Trade 612, 630; related to human rights see Ursula Kriebaum, 'Human Rights of the Population of the Host State in International Investment Arbitration' (2009) 10(5) Journal of World Investment & Trade 653, 662.

123 Bruno Simma, 'Foreign Investment Arbitration: A Place for Human Rights?' (2011) 60(3) International & Comparative Law Quarterly 573, 581; specifically on modern expropriation clauses see Lukas Stifter and August Reinisch, 'Expropriation in the Light of the UNCTAD Investment Policy Framework for Sustainable Development' in Steffen Hindelang and Markus Krajewski (eds), *Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified* (Oxford University Press 2016) 90–96.

124 On the origins, rationale and diffusion of such clauses see Mary E Footer, 'Bits and Pieces: Social and Environmental Protection in the Regulation of Foreign Investment' (2009) 18(1) Michigan State Journal of International Law 33, 43–44; Gazzini (n 122) 944–946.

125 See for example Caroline Henckels, 'Protecting Regulatory Autonomy Through Greater Precision in Investment Treaties: The TPP, CETA, and TTIP' (2016) 19(1) Journal of International Economic Law 27 who explains how more specific language in the recent generation of IIAs contributes to strengthening host states' right to regulate.

the USMCA[126] – which replaced NAFTA – states in Art 10.11: 'Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.' Indeed, FTAs often even contain entire chapters on the public interest: one may take the EU's sustainable development chapters as an example. They may be read into the FTA's investment chapters that contain investor rights.[127]

Systemic interpretation means that IIAs should be understood to be consistent with the state parties' other international obligations. Art 31 (3) (c) VCLT provides that in interpreting a treaty, account shall be taken of '[a]ny relevant rules of international law applicable in the relations between the parties'. Thus, one has to read common international obligations of the IIA's state parties to protect the public interest into investor rights. This could, for example, include international human rights or environmental protection treaties. The interpretation of investment law in

126 Agreement between the United States of America, the United Mexican States, and Canada (adopted 30 November 2018, revised 10 December 2019 by the Protocol of Amendment, entered into force 1 July 2020) (USMCA).

127 See the USMCA's chapters 23 and 24 on labor and environment and the separate Agreement on Environmental Cooperation among the Governments of Canada, the United Mexican States, and the United States of America (adopted 30 November 2018, entered into force 1 July 2020) (ECA) which replace and build on NAFTA's two side agreements on the protection of the environment (North American Agreement on Environmental Cooperation (adopted 14 September 1993, entered into force 1 January 1994, date of termination 1 July 2020) (NAAEC)) and labour standards (North American Agreement on Labor Cooperation (adopted 14 September 1993, entered into force 1 July 1994, date of termination 1 July 2020) (NAALC)) and the labour and environmental protection chapters in later US FTAs. For a comparative analysis of these US labour and environmental protection provisions see Patrick Abel, 'Comparative Conclusions on Arbitral Dispute Settlement in Trade-Labour Matters Under US FTAs' in Henner Gött (ed), *Labour Standards in International Economic Law* (Springer International Publishing 2018) 153–184. See also the sustainable development chapters in EU FTAs, for example in CETA and the EU-South Korea Free Trade Agreement (EU-Korea FTA); for a contextualisation of these EU provisions see Frank Hoffmeister, 'The Contribution of EU Trade Agreements to the Development of International Investment Law' in Steffen Hindelang and Markus Krajewski (eds), *Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified* (Oxford University Press 2016) 361–363.

light of other international treaties is often also suggested as a means to strengthen host states' right to regulate.[128]

b) Consideration of investor misconduct

Some have suggested to use these interpretive methods in a manner which would qualify as an indirect obligation as understood here. However, it will be shown that in many cases, such interpretation does not bring about indirect obligations.

For example, NGOs have proposed such an approach in *amicus curiae* briefs in *Biwater Gauff v Tanzania*. The claimant conducted water and sewage services in Dar es Salaam. After running into financial difficulties, the company could not provide and extend the population's access to water as contractually promised. Eventually, Tanzania terminated the contract. Therein, the claimant saw a violation of the UK-Tanzania-BIT.[129] The *amici* argued that Tanzania did not violate the BIT. In their view, the investor violated its responsibility under the human right to water and under concepts of sustainable development.[130] As summarised by the Tribunal,

> [t]he *Amici* submit that human rights and sustainable development issues are factors that condition the nature and extent of the investor's responsibilities, and the balance of rights and obligations as between the investor and the host State. They conclude that foreign corporations engaged in projects intimately related to human rights and the capacity to achieve sustainable development (such as the project here), have the highest level of responsibility to meet their duties and obligations as foreign investors, before seeking the protection of international law. This is precisely because such investments necessarily carry with them very serious risks to the population at large.[131]

Following this concept, human rights would constitute an indirect obligation: if investors violate them, they are deprived of protection under the BIT. The same would be true for sustainable development – however, with a rather indeterminate standard of conduct.

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128 See Chapter 3 n 57.
129 *Biwater Gauff v Tanzania* (n 1) paras 95–228.
130 ibid 378–380.
131 ibid 380.

In the same vein scholars have suggested that investor rights do not protect against a measure that the host state takes to fulfil its international obligations. Following this interpretation, consequently, an investor right could not protect investors who infringe on, for example, international human rights.[132]

However, it is suggested that such interpretation does not bring about indirect obligations in most cases. One has to bear in mind that states enjoy certain discretion in how they fulfil most of their international obligations.[133] This means that international law often only prescribes a certain result a state must achieve while leaving the means to the policy preferences of the state. Or it even only requires from the state a certain conduct, that is, to exercise best efforts in striving for a result. Often, there are many different ways a state can live up to these international obliga-

132 In this vein Muchlinski (n 88) 535 who only generally refers to 'binding conventions'; Moshe Hirsch, 'Interactions Between Investment and Non-Investment Obligations' in Peter Muchlinski, Frederico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008) 176–177 with a sound emphasis on the point in time in which the relevant international obligation is in force; Kriebaum, 'Human' (n 122) 669 who claims that '[t]here can be no legitimate expectations that are contrary to human rights law'; Knoll-Tudor (n 92) 341 who argues that FET is about a balance at giving the host state and the investor each what is due, which must include assessing the investors' behaviour, for example if they breach international labour standards; Bruno Simma and Theodore Kill, 'Harmonizing Investment Protection and International Human Rights: First Steps Towards a Methodology' in Christina Binder and others (eds), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press 2009) 705 contending that any legitimate expectations must include 'an expectation that the State would honour its international human rights obligations'; Kneer (n 29) 282, 289 bringing forward that human rights violations by investors exclude their investment protection or reduce compensation; Filip Balcerzak, *Investor – State Arbitration and Human Rights* (Brill Nijhoff 2017) 173 agreeing with *Kill*, *Kriebaum* and *Simma* that investors must expect the host state to enforce human rights law; see also the more specific proposal by Simma (n 123) 594–596 that investors should conduct a human rights audit that also takes into account the international human rights obligations of the host state and that this impact assessment could inform the definition of 'legitimate expectations'.

133 See only Olivier D Schutter, *International Human Rights Law: Cases, Materials, Commentary* (2nd edn, Cambridge University Press 2014) 441–462; Anne Peters, *Beyond Human Rights: The Legal Status of the Individual in International Law* (Cambridge University Press 2016) 69; for an in depth-analysis of the often-relevant concept of due diligence, see Joanna Kulesza, *Due Diligence in International Law* (Brill Nijhoff 2016) 18–114.

tions. For example, international human rights provide a comprehensive system in which the state must balance the different colliding interests. In many cases, there are alternative ways it can live up to its obligations.[134] In the above-mentioned case of *Biwater Gauff v Tanzania*, the human right to water could, for example, envisage both the state and the underfinanced investor to provide the water services. In other words: it is focussed on a certain result, not the means to that end. Just as other international treaties, human rights usually do not specify how the host state should treat the investor.[135]

This is well illustrated by the *Philip Morris v Uruguay* award. Uruguay had prescribed plain packaging for tobacco products. The claimant contended that Uruguay had violated the right to FET. Yet, the Tribunal denied that Uruguay had acted arbitrarily. It observed that Uruguay had enacted said regulation to comply with its obligations under the WHO Framework Convention on Tobacco Control.[136] Its Art 2 obliges state parties to protect the population against health, social, environmental and economic consequences of tobacco consumption and exposure to tobacco smoke. Observing that the Convention imposed rather general obligations, the Tribunal affirmed that Uruguay had a 'margin of appreciation' under the IIA 'at least' in the context of regulating public health.[137]

Conversely, reading international obligations of states into investor rights does not allow to discern a specific standard of conduct. It only crystallises through the host state's policy decisions.[138] In other words,

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134 cf Simma (n 123) 591–592 on the complex task of harmonising human rights and investment law obligations in a concrete case.

135 John H Knox, 'Horizontal Human Rights Law' (2008) 102(1) American Journal of International Law 1, 18.

136 WHO Framework Convention on Tobacco Control (adopted 21 May 2003, entered into force 27 February 2005) 2302 UNTS 166 (WHO Framework Convention on Tobacco Control).

137 *Philip Morris v Uruguay* (n 84) para 399; from the literature see the discussion about the transfer of the margin of appreciation-doctrine to international investment law by Barnali Choudhury, 'Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?' (2008) 41(3) Vanderbilt Journal of Transnational Law 775, 823–827.

138 On the example of investment-labour linkages, see Henner Gött and Till P Holterhus, 'Mainstreaming Investment-Labour Linkage Through "Mega-Regional" Trade Agreements' in Henner Gött (ed), *Labour Standards in International Economic Law* (Springer International Publishing 2018) 244–252; cf the methodological remarks on norm conflicts by Jörg Kammerhofer, 'The Theory of Norm Conflict Solutions in International Investment Law' in Marie-Claire Cordonier Segger, Markus W Gehring and Andrew P Newcombe (eds), *Sus-*

there is nothing that prescribes that investors must do X in order to receive and keep the respective investor right. Human rights (or other treaties) could also have allowed them to do Y if the host state had taken Y as an alternative domestic policy.[139] The same is true for public interest provisions in the same IIA and according contextual interpretation of investor rights. Most of them give states the same discretion.

Rather, the presented methods of interpretation merely allow consideration of the investor's misconduct as one balancing criterion within the analysis of an investor right. This is a noteworthy development by itself. In the past, tribunals have sometimes categorically refused to interpret investor rights in the light of other international treaties which protect the public interest.[140] Or they gave wide deference to the host state in this regard.[141]

There are indications that tribunals are increasingly more willing to consider investor misconduct. As a consequence of the right to regulate-debate, arbitral tribunals affirm the interpretive relevance of other international treaties more and more – although the concrete interpretive impact is not always clear.[142] For example, in the above-mentioned case of *Biwater Gauff v Tanzania*, the Tribunal considered the *amicus curiae* briefs as follows:

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tainable Development in World Investment Law (Kluwer Law International 2011) 89–91; Balcerzak (n 132) 152–153.

139 For positions which too quickly and too generally exclude FET protection when the host state fulfils its international human rights obligations, see Knoll-Tudor (n 92) 341; Kneer (n 29) 288–289; Julian Scheu, 'Trust Building, Balancing, and Sanctioning: Three Pillars of a Systematic Approach to Human Rights in International Investment Law and Arbitration' (2017) 48(2) Georgetown Journal of International Law 449, 497; cf also the methodological problem of applying international obligations of states to non-state actors rightly raised by Nowrot (n 122) 637.

140 On international environmental law see *Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica*, ICSID Case No. ARB/96/1, Final Award (17 February 2000) paras 71–72.

141 Regarding indigenous peoples' rights see *Glamis Gold, Ltd. v The United States of America*, Award (UNCITRAL, 8 June 2009) para 24; *Grand River Enterprises Six Nations, Ltd. and Others v United States of America*, Award (UNCITRAL, 12 January 2011) paras 137–145; for a discussion of these cases see for example Laurence B de Chazournes and Brian McGarry, 'What Roles Can Constitutional Law Play in Investment Arbitration?' (2014) 15(5–6) Journal of World Investment & Trade 862, 872–875.

142 In this direction point for example Kriebaum, 'Human' (n 122) 676 who argues that how much weight an investment tribunal may give to human rights depends on the design of the applicable treaty; Eric de Brabandere, *Investment Treaty Arbitration as Public International Law: Procedural Aspects and Implications*

> [T]he Arbitral Tribunal has also taken into account the submissions of the Petitioners […] which emphasise countervailing factors such as the responsibility of foreign investors, both in terms of prior due diligence as well as subsequent conduct; the limit to legitimate expectations in circumstances where an investor itself takes on risks in entering a particular investment environment; and the relevance of the parties' respective rights and obligations as set out in any relevant investment agreement (here the Lease Contract).[143]

It is notable that the tribunal used the term 'obligations' also when referring to the investor. Building on the submission by the *amici* that investors had responsibilities towards the public interest, the Tribunal affirmed that it gave weight to the investor's conduct as a countervailing factor. However, it remains unclear how these 'obligations' affected the Tribunal's decision.[144] Yet, it serves as an example of an award that generally affirms the analytical relevance of the investor's misconduct towards the public interest. Apparently, the Tribunal in *Suez v Argentina* had the same in mind when it observed that obligations under international investment and human rights law are not 'inconsistent, contradictory, or mutually exclusive'[145].

(Cambridge University Press 2015) 129 who considers that human rights are relatively absent in arbitral decisions even though tribunals have relied on the jurisprudence of the ECtHR to determine a breach of investor rights; Vivian Kube and Ernst-Ulrich Petersmann, 'Human Rights Law in International Investment Arbitration' (2016) 11(1) Asian Journal of WTO & International Health Law and Policy 65, 93 who observe that 'the occasional references by arbitrators to human rights for interpretative guidance […] do not follow a transparent, legal methodology'; sceptical Marc Jacob, 'Faith Betrayed: International Investment Law and Human Rights' in Rainer Hofmann and Christian J Tams (eds), *International Investment Law and Its Others* (Nomos 2012) 45–46 finding that 'human rights arguments have to date not fared particularly well in the practice of investment tribunals.'

143 *Biwater Gauff v Tanzania* (n 1) para 601.

144 Kriebaum, 'Human' (n 122) 676.

145 *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A. v The Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Liability (30 July 2010) para 262.

c) Specific state obligations as indirect obligations

Exceptionally, contextual and systemic interpretation can imply an indirect obligation. To do so, the relevant public interest obligation of the state that should be read into an investor right must be sufficiently specific so as not to leave the state any discretion how to fulfil its obligation. Such strict obligations exist in rare instances. Without such discretion, these obligations specify what the host state must do towards private actors.[146]

For example, several international labour standards[147] qualify as sufficiently specific in this regard. To name but one, ILO Convention No 105[148] requires parties to abolish forced labour. If the state encounters an investor which engages in forced labour, it is clear what it must do: prohibit said practice. The state has no discretion in that regard. Only the actual enforcement of the obligation is left to the state.

If the IIA's state parties are also parties to the ILO Convention, one must read the Convention into investor rights through systemic interpretation according to Art 31 (3) (c) VCLT. In some cases, contextual interpretation may also apply to the same end. For example, in Art 23.3 CETA, the parties reaffirm their commitments under the ILO Declaration on Fundamental Principles and Rights at Work and ILO Conventions.

Then, the prohibition of forced labour serves as a determinate standard of conduct. If investors breach it, systemic and contextual interpretation

146 Knox (n 135) 2 has illustrated this with the model of a norm pyramid for human rights: Most human rights obligations only generally require the state to protect human rights against violations by other private actors, constituting the road floor of the pyramid. Domestic policy decisions must specify and enforce them. Higher located in the pyramid are a smaller number of private duties that human rights specify as actions necessary to protect human rights in this regard, only leaving their enforcement to governments. These are the obligations of interest here. Finally, there are very few human rights obligations which international law specifies and enforces itself – the top of the pyramid: those forming part of international criminal law. These belong to this book's category of direct obligations. See also more generally Bruno Simma and Andreas L Paulus, 'The Responsibility of Individuals for Human Rights Abuses in Internal Conflicts: A Positivist View' (1999) 93(2) American Journal of International Law 302, 313.

147 For a general call to consider labour standards see Reingard Zimmer, 'Implications of CETA and TTIP on Social Standards' in Henner Gött (ed), *Labour Standards in International Economic Law* (Springer International Publishing 2018) 218.

148 ILO Convention (No 105) concerning the Abolition of Forced Labour (adopted 25 June 1957, entered into force 17 January 1959) 320 UNTS 291 (ILO Convention No 105).

requires that they forfeit their investor rights against state measures which build on this prohibition. This consequence is automatic, because the state has no discretion in how it addresses investors who engage in forced labour. The ILO Convention specifies that it is prohibited. Nevertheless, the IIA does not integrate it as a direct obligation: the state cannot claim compliance with the prohibition through the IIA and demand compensation. Instead, it deprives investors of the rights that it would otherwise award. Thus, in this case, the presented methods of interpretation imply an indirect obligation.

Practice gave rise to a case in which such an indirect obligation would have applied if the case had not been discontinued. In *Foresti v South Africa*, investors filed a claim against South Africa which enacted mineral ownership laws to eliminate the consequences of apartheid.[149] The Convention on the Elimination of All Forms of Racial Discrimination[150] prohibits apartheid and does not leave states any discretion to that end. Hence, the Tribunal would have had to read South Africa's obligation into the applicable IIA's non-discrimination right. If the investor's mineral ownership followed from the apartheid regime, the investor would not have qualified for protection.[151] This implies an indirect obligation – if investors engage in apartheid in breach of the named prohibition, they forfeit the right to non-discrimination.

Moreover, indeed any IIA that contains substantive direct obligations as discussed in Part I, allows for such contextual interpretation of investor rights. Consistency requires that an investor who violates such direct obligations cannot be protected for the same conduct by an investor right.[152] This means that such direct obligations operate at the same time as indirect obligations.[153] They serve as a good example of the possibility that the

149 *Piero Foresti and Others v The Republic of South Africa*, ICSID Case No. ARB(AF)/07/1, Award (4 August 2010) paras 54–58, 79–82.

150 International Convention on the Suppression and Punishment of the Crime of Apartheid (adopted 30 November 1973, entered into force 18 July 1976) 1015 UNTS 243 (Anti-Apartheid Convention).

151 Similarly Simma (n 123) 585–586.

152 Supported for example by Anne-Juliette Bonzon, 'Balance Between Investment Protection and Sustainable Development in BITs' (2014) 15(5–6) Journal of World Investment & Trade 809, 822.

153 See *Hesham Talaat M. Al-Warraq v The Republic of Indonesia*, Final Award (UNCITRAL, 15 December 2014) paras 631–648, 663 in which the international obligation of investors under Art 9 Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference (adopted 5 June 1981, entered into force 23 September 1986)

same norm has a dual character as both a direct and an indirect obligation. For example, if the IIA contains a direct investor obligation prohibiting corruption, this has consequences for any investor right in the same IIA. Consistency requires that the same fraudulent conduct which violates said direct obligation cannot be protected under, for example, the right to FET.

It is notable that this type of indirect obligation has a narrower scope than the ones encountered as part of admissibility and jurisdiction requirements in the previous Section. They do not generally deprive investors of all protection in case of a breach. Instead, investors only lose protection against those state measures which serve to protect the same type of public interest as the indirect obligation. In the above-mentioned example, investors only lose protection against state measures that serve to enforce the ILO Convention. They continue to be protected against all other types of state measures. For example, they could still invoke investor rights against anti-corruption measures by the host state. In contrast, the indirect obligations encountered in Section I categorically deprived investors of access to investment arbitration.

5. Compliance with host state's domestic law after admission

Finally, the requirement to comply with the host state's domestic law forms an established indirect obligation.

Tribunals consider that investors who violate domestic law after having been admitted to the host state do not qualify for substantive investment protection under certain conditions (a). One can construe this requirement as an indirect obligation: if investors do not comply, they are deprived of substantive protection by IIAs' investor rights (b). The requirement can relate to very different facets of the public interest (c).

‹https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2399/download› accessed 7 December 2021 (OIC Investment Agreement) features both as grounds to reject international investor obligation and as the basis for a counterclaim, hence in the indirect and the direct dimension. Futhermore, if the international community would eventually decide to conclude an international treaty with directly applicable human rights obligations (see above Chapter 1.III.1), of course these obligations could be read into an IIA pursuant to Art 31 (3) (c) VCLT, see Peter Muchlinski, 'The Impact of a Business and Human Rights Treaty on Investment Law and Arbitration' in Surya Deva and David Bilchitz (eds), *Building a Treaty on Business and Human Rights: Context and Contours* (Cambridge University Press 2017) 362–370.

a) Compliance as a substantive requirement

Breaches of domestic law must take place after the admission of the investment to become a matter for the merits phase in an arbitration. Before the admission, compliance with domestic law already conditions investment tribunals' jurisdiction – bringing about an indirect obligation which affects the procedural right to file an investment claim as shown in Chapter 7.I.2. In contrast, the requirement studied here is one that has a consequence for the investor's substantive international right. It demands that the investor complies with domestic law throughout the entire performance of the investment.[154]

Again, this requirement can follow from explicit IIA clauses or as an implicit part of any investor right's personal scope – of defining what constitutes a 'foreign investment' in the meaning of the IIA. For example, as will be seen, the Tribunal in *Al-Warraq v Indonesia* applied Art 9 of the applicable OIC Agreement to that end. The provision stipulates:

> 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.

The Tribunal identified fraudulent behaviour by the investor which violated this clause.[155] The Tribunal thus concluded:

> […] that the Claimant failed to uphold the Indonesian laws and regulations. […] The Claimant having breached the local laws and put the public interest at risk, he has deprived himself of the protection afforded by the OIC Agreement.[156]

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154 See n 20 and 21.

155 *Al-Warraq v Indonesia*, Final Award (n 153) paras 631–645.

156 ibid 645. Even though the Tribunal referred to the claim's inadmissibility due to the clean hands doctrine in the subsequent paragraphs, it is submitted that the Tribunal in reality engaged in an interpretation and application of the substantive investor rights. Up until paragraph 645, the Tribunal interpreted the investor rights in the light of Art 9 OIC Investment Agreement – hence, it understood the personal scope of its rights as covering only investors that complied with this clause. It appears that the subsequent argument based on the clean hands doctrine only served to support and strengthen this argument. It has no autonomous relevance to the case. Chapter 7.IV will explain in more detail why invoking the clean hands doctrine is generally superfluous.

Even without any such explicit clause, the Tribunal in *Plama v Bulgaria* has denied substantive protection for a breach of domestic anti-corruption laws[157] – supported for example by the Tribunals in *World Duty Free v Kenya*[158] and *Yukos v Russia*.[159]

b) Compliance as an established indirect obligation

For similar reasons as its jurisdictional counterpart, the requirement implies an indirect obligation. If investors breach domestic law throughout the investment after it has been admitted, they are subject to a sanction as the IIA deprives them of substantive protection.

It is fair to say that this indirect obligation is particularly far-reaching. The investor has to observe it throughout the entire performance of the investment. This means that investment law takes account of the investor's conduct over, potentially, many years. It institutes a constant threat of sanctioning non-compliance with the depriving of substantive protection.

c) Content of the obligation

From the quoted reasoning in *Plama v Bulgaria*, it is explicitly apparent that the Tribunal measured the investor's behaviour against its impact on the public interest – here, the Indonesian rule of law. This shows that tribunals applying domestic anti-corruption laws, at least incidentally, serve this public good.

Other tribunals have applied domestic laws that protect different aspects of the public interest. For example, the ICSID Tribunal in *Maffezzini v Spain* applied Spanish domestic regulation on environmental protection. The claimant in this case was an Argentinian entrepreneur investing in the chemicals industry. The Tribunal held that Spanish law required an environmental impact assessment ('EIA'). It pointed out that international law increasingly demanded such an assessment, too. It then held that the claimant had not adequately conducted the EIA because he wanted to minimise his costs. Thus, Spain could not be responsible for interfering with

157 *Plama v Bulgaria*, Award (n 19) para 139.
158 *World Duty Free v Kenya* (n 51) para 157.
159 *Yukos v Russia*, Final Award (n 21) para 1349.

the investment based on domestic environmental law.[160] In the same vein, the ICSID Tribunal in *World Duty Free v Kenya*, an investment contract arbitration, declared the investment contract void due to corruption by the investor that *inter alia* violated the host state's domestic law.[161]

Furthermore, the Tribunal in *Quiborax v Bolivia* considered domestic labour and environmental regulation. The claimants engaged in the mining of the Bolivian Gran Slaar de Uyuni basin, an environmentally sensitive dry salt lake area. They claimed that Bolivia violated the Bolivia-Chile BIT[162] by annulling the mining concessions.[163] The respondent raised the defence that investment law did not protect the investors because they breached domestic industrial safety, environment and labour laws. The Tribunal dismissed the argument – but only for the reason that the violations were 'minor breaches of law',[164] and that 'Bolivia has not established that a lack of environmental licences would warrant the termination of the concessions.'[165]

Both awards indicate the potentially broad scope of public goods and individual rights that the indirect obligation to comply with the host state's domestic law can protect. The award in *Quiborax v Bolivia* also shows that tribunals require qualified breaches of domestic law. The respective jurisprudence on compliance with domestic host state law at the time of admission for establishing tribunals' jurisdiction applies here, too. To recall: tribunals have demanded *inter alia* that the breach reaches a certain intensity, that the investor acted negligently or in bad faith.[166] It is submitted that such qualifications are necessary: it would be disproportionate if minor breaches of domestic law could cause the drastic consequence of entirely depriving the investor of investment protection. Therefore, the indirect obligation's standard of conduct does not purely incorporate the domestic obligation but internationalises it through these qualifications.

160 *Maffezini v Spain*, Award (n 87) paras 65–71.
161 *World Duty Free v Kenya* (n 51) para 157.
162 Bolivia-Chile BIT (adopted 22 September 1994, entered into force 21 July 1999, date of termination 11 April 2020) ‹https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/448/download› accessed 7 December 2021 (Bolivia-Chile BIT).
163 *Quiborax S.A. and Non Metallic Minerals S.A. v Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Award (16 September 2015) paras 7–35.
164 ibid 219.
165 ibid 220.
166 See Chapter 7.I.2.c).

Another parallel is that non-compliance with domestic law after admission to the investment can deprive investors of investment protection entirely. This means that if investors breach domestic law that protects public good X, they may also lose investment protection against state measures that protect the entirely different public good Y. A nexus between the state's regulatory intentions and the scope of the domestic law that the investors breached is not necessary.

6. Interim conclusion

This Section has shown a development to make substantive investor rights dependent on the investor's conduct towards the public interest. Investor rights are not only about delineating the business risk undertaken by the investor anymore. Instead, investment law is increasingly also about appreciating investors' role in society, their impact on public goods and individual rights.

Tribunals have considered very different facets of the public interest to be relevant, including cultural heritage, human rights, environmental protection and the rule of law. Some of the approaches presented took account of the investor's actions only as one balancing criterion amongst others. This means that investor misconduct 'tips the scale' to the disfavour of the investor when the tribunal interprets an investor right and applies it to the facts of the case. They do not constitute indirect obligations, but serve similar functions in a less stringent, automatic way. Other doctrinal methods have already brought about indirect obligations – especially the requirement to comply with the host state's domestic law. They sanction non-compliance with a standard of conduct with the loss of investment protection.

III. Rules on compensation

The requirements of investor rights represent one side of how indirect obligations come about in substantive investment law. Of similar importance are the rules on compensation for damages caused to foreign investors by the host state. If the host state violates an investor right, it must pay

compensation following customary law of state responsibility.[167] Also, the state must pay compensation to legally expropriate an investment.[168] This Section will show that these rules, too, imply indirect obligations. These are constellations in which tribunals partly or even completely reduce the amount of compensation because the investor infringed the public interest.

This Section will examine two focal points for possible indirect obligations: Tribunals may adopt a qualitative instead of a quantitative methodology for calculating compensation or they may employ the principle of contributory negligence. As for the former, recent IIAs contain rules with indirect obligations to that end. A few arbitral awards appeared to have

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167 However, one could doubt that Art 36 ILC Articles on State Responsibility – which reflects customary law – is applicable to international investment law: Art 33 ILC Articles on State Responsibility declares the chapter on consequences for breaches of international law to be applicable only to obligations of states owed to other states or to the international community without codifying in that regard the responsibility of a state towards any person or entity other than a state. However, arbitral jurisprudence and scholars regularly resort to Art 36 ILC Articles on State Responsibility and on the relevant PCIJ's decision in *Chorzów Factory* for determining compensation for breaches of investment law given that IIAs usually do not provide any rules on the determination of the amount of compensation owed for violations of obligations, see for example *LG&E Energy Corp. LG&E Capital Corp. and LG&E International, Inc. v Argentine Republic*, ICSID Case No. ARB/02/1, Award (25 July 2007) paras 29–32; *BG Group v Argentina* (n 101) paras 422–428; *National Grid PLC v The Argentine Republic*, Award (UNCITRAL, 3 November 2008) para 269; Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law* (British Institute of International and Comparative Law 2008) 28–32; Salacuse (n 84) 555–558. Thus, the practice of investment tribunals can be understood to reflect that investment law has always entailed rules on the consequences of a breach identical to the respective inter-state law, or as a convergence of these rules crystallizing with the creation of the ILC Articles, or even as evidence of the state-centred model of international investment obligations as inter-state in their substantive nature. Irrespective of the doctrinal explanation, the applicability of the rule reflected in Art 36 ILC Articles on State Responsibility to breaches of international investment obligations is well-established, see Helmut P Aust, 'Investment Protection and Sustainable Development: What Role for the Law of State Responsibility?' in Steffen Hindelang and Markus Krajewski (eds), *Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified* (Oxford University Press 2016) 210–213 and the various possible explanations presented by Martins Paparinskis, 'Investment Treaty Arbitration and the (New) Law of State Responsibility' (2013) 24(2) European Journal of International Law 617, 635–640.

168 Dolzer and Schreuer (n 18) 100.

considered investor misconduct in calculating compensation, too – but only as a balancing criterion (1.). With regard to the latter, tribunals have applied the principle of contributory negligence in a manner that brings about indirect obligations to protect different public goods and individual rights (2.).

1. Qualitative methodology of calculating compensation

A qualitative methodology of calculating compensation may bring about indirect obligations. This Section will first explain the rules on calculation (a). Then, it will study new IIAs which contain rules that one could understand as indirect obligations. They define investor misconduct towards the public interest as a relevant criterion for the calculation (b). Apart from these new treaties, arbitral jurisprudence does not allow to discern such indirect obligations so far. Instead, some tribunals have considered investor misconduct as a vague balancing criterion that has some relevance for calculating compensation (c).

a) Rules on calculation

If an investment tribunal has determined that the state violated an investor right, it grants compensation to the investor for damages caused by this violation. This requires the tribunal to calculate the compensation. The determining of the right calculation methodology is complex, technical and often heatedly discussed by the disputing parties. Investment tribunals enjoy substantial discretion in choosing the method and, indeed, exercise this discretion in different ways.[169] Generally, these methods aim to adequately value the economic worth of the investment before the state's interference, or the loss of profit. They include, for example, market or sales comparisons, income- or asset-based valuation approaches.[170] Thus,

169 Ripinsky and Williams (n 167) 192; Jimmy S Hansen, '"Missing Links" in Investment Arbitration: Quantification of Damages to Foreign Shareholders' (2013) 14(3) Journal of World Investment & Trade 434, 446; regarding NAFTA see for example *Myers v Canada* (n 92) para 309.

170 See the in-depth analysis by Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law* (2nd edn, Oxford University Press 2017) paras 4.73–5.273.

rules on calculating compensation are usually about the most adequate *quantitative* assessment of the investment.[171]

b) Indirect obligations in new IIA clauses

However, new IIA clauses have included a *qualitative* element into these rules. They consider the investor's conduct towards the public interest as an attenuating factor. This means that if the investor adversely affects the public interest, the result of the calculation is a lower compensation.

There are new clauses which explicitly require tribunals to look into the investor's conduct[172] – without explicitly addressing its impact on the public interest. For example, Art 12 (2) of the Draft Pan African Investment Code stipulates:

> Where appropriate, the assessment of adequate compensation shall be based on an equitable balance between the public interest and interest of the investor affected, having regard to all relevant circumstances and taking account of: the current and past use of the property, the history of its acquisition, the extent of previous profit made by the foreign investor through the investment, and the duration of the investment.

Similarly, Art 6 SADC Model BIT Template proposes as the third IIA design option the following clause:

> […] fair and adequate compensation shall be based on an equitable balance between the public interest and interest of those affected, having regard for all relevant circumstances and taking into account the current and past use of the property, the history of its acquisition, the fair market value of the property, the purpose of the expropriation, the extent of previous profit made by the foreign investor through the investment, and the duration of the investment.

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171 See Toni Marzal, 'Quantum (In)Justice: Rethinking the Calculation of Compensation and Damages in ISDS' (2021) 22(2) Journal of World Investment & Trade 249, 254–279 on the evolution of quantitative calculation methods with a criticism that tribunals conceive quantum assessment as a 'fact-finding operation' and exclude 'considerations of equity, fairness or policy' (255).

172 Similar to the findings in the previous Chapters, it is by such wording in new IIA clauses that a change of perspective from the state as the entity to be disciplined to the investor is brought about.

Both clauses require the arbitral tribunal to strike a balance between private and public interests in determining the compensable damage. The listed balancing criteria also require the examining of the investor's conduct. How investors made 'use' of their property is a perspective that potentially allows to consider how their conduct affected the public interest – especially as the tribunal should consider 'all relevant circumstances'. Here, investor misconduct appears as a balancing criterion in the calculation exercise.

A more explicit reference to the public interest is offered by the 2015 India Model BIT. Its Art 5 covers the protection against expropriation and prescribes that

> […] compensation shall be adequate and be at least equivalent to the fair market value of the expropriated investment […]. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

This Article must be read together with Art 26 which is a provision on the award of an investment tribunal. It further concretises which criteria are relevant for determining the amount of compensation. It stipulates in its paragraph 3 that '[…] [f]or the calculation of monetary damages, the Tribunal shall also reduce the damages to take into account any restitution of property or repeal or modification of the measure, or other mitigating factors.[4] [sic]' Footnote 4 spells out that

> [m]itigating factors can include, current and past use of the investment, the history of its acquisition and purpose, compensation received by the investor from other sources, any unremedied harm or damage that the investor has caused to the environment or local community or other relevant considerations regarding the need to balance public interest and the interests of the investor.

It is remarkable how explicitly this footnote requires to consider how the investor affected the public interest. It specifically requires a tribunal to look into 'unremedied harm' the investor 'caused' to public goods such as the environment and individual rights of the local community. Potentially, it relates to other aspects of the public interest too, given that it also points to 'other relevant considerations'.

In doing so, one could argue that the India Model BIT brings about an indirect obligation. If the investor harms the public interest, the BIT accords a legal sanction in the form of a lower amount of compensation.

Consequently, investors partly forfeit their investor right – it is devaluated. Admittedly, this indirect obligation remains vague in its content.[173] The BIT is silent on what exactly constitutes an 'unremedied harm' to a relevant public interest. Nor does the BIT specify by how much the tribunal shall reduce the amount of compensation. Hence, alternatively, one could read the clause as merely defining investor misconduct as a relevant balancing criterion.[174] The tribunal should apply it when it makes use of its discretion to calculate compensation. Even then, the clause marks a remarkable change from a purely quantitative calculation method.

Clearer is the existence of an indirect obligation in the ECOWAS Investment Rules. Its Art 18 stipulates in the here relevant parts:

> (2) Where an investor is alleged by a host Member State […] to have failed to comply with its obligation relating to preestablishment impact assessment, the tribunal […] shall consider whether this breach [..] is materially relevant to the issues before it, and if so, what mitigating or offsetting effects this may have on the merits of a claim or on any damages awarded in the event of such award.
>
> […]
>
> (4) Where a persistent failure to comply with Article 14 or 15 is raised by a host Member State defendant […], the tribunal […] shall consider whether this breach […] is materially relevant to the issues before it, and if so, what mitigating or offsetting effects this may have on the merits of a claim or on any damages awarded in the event of such award.

Paragraph 2 refers to the pre-establishment social and environmental impact assessment obligations that Art 12 imposes on investors. Art 14 and 15 impose post-establishment investor obligations such as the obligation to 'uphold human rights in the workplace and the community in which they are located'.

By referring to these concrete standards of conduct, Art 18 construes an indirect obligation: in case the investor breaches them, the BIT accords the

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173 Notwithstanding, other indirect obligations that the analysis identified were at times vague in their scope too, see for example Chapter 7.I.1. That the standard of conduct is indeterminate does not appear to be a fundamental argument against affirming that a clause brings about an indirect obligation.

174 Similar to other identified instances in which substantive requirements of investor rights consider investor misconduct towards the public interest as a balancing criterion amongst others, see for example Chapter 7.II.2.

legal sanction of reducing compensation. The provision even sets different requirements for such an indirect obligation depending on the relevant standard of conduct. Whereas breaches of pre-establishment obligations *per se* qualify for a reduction of damages, post-establishment obligations presuppose a 'persistent failure to comply' – hence, recurring violations.

Yet, one could contest the character of an indirect obligation because the tribunal only 'may' apply a mitigating or offsetting effect. Therefore, it appears that the tribunal remains free to reduce the amount of compensation. Then, there would not be an automatic sanction in case of non-compliance. However, it seems adequate to consider Art 18 to be, at the very least, close to forming an indirect obligation. The provided criteria are fairly specific. It is unlikely that a tribunal would simply disregard them in exercising its discretion.

Surprisingly, the 2019 Netherlands Model BIT is particularly clear in instructing arbitral tribunals to take account of investor misbehaviour. Its Art 23 stipulates:

> Without prejudice to national administrative or criminal law procedures, a Tribunal, in deciding on the amount of compensation, is expected to take into account non-compliance by the investor with its commitments under the UN Guiding Principles on Business and Human Rights, and the OECD Guidelines for Multinational Enterprises.

It is remarkable that this provision builds on international CSR norms against which investors' behaviour can be tested. Notwithstanding that these norms are legally non-binding, Art 23 provides them with legal effect as tribunals could modify the calculation method by evaluating investors' behaviour towards human rights. Nonetheless, Art 23 is somewhat ambiguous in only 'expecting' – rather than 'requiring' – tribunals to take into account the investors behaviour. It seems that this expression serves to respect the discretion that the arbitrators have in deciding on the calculation methodology. As an 'expectation' is more than a simple 'suggestion', one may understand this provision as generally requiring tribunals to take account of investors' non-compliance with the listed CSR instruments while leaving tribunals leeway to disregard this criterion in exceptional circumstances.

c) Consideration of investor misconduct in arbitral awards

In contrast to these new IIA clauses, indirect obligations have not followed from calculation methods for compensation in arbitral practice. However, at least to some extent, tribunals have considered the investor's conduct towards the public interest as a relevant analytical criterion for the calculation of compensation. Herein, the tribunals show a tendency to a more qualitative calculation method – intimating the approaches of the presented new IIA clauses.

Tribunals did so by considering investors' role in society to be relevant for valuing the investment. In this direction, some tribunals expected the investor to assess the political risks in the host state[175] – indicating in vague terms that investors should conduct an impact assessment before investing.

For example, in *AMT v Zaire*, the ICSID Tribunal reduced the compensable damage caused by violent acts of Zairian soldiers. It argued that the investor had invested in Zaire knowing that it suffered from political turmoil,[176] stating that

> […] the Tribunal will opt for a method that is most plausible and realistic in the circumstances of the case, while rejecting all other methods of assessment which would serve unjustly to enrich an investor who, rightly or wrongly, has chosen to invest in a country such as Zaire, believing that by so doing the investor is constructing a castle in Spain or a Swiss chalet in Germany without any risk, political or even economic or financial or any risk whatsoever.[177]

Conversely, the Tribunal seems to have expected the investor to assess the general political situation of the host state before investing. The investor failed to do so in this case: the company did not take account of the rule of law situation in Zaire. For this reason, the investment was valued to be of less worth – and hence the investor received less compensation.

Similarly, the award in *Lemire v Ukraine* rejected a favourable calculation method the investor had suggested. It held that the method must 'reflect country risk, i.e. the fact that the same company, situated in the US or

175 Maria Gritsenko, 'Relevance of the Host State's Development Status in Investment Treaty Arbitration' in Freya Baetens (ed), *Investment Law Within International Law: Integrationist Perspectives* (Cambridge University Press 2013) 349–351.

176 *American Manufacturing & Trading, Inc. v Republic of Zaire*, ICSID Case No. ARB/93/1, Award (21 February 1997) paras 7.13–7.15; Gritsenko (n 175) 350.

177 *American Manufacturing & Trading v Zaire* (n 176) para 7.15.

in Ukraine, is subject to different political and regulatory risks'.[178] Then, the Tribunal continued to assess whether the compensation the investor claimed was 'a fair reflection of the actual loss, reasonably proportional to the investment'.[179] To answer this question, it closely inquired into the claimant's actions. It stated *inter alia* that '[h]e had the courage to venture into a transitional State',[180] was an investor 'who [took] considerable risks'[181] and 'has devoted a significant proportion of his career to the [investment project] in Ukraine, and he brought and implemented a new conception of commercial radio which was entirely new in this ex-USSR environment.'[182]

For the present purpose it is notable that the Tribunal undertook a form of proportionality analysis when it assessed the due compensation. It engaged in a qualitative weighing and balancing in calculating the compensation. The result should reflect the societal conditions the investor encountered in the host state.[183] But it also seems that the investor's actions and his impact on society were relevant for the calculation as well.

Even clearer in addressing investors' conduct towards the public interest is the ICSID award in *Bear Creek v Peru.* This Tribunal also refused to apply a calculation method the investor had suggested. Said method would have compensated the investor for profits it could have gained had the project been carried out. Yet, the investor had not proven that a hypothetical purchaser of the project would have obtained the necessary social license. It referred to the well-known resistance by local indigenous communities.[184]

Herein, the Tribunal took account of how the project affected indigenous peoples. Because the project interfered with their rights, the Tribunal considered the investment to be of less value. It is an indirect way of sanctioning a public interest-adverse investment: To engage in a project which infringes on indigenous peoples' rights from the outset reduces the

178 *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Award (28 March 2011) para 280; Gritsenko (n 175) 351.
179 *Lemire v Ukraine*, Award (n 178) para 304.
180 ibid 303.
181 ibid.
182 ibid 305.
183 cf Gritsenko (n 175) 351 who identifies that the investor has been treated favourably in the choice of calculation methodology because he was considered a 'path breaker' for necessary investment in the risky environment of Ukraine.
184 *Bear Creek v Peru*, Award (n 19) paras 595–604.

amount of compensation achievable – because potential profits cannot be claimed.

The ICSID award in *Unglaube v Costa Rica* is perhaps the clearest example for considering investor conduct towards the public interest in the calculation method. The German claimants were engaged in the tourism sector in Costa Rica. To that end they owned land close to the beach Playa Grande. This beach was also an environmentally sensitive nesting area for leatherback turtles.[185] Costa Rica intended to expropriate the claimants to protect this nesting habitat and did so after several attempts, yet without compensation.[186] The Tribunal found a breach against the protection against expropriation under the Germany-Costa Rica BIT. In determining its methodology to calculate damages, the Tribunal explicitly took into account that the area was environmentally sensitive and could only be used subject to certain limitations:

> If, as Claimants' expert has suggested, it is appropriate, in determining fair market value, to identify the highest and best use of this particular property, it seems plain to the Tribunal that that can only be the highest and best use subject to all pertinent legal, physical, and economic constraints. In this case, it obviously should refer not to high density usage – appropriate to a large city or factory area – but rather to a usage appropriate to the environmentally-sensitive surroundings – including residential home construction, with a density comparable to that permitted by the guidelines set forth in the 1992 Agreement.[187]

This included that the property could, according to national standards, only be used for example with a maximum density of 20 persons per hectare, a maximum building height of two floors and a minimum setback from the street of 7 meters.[188] This means that to the extent the claimants did not use their property environmentally-friendly, they partially lose compensation as the tribunal would not recognize that use to reflect a 'fair market value'. Here, national environmental standards translate to an international calculation method for damages.[189] The award is remarkable in light of the Tribunal's findings in *CDSE v Costa Rica* twelve years before. It also dealt with tourism in an environmentally sensitive area in Costa Rica

185 *Unglaube v Costa Rica* (n 90) paras 37–39.
186 ibid 192–223.
187 ibid 309.
188 ibid 310.
189 Supported by Viñuales, 'Foreign' (n 91) 30.

and rejected that the environmental purpose of the governmental taking could have any impact on the calculation of damages.[190]

Overall, all these awards indicate a more qualitative calculation method that takes account of the investor's behaviour towards the public interest:[191] Investors have to assess the host state's general political environment before investing and, in doing so, becoming part of the host state's society. Their decision to invest in the respective state must be reflected in the amount of compensation.

This jurisprudence does not bring about an indirect obligation because there is no automatic sanction for breaching a defined standard of conduct. Instead, the investor's behaviour constitutes a balancing criterion in the calculation method.

This is supported by the ILC commentary on Art 36 of the ILC Articles on State Responsibility. This article addresses the compensation that states owe when committing an internationally wrongful act. The commentary states:

> As to the appropriate heads of compensable damage and the principles of assessment to be applied in quantification, these will vary, depending upon the content of particular primary obligations, *an evaluation of the respective behaviour of the parties* and, more generally, a concern to reach an equitable and acceptable outcome.[192]

190 *Santa Elena v Costa Rica* (n 140) para 71.

191 It is also a scholarly suggestion, see for example Diane A Desierto, 'ICESCR Minimum Core Obligations and Investment: Recasting the Non-Expropriation Compensation Model During Financial Crises' (2012) 44(3) George Washington International Law Review 473, 519 suggesting that the value of an investment should be considered lower if the investor suffered losses because the host state had to enact social protection measures – in reaction to certain behaviour by the respective investor – in a systemic economic crisis to comply with ICESCR minimum core obligations.

192 ILC 'Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries' (2001) II(2) Yearbook of the International Law Commission, 31 (53rd session of the International Law Commission, 23 April-1 June and 2 July 2001), 100 (emphasis added); see also Desierto, *Public* (n 37) 353 who underlines that 'compensation must be *equitably* determined from the perspective of both the injuring party and the injured party' (emphasis in the original).

2. Contributory negligence

Furthermore, investment practice has given rise to indirect obligations as part of the principle of contributory negligence. If investors negligently contribute to the damages that the host state has caused, the Tribunal reduces the amount of compensation (a). Tribunals have established standards of conduct for such negligence which relate to the public interest. If investors breach them, they partly lose compensation they would otherwise have received. This meets the definition of an indirect obligation. Four arbitral awards stand out as particularly good examples: The award in *MTD v Chile* applied an environmental indirect obligation (b); the award in *Yukos v Russia*, where the Tribunal reduced the investor's compensation for violating the Russian rule of law through corruption (c); the award in *Copper Mesa v Ecuador* implied an indirect human rights obligation (d); and the award in *Bear Creek v Peru*, which concerned the indirect obligation related to the protection of indigenous peoples' rights (e).

a) Foundations of contributory negligence

Contributory negligence is a general principle of law.[193] It is reflected in Art 39 of the ILC Articles on State Responsibility. The provision stipulates that for determining reparation, 'account shall be taken of the contribution 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*.' (emphasis added). The principle applies in investment law, too. It requires that investors' conduct is (at least in part) causal for the damages that they suffered from the host state's wrongful act.[194] To the extent investors caused the damage themselves, they do not receive compensation. Tribunals may reduce the amount even down to zero if investors alone caused the damage.

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193 *Case Concerning Elettronica Sicula S.p.A. (ELSI) (USA v Italy)* (Judgment) [1989] ICJ Rep 15, paras 78, 100–101; *LaGrand Case (Germany v USA)* (Judgment) [2001] ICJ Rep 466, para 116; Borzu Sabahi, *Compensation and Restitution in Investor-State Arbitration: Principles and Practice* (Oxford University Press 2011) 175–176.

194 Brigitte Bollecker-Stern, *Le préjudice dans la théorie de la responsabilité internationale* (Editions A. Pedone 1973) 316; on this nexus between investor and state misconduct see also Jarrett, Puig and Ratner (n 28) 10.

As a first step, the tribunal will enquire who acted in a certain case, for example, who polluted the groundwater. But causation is not only a question of fact. It is well-established that one must complement the analysis with a normative assessment that involves value judgments.[195] Typical questions concern whether certain damages were foreseeable or if they follow sufficiently directly from the state's action.[196]

Investor rights inform this normative analysis. Their scope of protection and purpose guide tribunals in determining which damages the state must compensate. For example, the purpose of the right to FET is to protect investors against unforeseeable legislative changes. Thus, which damages, caused to the detriment of the investor, were foreseeable will also depend on how the tribunal interprets the right to FET. Many tribunals exclude those damages which accrue from risks that investors must bear as part of their business decision to invest; since, originally, distribution of risks was the central criterion for determining causation.[197]

b) MTD v Chile and the environment

Tribunals have drawn on indirect obligations in applying the principle of contributory negligence. They did so by including the investor's misconduct towards the public interest as a normative criterion for causation of

195 Martin Jarrett, *Contributory Fault and Investor Misconduct in Investment Arbitration* (Cambridge University Press 2019) 25.

196 The normative character of causation is explicitly pointed out in ILC 'Draft Articles on the Responsibility of International Organizations, with Commentaries' ‹http://legal.un.org/ilc/texts/instruments/english/commentaries/9_11_2011.pdf› accessed 7 December 2021, Art 31 para 10 with further references; see also André Hauriou, 'Les Dommages Indirects Dans Les Arbitrages Internationaux' (1924) 31 Revue Générale de Droit International Public 203, 209; Jarrett (n 195) 45. The proximity or foreseeability of damage was for example debated in *Trail Smelter Case (United States/Canada)* (Award) (1938 and 1941) 3 RIAA 1905, 1931 which rejected to award damages in respect to companies because they were 'too indirect and remote' as to be considered to be caused by the Trail Smelter fumes; see also Sabahi (n 193) 172.

197 See the general teleological remark by *Maffezini v Spain*, Award (n 87) para 64; more specifically on the role of risk distribution in compensation rules in international investment law see Sabahi (n 193) 120; Marboe (n 170) para 4.110; in the same vein on the international law of state responsibility see ILC 'Articles on State Responsibility with Commentaries' (n 192) 103–104.

damages. A good example portraying such an indirect obligation towards the environment is the award in *MTD v Chile*.

In this case, the claimants pursued the construction of a self-sufficient satellite city in Pirque, Chile. Yet, the Chilean authorities had zoned the pertinent area for agriculture. To realise the project, they needed to rezone the area. Due to lacking coordination between governmental agencies, Chile authorised the investment before the necessary rezoning permit had been issued. Eventually, the competent Chilean authorities rejected the rezoning permit.[198] In reaction, the claimant contended that Chile violated the obligations to MFN treatment, FET as well as expropriation and that the state breached investment contracts.[199]

The Tribunal found that Chile had violated the right to FET.[200] However, it only awarded the claimant compensation for fifty percent of the damages caused.[201] It held that 'BITs are not an insurance against business risk'[202] and that the claimants had 'failed to protect themselves against business risks inherent to their investment in Chile'.[203] It argued that a prudent businessman would have undertaken:

- to carry out at least a rudimentary inquiry on the agricultural land's quality and its role in the environmental health of the region;[204] furthermore, to verify the validity of the landowner's and the financing bank's land valuation and assumption of the region's development and re-zoning;[205]
- to seek contractual protections against losses arising from difficulties in obtaining governmental authorisations,[206] in particular, to bring about the 'issuance of the required development permits' before concluding a promissory contract on the investment;[207]
- not to proceed to enter into a promissory contract to conduct an investment without knowledge of Chile's laws despite warnings from

198 *MTD Equity Sdn. Bhd. and MTD Chile S.A. v Republic of Chile*, ICSID Case No. ARB/01/7, Award (25 May 2004) paras 39–85, 166, 253.
199 ibid 105.
200 ibid 166, 253.
201 ibid 243.
202 ibid 177; citing *Maffezini v Spain*, Award (n 87) para 69, however, the correct reference being para 64.
203 *MTD v Chile*, Award (n 198) para 253.
204 ibid 169.
205 ibid 170, 172–178.
206 ibid 170, 178.
207 ibid 178.

> government officials and without additional professional advice on risks associated with the investment.[208]

The principle of contributory negligence as applied by the Tribunal implies an indirect obligation. The standards of conduct relate to the investment's environmental impact. One can read these passages as requiring a rudimentary form of an environmental impact assessment prior to initiating the investment. Because the investors breached this standard, the Tribunal accorded a sanction: the partial loss of their investment protection by fifty percent. Notably, the Tribunal explicitly understood its findings as a means for the investor to 'bear responsibility'[209] – a term which is usually employed in the context of legal obligations.

This indirect obligation is more flexible concerning the sanction applied than the obligations encountered in the analysis of admissibility and jurisdiction requirements in Chapter 7.I and the substantive requirements of investor rights in Chapter 7.II. Instead of the alternatives of granting full or no protection, the rules on contributory negligence allow for depriving the investor of an investor right only in part in case of breaching an indirect obligation. In the example of *MTD v Chile*, the Tribunal saw equal contributions by the host state and the investor, and thus sanctioned the investor by a reduction of fifty percent.

Problematic about this award is that the underlying standard of conduct remains relatively unclear in scope. What is more, the Tribunal's reasoning in other passages emphasises that the claimant mainly violated its own interests. For example, it also remarked that the claimant had not sufficiently protected itself in the contract with the host state against a possible rejection of the rezoning.[210] In the same vein, the Annulment Committee noted that the claimant had been subject to 'a failure to safeguard its own interests rather than a breach of any duty owed to the host State.'[211] Nevertheless, the award is an instance in which the indirect obligation at least incidentally served the public interest. Indeed, Chapter 6.III has pointed out that it is precisely a feature of indirect obligations to build on investors' self-interest: They turn public interest-friendly behaviour into an own interest of the investor. The award in *MTD v Chile* illustrates this effect well.

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208 ibid 170.
209 ibid 242.
210 ibid 178.
211 *MTD Equity Sdn. Bhd. and MTD Chile S.A. v Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment (21 March 2007) para 101.

c) Yukos v Russia and the rule of law

Another good example of an indirect obligation is the award in *Yukos v Russia* relating to the Russian rule of law.

The claimants had invested in oil, gas and petroleum production in Russia.[212] They claimed that Russia had caused the investment's insolvency and illegally nationalised their assets.[213] In their view, Russia took these measures to harass them because they supported the political opposition. By this, Russia had violated the right to FET and the protection against illegal expropriation.[214] Russia countered that the claimants had engaged in tax fraud.[215]

The PCA Tribunal in its 2014 award affirmed that Russia had violated the investors' rights.[216] Yet, it also found that the claimants had contributed to the damage. Some of their tax avoidance arrangements had formed a valid basis for the government's measures.[217] Observing that the governmental reaction was disproportionate, it reduced the damages awarded to Yukos by 25 percent: from roughly USD 67 billion to USD 50 billion.[218]

The award is another instance in which a tribunal tested an investor's conduct against a public interest standard. Here, the Tribunal examined if the investors engaged in tax fraud. To that end, it studied if the investor had fraudulently abused loopholes in Russian tax law on low-tax regions to avoid taxation. As a sanction for this fraudulent conduct, it devalued the claimants' rights by 25 percent. This constitutes an indirect obligation as defined above.

In its reasoning, the Tribunal itself appears aware that it is applying an obligation to the investors. It held:

> [A]n award of damages may be reduced if the victim of the wrongful act of the respondent State also committed a fault which contributed to the prejudice it suffered and for which the trier of facts, in the exercise of its discretion, considers the claiming party should bear some responsibility. In the view of the Tribunal, Claimants should pay

212 *Yukos v Russia*, Final Award (n 21) paras 71–72.
213 Borzu Sabahi and Diora Ziyaeva, 'Yukos v. Russian Federation: Observations on the Tribunal's Ruling on Damages' (2015) 13(5) Oil, Gas & Energy Law 1, 2–3.
214 *Yukos v Russia*, Final Award (n 21) paras 81–105.
215 ibid 84–86, 96.
216 ibid 1575–1585.
217 ibid 1610–1621.
218 ibid 1634–1637, 1827.

> a price for Yukos' abuse of the low-tax regions by some of its trading entities.[219]

The Tribunal's use of terminology in this passage is revealing: the investors were at 'fault' and hence had to bear some 'responsibility'. It also very explicitly underlined the sanctioning character by considering that the claimants had to 'pay a price'. However, it rejected to foreclose the investors completely from protection.[220] Instead, it distributed the responsibilities between the claimants and the respondent by weighing how grave their respective misconduct was.[221]

By applying the principle of contributory negligence, the Tribunal construed an investor obligation towards the Russian rule of law. Fraudulent behaviour is a form of abusing a state's legislative framework and thus undermines the rule of law. The respondent itself highlighted this connection in its submissions.[222] Herein lies the incidental protection of the rule of law by the principle of contributory negligence.

d) Copper Mesa v Ecuador and human rights

A human rights-related application of the principle of contributory negligence features in the *Copper Mesa v Ecuador* award. Ecuador had granted the claimant mining concessions at Junín, Chaucha and Telimbela and revoked or terminated these later.[223] The claimant argued that this violated the Canada-Ecuador-BIT[224]. After finding that Ecuador had indeed violated this treaty, the Tribunal reduced the compensation awarded to the claimant as regards the Junín concessions by 30 percent due to contributory negligence.[225]

In the Junín area, a large part of the population, mostly farmers, rejected any mining activities because they would be directly and adversely

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219 ibid 1633–1634.
220 ibid 1343–1374.
221 ibid 1635–1637.
222 ibid 109.
223 *Copper Mesa Mining Corporation v The Republic of Ecuador*, PCA Case No. 2012–2, Award (15 March 2016) paras 1.8–1.9.
224 Canada-Ecuador BIT (adopted 9 April 1996, entered into force 6 June 1997, date of termination 19 May 2018) ‹https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/609/download› accessed 7 December 2021 (Canada-Ecuador BIT).
225 *Copper Mesa v Ecuador* (n 223) para 7.32.

affected, forming an anti-mining opposition in an area with weak police presence.[226] Already before establishing the investment, potentially violent tensions between the claimant and local anti-miners became apparent.[227] These tensions exacerbated with recurring violence and protests taking place,[228] eventually blocking access to the operation of the Junín concessions by anti-miners.[229] The claimant then decided to employ armed security guards. The Tribunal found that the claimants had indeed organised 'armed men in uniform using tear gas canisters and firing weapons at local villagers and officials' and had thus 'acquired, irrevocably, a malign reputation for intimidation, threats, deception, mendacity and violence amongst members of the local communities', leading to a 'reckless escalation of violence'.[230]

Applying Art 39 of the ILC Articles on State Responsibility, the Tribunal found that the 'Claimant's injury was caused both by the Respondent's unlawful expropriation and also by the Claimant's own contributory negligent acts and omissions and unclean hands', leaving open if this was a matter of causation, contributory fault or unclean hands.[231] The Tribunal found negligence on behalf of the claimant with the following reasoning:

> In short, a foreign investor, by its local agents, whatever the illegal provocations by local residents in the form of road-blocks, violence, arson and other impediments, should not resort to recruiting and using armed men, firing guns and spraying mace at civilians, not as an accidental or isolated incident but as part of premeditated, disguised and well-funded plans to take the law into its own hands. […]
>
> In the Tribunal's view, the evidence establishes that several of the Claimant's senior personnel in Quito were guilty of directing violent acts committed on its behalf, in violation of Ecuadorian criminal law. Their resort to subterfuge and mendacity aggravated those acts. The consequences could have led to serious injury and loss of life. […][232]

Applying the concepts suggested by this chapter, one can read this decision as implying an indirect human rights obligation of the claimant. The

226 ibid 4.10–4.12.
227 ibid 4.95–4.97.
228 ibid 4.157.
229 ibid 4.214.
230 ibid 4.265.
231 ibid 6.97.
232 ibid 6.99–6.100.

Tribunal uses terms associated with the human right to life, for example that the claimant could have caused significant injury and loss of life. Even though the Tribunal notes that the claimant violated Ecuadorian criminal law, the analysis does not actually apply and analyse a domestic norm. Rather, the Tribunal appears to evaluate the conduct of the claimant autonomously, building on its discretion in determining contributory negligence, causation or clean hands as principles of international law. Some have criticised that the Tribunal did not invoke human rights norms.[233] Indeed, the Tribunal appears to adopt a pragmatic – rather than idealist – approach to the violence caused by the claimant. It is precisely this rather 'hidden' way of addressing investor misconduct towards the public interest that is typical for the pattern of indirect obligations in arbitral jurisprudence.

e) Bear Creek v Peru and indigenous peoples

In *Bear Creek v Peru*, contributory negligence gave rise to an indirect obligation related to indigenous peoples.

In this case, the claimant had received a governmental decree by Peru to operate a mine in Santa Ana close to the Bolivian border. Local indigenous communities protested against the prospective enterprise, even leading to violent outbreaks. The government reacted by prohibiting mining activities in the area through a second decree. It effectively denied Bear Creek the possibility of operating the mine as envisaged in the first decree.[234] In this light, the claimant filed ICSID proceedings against Peru on the basis of the Peru-Canada-FTA.[235] Peru defended itself by arguing that the claimant had acted in contributory negligence by not reaching out and engaging sufficiently with the affected local communities (the concept of a 'social license'). Through this omission, the company had caused the unrests that led the state to prohibit all mining activities.[236]

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233 Choudhury, 'Investor' (n 23) 100 considers the Tribunal's approach to 'underemphasize the overarching importance of human rights' as it 'equates human rights breaches with investor negligence such as abusing low tax regions'.

234 *Bear Creek v Peru*, Award (n 19) paras 119–216.

235 Canada-Peru FTA (adopted 29 May 2008, entered into force 1 August 2009) ‹https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2568/download› accessed 7 December 2021 (Canada-Peru FTA).

236 *Bear Creek v Peru*, Award (n 19) paras 560–564.

(1) The Tribunal's award

The Tribunal rejected this argument – however, only based on the lack of proof. It investigated the investor's conduct and considered its outreach activities. These included projects such as job programmes for neighbouring communities. In doing so, the Tribunal generally acknowledged that it had to assess if the 'Claimant took the appropriate and necessary steps to engage all of the relevant and likely to be affected communities'.[237] It concluded that Peru had failed to prove any alleged negligence on the part of the investor.[238] Instead, it took the social unrests as the reason to change the methodology of compensation calculation as discussed above.[239]

The award is notable because the Tribunal accepted as a matter of principle that the investor's actions towards indigenous communities were relevant.[240] It examined the claimant's social activities when determining possible contributory negligence – conversely implying that it measured the conduct against a certain standard. It explicitly found it possible that misconduct could have caused a reduction of compensation. This reflects the linkage between a standard of conduct and a sanction characteristic for an indirect obligation.

Interestingly, the Tribunal elaborated further on the conduct it expected from the investor. It did not only investigate the company's obligations under domestic Peruvian law to obtain a so-called social license. It also commented that

> [e]ven though the concept of '*social license*' is not clearly defined in international law, all relevant international instruments are clear that consultations with indigenous communities are to be made with the purpose of obtaining consent from all the relevant communities […][241]

237 ibid 406.
238 ibid 565–569.
239 See Chapter 7.III.1.c).
240 This is noteworthy in light of other tribunals who have rejected to consider the attempt of investors to engage with the local population as part of a possible contributory negligence test; for such a strict approach see for example *South American Silver Limited (Bermuda) v The Plurinational State of Bolivia*, PCA Case No. 2013–15, Award (22 November 2018) para 875.
241 *Bear Creek v Peru*, Award (n 19) para 406.

Consequently, it cited Art 32 of the UNDRIP.[242] UNDRIP represents soft law which is at least in parts considered to reflect binding international obligations of states.[243] Therefore, the Tribunal appears to apply these standards within the principle of contributory negligence. In short, one could understand the Tribunal to mean that the investor must comply with UNDRIP. Otherwise, if the state acted to protect indigenous communities and violated an investor right, any compensation awarded would be reduced. This shows how the indirect obligation relates to the protection of the public interest – here, the rights of indigenous peoples.

(2) Sands' Partial Dissenting Opinion

Arbitrator *Sands* went even further in his Partial Dissenting Opinion. He concluded that Peru had sufficiently established Bear Creek's contributory negligence. In his assessment, he relied on the rights of local indigenous communities under national and international law. To that end, he cited ILO Convention No 169, the Indigenous and Tribal Peoples Convention which Peru had concluded in 1994, referring to two articles of the Convention:[244] Art 13 (1), the obligation to

> respect the special importance for the cultures and spiritual values of the peoples concerned of their relationship with the lands or territories, or both as applicable, which they occupy or otherwise use, and in particular the collective aspects of this relationship.

He also cited Art 15 which stipulates that

> [t]he rights of the peoples concerned to the natural resources pertaining to their lands shall be specifically safeguarded. These rights inclu-

242 UNGA 'United Nations Declaration on the Rights of Indigenous Peoples' UN Doc A/RES/61/295 (13 September 2007).

243 For further analysis, especially on UNDRIP's character as customary international law, see Martin Scheinin and Mattias Åhrén, 'Relationship to Human Rights, and Related International Instruments' in Jessie Hohmann and Marc Weller (eds), *The UN Declaration on the Rights of Indigenous Peoples: A Commentary* (Oxford University Press 2018) 64–85.

244 ILO Convention (No 169) Concerning Indigenous and Tribal Peoples in Independent Countries (adopted 27 June 1989, entered into force 5 September 1991) 1650 UNTS 383; *Bear Creek Mining Corporation v Republic of Perú*, ICSID Case No. ARB/14/21, Partial Dissenting Opinion by Professor Philippe Sands QC (12 September 2017) paras 10–13.

> de the right of these peoples to participate in the use, management and conservation of these resources.

While *Sands* acknowledged that these international obligations address states, not private actors, he pointed out that this 'does not, however, mean that it is without significance or legal effects for them.'[245] To the contrary, he considered them relevant to define the standard of contributory negligence. He offered four doctrinal arguments to that end:

1. Art 837 of the Canada-Peru FTA defines international law as one of the applicable rules to the arbitration, which includes the ILO Convention.[246]
2. Peruvian law incorporated the ILO Convention which is thus applicable as domestic law to the investor.[247]
3. The parties to the dispute agreed that the ILO Convention was applicable to the case and to the conduct of the investor.[248]
4. *Sands* also seems to suggest that the ILO Convention itself may have a limited direct effect on private parties as a matter of international law. He cites the ICSID award in *Urbaser v Argentina*, discussed above,[249] with its statement that human rights 'are complemented by an obligation on all parts, public and private parties, not to engage in activity aimed at destroying such rights.'[250]

He concluded that the investor had failed to meet these obligations by not involving all the potentially affected communities, 'offering jobs only to some and engaging in consultations which were uneven and insufficient across the totality of communities.'[251] In consequence, he suggested to reduce the compensable damage by fifty percent and also advocated for the splitting of proceeding costs by the parties.[252]

This partial dissenting opinion most explicitly describes the existence of an indirect obligation. *Sands* defines a concrete standard of contributory negligence by building on ILO Convention No 169. He is even explicit about the doctrinal reasons for including the Convention. On this basis,

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245 ibid 10.
246 ibid 11.
247 ibid 9, 12.
248 ibid.
249 See Chapter 3.I.2.
250 *Bear Creek v Peru*, Partial Dissenting Opinion by Professor Philippe Sands QC (n 244) para 10 citing *Urbaser v Argentina*, Award (n 79) para 1199.
251 *Bear Creek v Peru*, Partial Dissenting Opinion by Professor Philippe Sands QC (n 244) para 33.
252 ibid 39–40.

he expresses that the investor had to follow a certain standard of conduct. Because the investor's actions were insufficient, a sanction of fifty percent less compensation was in order. The reference to the ILO Convention also shows that contributory negligence serves to further the public interest: the investor was expected to contribute to it.

3. Interim conclusion

Section III has proven that the rules on compensation imply indirect obligations. Even after having found that the state violated an investor right, tribunals used the amount of compensation as leverage: If investors violated the public interest, they received less compensation than the tribunal would have granted otherwise.

The analysis especially found indirect obligations as part of the principle of contributory negligence. Tribunals have interpreted such 'negligence' as standards of conduct towards the public interest with which the investors must comply. The definition of what amounts to 'negligence' does not necessarily require or imply a breach of an obligation directly applicable to investors. It may thus serve to give legal effect to norms that otherwise for example only bind states.[253] The analysis found such obligations towards the environment, the rule of law, human rights and indigenous peoples. This indirect obligation sanctions investors by reducing compensation if the breach contributed to the same damages that the state has caused by interfering with the investors.

Because tribunals can choose to reduce this amount only in part, rules on compensation allow for nuanced sanctions. The tribunal can reflect the gravity of the conduct in comparison to the state's wrongdoing in the percentage of reduction. In short: it can impose gradual sanctions.

253 Supported for example by Markus Krajewski, 'A Nightmare or a Noble Dream? Establishing Investor Obligations Through Treaty-Making and Treaty-Application' (2020) 5(1) Business and Human Rights Journal 105, 125–126; Viñuales, 'Diligence' (n 51) 366; Farouk El-Hosseny and Patrick Devine, 'Contributory Fault Under International Law: A Gateway for Human Rights in ISDS?' (2020) 35(1–2) ICSID Review 105, 128; Kryvoi (n 27) 601–603 by implication.

IV. The clean hands doctrine

So far, Chapter 7 proceeded along systematic categories: jurisdiction and admissibility of arbitral claims, requirements of investor rights, rules on compensation. However, tribunals and scholars have also discussed the clean hands doctrine in a manner that could imply indirect obligations. Tribunals have applied it both as a question of admissibility and in the merits phase. Therefore, the doctrine will be discussed in this Section separately. It will show that the doctrine does not give rise to indirect obligations and that it is redundant altogether.

This Section will first explain the clean hands doctrine and how its very existence remains controversial in international law (1.). Then, it will show that arbitral tribunals and scholars have applied it in investment law in a manner that would imply an indirect obligation not to commit fraud or corruption (2.). However, it is suggested that these cases only relate to doctrinal requirements that have already been studied in the last Sections. The use of the clean hands doctrine is superfluous; hence, it does not play a role in bringing about indirect obligations (3.).

1. The clean hands doctrine as a general principle of law

The clean hands doctrine is said to go back to Roman law principles that are today linked to the doctrine of estoppel.[254] It also has a long tradition in the law of equity in common law legal systems. The US Supreme Court in *Precision Instrument Mfg. Co. v Automotive Co.* in 1945 instructively held that '[i]t is a self-imposed ordinance that closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief, however improper may have been the behaviour of the defendant.'[255] In other words, the clean hands doctrine precludes claimants from protection if they act with fault in the same context as the respondent.[256]

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254 For example, the principles *ex dolo malo non oritur actio*, *nullus commodum capere potest de iniuria sua propria* and *ex iniuria ius non oritur*, see Stephen M Schwebel, 'Clean Hands, Principle' in Anne Peters (ed), *Max Planck Encyclopedia of Public International Law* (March 2013) para 1.

255 *Precision Instrument Mfg. Co. v Automotive Co.* (1945) 324 U.S. 806 (US Supreme Court) 814.

256 cf for the common law doctrine Ori J Herstein, 'A Normative Theory of the Clean Hands Defense' (2011) 17(3) Legal Theory 171, 173–174.

Whether the clean hands doctrine is established as a general principle of law in international law remains controversial. Preponderantly, its existence is rejected.[257] ILC Special Rapporteur *Crawford* in his Second Report on State Responsibility considered the arbitral practice to be divided. There were only a few, older cases related to specific circumstances in the law of diplomatic protection. Thus, he rejected its existence as a general principle of law.[258] Similarly, while admitting that the principle has been invoked in inter-state relations, Special Rapporteur *Dugard* in his Sixth Report on Diplomatic Protection found that 'the evidence in favour of the clean hands doctrine is inconclusive' in the law of diplomatic protection and its authority 'is uncertain and of ancient vintage, dating mainly from the mid-nineteenth century'.[259] The ICJ, too, is yet to accept it.[260] Only the dissenting opinions of Judges *Schwebel* in *Nicaragua v USA* and *van den Wyngaert* in the *Arrest Warrant Case* argued in favour of applying

257 The lack of authority for a clean hands doctrine was masterfully laid out in detail by Jean J Salmon, 'Des «Mains Propres» comme condition de recevabilité des réclamations internationales' (1964) 10 Annuaire Français de Droit International 225, 232–266; similarly Charles Rousseau, *Droit international public*, vol V Les rapports conflictuels (Sirey 1983) 172; Aleksandr Shapovalov, 'Should a Requirement of "Clean Hands" Be a Prerequisite to the Exercise of Diplomatic Protection? Human Rights Implications of the International Law Commission's Debate' (2005) 20(4) American University International Law Review 829, 861–866; but see the affirmation of the principle on a general basis by Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (Stevens & Sons Limited 1953) 155–158; Gerald Fitzmaurice, 'The General Principles of International Law, Considered from the Standpoint of the Rule of Law' (1957) 92 Recueil des Cours 1, 119, however without any further arguments.

258 ILC 'Second Report on State Responsibility, by Mr. James Crawford, Special Rapporteur' UN Doc A/CN.4/498 and Add.1 – 4 (17 March, 1 and 30 April, 19 July 1999), paras 334–336; see also ILC 'Articles on State Responsibility with Commentaries' (n 192) Art 19 para 9.

259 ILC 'Sixth Report on Diplomatic Protection, by Mr. John Dugard, Special Rapporteur' UN Doc A/CN.4/546 (11 August 2004), paras 6, 18.

260 The ICJ has only cited the supposedly related maxim *ex iuria ius non oritu* and estoppel in *Case Concerning the Gabčikovo-Nagymaros Project (Hungary v Slovakia)* (Judgment) [1997] ICJ Rep 7, para 133. Furthermore, there are individual and dissenting opinions which affirm the existence of related principles such as the *exceptio non adimpleti contractus*, see *The Diversion of Water From the Meuse (Netherlands v Belgium)* (Individual Opinion By Mr. Hudson) [1937] PCIJ Rep Series A/B No 70, 77; *The Diversion of Water From the Meuse (Netherlands v Belgium)* (Dissenting Opinion of M. Anzilotti) [1937] PCIJ Rep Series A/B No 70, 50; but see the contrary position by *Application of the Interim Accord of 13 December 1995 (the former Yugoslav Republic of Macedonia v Greece)* (Separate Opinion of Judge Simma) [2011] ICJ Rep 695, paras 19–20.

it.[261] In 2007, the Arbitral Tribunal constituted under Annex VII of the UN Convention on the Law of the Sea even held in *Guyana v Suriname* that '[n]o generally accepted definition of the clean hands doctrine has been elaborated in international law'.[262] Recently, in *Certain Iranian Assets*, the ICJ has explicitly left open if the clean hands doctrine exists in international law.[263]

2. Clean hands as a suggested indirect obligation

Nevertheless, the clean hands doctrine has been applied by a number of arbitral tribunals and suggested by scholars as a means to deprive investors of protection. These cases related to investors who engaged in corruption or fraud. In this view, the clean hands doctrine constitutes an indirect obligation: if investors present their case with unclean hands, they lose investment protection – even though it sometimes remains unclear if the obligation operates on the procedural level of access to investment arbitration or as a matter of receiving substantive investor rights. To prevent this loss of rights, investors have to comply with domestic anti-fraud and anti-corruption laws – similar to the study's findings in Chapter 7.I.2 and Chapter 7.II.5.

For example, in *Hamester v Ghana*, the respondent raised the defence that there was no 'investment' in accordance with Ghanaian law[264] as required by Art 10 of the Ghana-Germany BIT.[265] Ghana argued that the claimant had committed fraud and hence was to be disqualified from investment protection. Even though this argument conforms with the

261 *Case Concerning Military and Paramilitary Activities in and against Nicaragua (Nicaragua v United States of America)* (Dissenting Opinion of Judge Schwebel) [1986] ICJ Rep 259, para 268; *Case Concerning the Arrest Warrant of 11 April 2000 (Democratic Republic of the Congo v Belgium)* (Dissenting Opinion of Judge van den Wyngaert) [2002] ICJ Rep 137, para 35.

262 *Award in the Arbitration Regarding the Delimitation of the Maritime Boundary Between Guyana and Suriname (Guyana v Suriname)* (Award) (2007) 30 RIAA 1, para 418.

263 *Certain Iranian Assets (Islamic Republic of Iran v United States of America)* (Preliminary Objections) [2019] ICJ Rep 7, para 122.

264 *Hamester v Ghana* (n 19) para 81.

265 Ghana-Germany BIT (adopted 24 February 1995, entered into force 23 November 1998) ‹https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1328/download› accessed 7 December 2021 (Ghana-Germany BIT).

requirement to comply with domestic law as discussed above,[266] the Tribunal dealt with it differently as follows:

> [T]he Tribunal will examine whether, on the facts of the case, there could have been international responsibility on the part of the [Respondent] towards Hamester for the different claims raised as to the [Joint Venture Agreement]'s performance. It is only if any of the acts complained of raises or could have raised an international responsibility of the [Respondent], that it then becomes relevant to analyse in detail the investor's behaviour and the accusations of fraud, in order to determine whether the investor has claimed with clean hands, and whether this could have consequences on any relief.[267]

The Tribunal did not have to go into any more detail because it already denied the respondent's responsibility.[268] Nevertheless, it is notable that the Tribunal seemed ready to apply the clean hands doctrine to examine the investor's alleged fraud. It found it possible that wrongful conduct could lead to 'consequences on any relief' – precisely implying an effect tantamount to an indirect obligation as understood here. Different from other tribunals as presented above,[269] the Tribunal does not rely on a self-standing requirement under the applicable IIA to comply with domestic law. Instead, it is the clean hands doctrine as a general principle of law which appears to bring about the indirect obligation.

Similarly, the Tribunal in *Fraport v Philippines (Fraport II)* understood other arbitral awards which required investors to comply with the host state's domestic law as authority for the clean hands doctrine. It held:

> Investment treaty cases confirm that […] treaties do not afford protection to illegal investments either based on clauses of the treaties, as in the present case according to the above analysis, or, absent an express provision in the treaty, based on rules of international law, such as the 'clean hands' doctrine or doctrines to the same effect. One of the first cases having ruled on this issue, *Inceysa v. El Salvador*, has held that 'because Inceysa's investment was made in a manner that was clearly illegal, it is not included in the scope of consent expressed by Spain and the Republic of El Salvador in the BIT and, consequently,

266 See Chapter 7.I.2 and Chapter 7.II.5.
267 *Hamester v Ghana* (n 19) para 317.
268 ibid 350.
269 See Chapter 7.I.2 and Chapter 7.II.5.

> the disputes arising from it are not subject to the jurisdiction of the Centre.'[270]

On the one hand, the Tribunal affirmed the existence of the legality requirement – and hence, the indirect obligation that breaching domestic law deprives investors of international investment protection. On the other hand, it appeared to understand it as flowing from the clean hands doctrine. However, the quoted passage from *Inceysa v El Salvador* is at odds with such an interpretation: it does not mention the clean hands doctrine but interprets the scope of the disputing parties' consent to arbitrate. There, the Tribunal only started 'from the premise that the consent of the parties was […] given in good faith'.[271] The role of the clean hands doctrine in this interpretive exercise remains unclear.

Another example of a tribunal that has applied the clean hands doctrine is the award in *Al Warraq v Indonesia*. It has already been discussed above as one that applies the requirement to comply with domestic law.[272] But the Tribunal also referred to the clean hands doctrine in its reasoning after having found that the investor had violated Indonesian laws:

> In this regard, the Tribunal is of the view that the doctrine of 'clean hands' renders the Claimant's claim inadmissible. […] As mentioned above, it is established the Claimant has breached Article 9 of the OIC Agreement by failing to uphold the Indonesian laws and regulations and in acting in a manner prejudicial to the public interest. The Claimant's actions were also prejudicial to the public interest. The Tribunal finds that the Claimant's conduct falls within the scope of application of the 'clean hands' doctrine, and therefore cannot benefit from the protection afforded by the OIC Agreement. The Tribunal concludes that, although it has been established that the Claimant did not receive fair and equitable treatment, as set out in paragraphs 555 to 603 above however, by virtue of Article 9 of the OIC Agreement the Claimant is prevented from pursuing his claim for fair and equitable treatment.[273]

Here, the Tribunal appears to combine different approaches to indirect obligations. On the one hand, it relied on interpreting an explicit clause

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270 *Fraport AG Frankfurt Airport Services Worldwide v The Republic of the Philippines (Fraport II)*, ICSID Case No. ARB/11/12, Award (10 December 2014) para 328.

271 *Inceysa v El Salvador* (n 19) para 181.

272 See Chapter 7.II.5.

273 *Al-Warraq v Indonesia*, Final Award (n 153) paras 646–648.

in the OIC Agreement to require compliance with domestic law and the public interest. On the other hand, it also applied the clean hands doctrine to reach the result that the investor is deprived of protection. Notably, the Tribunal introduced the doctrine after having found a breach of the FET right – hence, in the analysis on the merits. But declaring the claim inadmissible should have prevented the Tribunal from entering this substantive analysis in the first place. Thus, it appears that the clean hands doctrine rather served as an auxiliary argument to support the preceding, ordinary interpretation of the OIC Agreement.

This line of cases has prompted some scholars to understand the clean hands doctrine as the central principle to examine the investors' misconduct – even where tribunals have actually applied explicit treaty clauses without mentioning the doctrine.[274] Others distinguish the clean hands doctrine and the requirement of legality while finding overlaps.[275] Again, others have read the doctrine into other requirements studied in this Chapter, for example into the principle of *ordre public international*.[276] Just as the presented cases, these scholars focus on fraud, corruption and misrepresentations by the investor – hence, on a certain facet of misconduct towards the public interest, namely the violation of the state's rule of law.

3. Redundancy of the clean hands doctrine

Notwithstanding these interpretations, it is suggested that the clean hands doctrine is redundant.

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274 Rahim Moloo, 'A Comment on the Clean Hands Doctrine in International Law' (2011) 8(1) Transnational Dispute Management 1, 6–11; Dumberry, 'State' (n 21) 234.

275 Aloysius Llamzon, 'Yukos Universal Limited (Isle of Man) v the Russian Federation: The State of the "Unclean Hands" Doctrine in International Investment Law: Yukos as Both Omega and Alpha' (2015) 30(2) ICSID Review 315, 316–321, 325.

276 Andrea K Bjorklund and Lukas Vanhonnaeker, 'Yukos: The Clean Hands Doctrine Revisisted' (2015) 9(2) Diritti Umani e Diritto Internazionale 365, 374 on reading the *ordre public international* as an expression of the clean hands doctrine; Monebhurrun (n 119) 62–64 on understanding international public policy as well as IIA provisions which prohibit corrupt behavior as reflecting the clean hands doctrine; Patrick Dumberry, 'The Clean Hands Doctrine as a General Principle of International Law' (2020) 21(4) Journal of World Investment & Trade 489, 521 on reading the legality requirement as an expression of the clean hands doctrine.

It is important to distinguish that applying the clean hands doctrine means invoking an alleged general principle of law (Art 38 (1) (c) ICJ-Statute). A different matter is the interpretation of the IIA as an international treaty (Art 38 (1) (a) ICJ-Statute). They represent two different sources of international law.[277]

The above-mentioned Tribunals applied the clean hands doctrine too carelessly. From their reasoning, it appears that they engaged in ordinary treaty interpretation – hence, applied the IIA as the indirect obligations' relevant source. As seen, the Tribunals in *Inceysa v El Salvador* and *Al Warraq v Indonesia* both built on explicit treaty clauses to establish the legality requirement.[278] The clean hands doctrine does not add anything to the interpretive result that states do not wish to grant protection to investments that contravene with domestic law. It seems that tribunals referred to the doctrine as a supplementary, rhetorical argument to give additional authority to their findings.

The Tribunal in *Yukos v Russia* came to the same conclusion as presented here. It is worth to quote the Tribunal's reasoning at length:

> The Tribunal notes that there is support in the decisions of tribunals in investment treaty arbitrations for the notion that, even where the applicable investment treaty does not contain an express requirement of compliance with host State laws (as is the case with the ECT), an investment that is made in breach of the laws of the host State may either: (a) not qualify as an investment, thus depriving the tribunal of jurisdiction; or (b) be refused the benefit of the substantive protections of the investment treaty. […]
>
> The Tribunal agrees with this proposition. In imposing obligations on States to treat investors in a fair and transparent fashion, investment treaties seek to encourage legal and bona fide investments. An investor who has obtained an investment in the host State only by acting in bad faith or in violation of the laws of the host state, has brought itself within the scope of application of the ECT through wrongful acts. Such an investor should not be allowed to benefit from the Treaty. […]

277 Very clearly pointed out by Bjorklund and Vanhonnaeker (n 276) 365–369.

278 See also *South American Silver v Bolivia* (n 240) para 449 on how the Tribunal in *Al-Warraq v Indonesia*, while invoking the clean hands doctrine, also expressly referred to Art 9 OIC Investment Agreement which requires the investor to comply with domestic law.

> 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' […].
>
> [A]s Claimants point out, despite what appears to have been an extensive review of jurisprudence, Respondent has been unable to cite a single majority decision where an international court or arbitral tribunal has applied the principle of 'unclean hands' in an inter-State or investor-State dispute and concluded that, as a principle of international law, it operated as a bar to a claim.[279]

Here, the Tribunal strictly distinguished between a teleological interpretation of the ECT and the application of the clean hands doctrine as a general principle of law. It already found the legality requirement to be established by the first method – while denying the existence of the doctrine altogether. This reasoning is even more notable considering that one member of the Tribunal – *Schwebel* – had argued as an ICJ Judge in favour of the doctrine in the above-mentioned dissenting opinion in *Nicaragua v USA*.[280]

Recently, the PCA Tribunal in *South American Silver Limited* joined the *Yukos* Tribunal in rejecting that the clean hands doctrine exists as a general principle of law within the meaning of Art 38 (1) (c) ICJ Statute.[281] Also regarding investment arbitration decisions, it was of the view that other investment tribunals 'reached their respective conclusions based on the appropriate treaty provisions or the applicable national law'[282] rather than on the clean hands doctrine as a general principle of law.

Furthermore, while the doctrine may fit well for fraudulent investor behaviour, it is less the case for other infringements of the public interest such as human rights, the environment or workers' rights. The reason is that the principle, as seen, operates with regard to a relative legal relationship, here between the host state and the investor. It does not condemn just any form of unethical conduct but watches especially the *fairness* be-

279 *Yukos v Russia*, Final Award (n 21) paras 1349, 1352, 1358, 1362.
280 ibid 1357–1363 with reference to *Nicaragua Case*, Dissenting Opinion of Judge Schwebel (n 261) paras 268–272; see also Bjorklund and Vanhonnaeker (n 276) 368, 373.
281 *South American Silver v Bolivia* (n 240) paras 445–446.
282 ibid 448.

tween the parties.[283] Another often-mentioned purpose is to safeguard the tribunal's integrity as it should not assist in inequitable behaviour.[284] Deceitful conduct like fraud and corruption go to the heart of the fair relative relationship between the parties (*tu quoque*).[285] They may be considered to violate a tribunal's integrity. This is not the case for violations of the other above-mentioned public goods and individual rights. Therefore, the clean hands doctrine cannot convey the many different indirect obligations that Chapter 7 has encountered throughout the analysis.

Notwithstanding the above discussion, other general principles such as good faith and estoppel can, of course, play an important role in investment law's interpretation, including indirect obligations. But it appears more adequate to understand them as corrective and complementing criteria *within* indirect obligations that have been identified in this Part[286] – hence not as reflecting indirect obligations themselves.[287]

All in all, it is suggested that investment law should affirm the prepondering opinion in general international law and deny that the doctrine of clean hands constitutes an established general principle. The encountered discussions by tribunals and scholars do not represent its growing recognition within investment law. Rather, they reflect a general, increasing concern that investment law should examine the investors' misconduct.[288] The doctrine appears as a form of 'workaround' to introduce indirect obli-

283 Herstein (n 256) 171–172; Llamzon (n 275) 323.

284 *Precision Instrument Mfg. Co. v Automotive Co.* (n 255) 814; Llamzon (n 275) 324.

285 cf Llamzon (n 275) 324; another way of framing this particular legal nature is to depict it as relating to the reciprocal obligations of the parties, see Ori Pomson, 'The Clean Hands Doctrine in the Yukos Awards: A Response to Patrick Dumberry' (2017) 18(4) Journal of World Investment & Trade 712, 716–718.

286 A good example how considerations of equity and good faith should be applied within the interpretation of international investment law offers Muchlinski (n 88) 531–532.

287 cf for an explanation of the doctrine of estoppel as a mechanism 'which precludes assertion of an *existent* legal position' (emphasis added) see Andreas Kulick, 'About the Order of Cart and Horse, Among Other Things: Estoppel in the Jurisprudence of International Investment Arbitration Tribunals' (2016) 27(1) European Journal of International Law 107, 124–128.

288 That remains, for example, the opinion of Caroline Le Moullec, 'The Clean Hands Doctrine: A Tool for Accountability of Investor Conduct and Inadmissibility of Investment Claims' (2018) 84(1) Arbitration: The International Journal of Arbitration, Mediation and Dispute Management 13, 21, 36–37, who however welcomes a greater place for taking account of the investor's misconduct in international investment law; see also the observation that investment law is in the course of developing a 'social conscience' by Footer (n 124) 33 and

gations as an element originally alien to the field. Therefore, the invoking of the doctrine shows that investment law is in a transitory phase that is still doctrinally underdeveloped in how it addresses investors' misconduct.

that investors' conduct is increasingly seen more critically as put forward by Llamzon (n 275) 323.