NOTES

BLAME TO GO AROUND: TREATY LANGUAGE AND THE CORRUPTION DEFENSE IN INVESTOR-STATE ARBITRATION

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Anyone who wants to tackle corruption must be willing to go all the way. There are no shortcuts.

—Oby Ezekwesili

I. INTRODUCTION

Billions of dollars in foreign investment are made each year under the protection of investor-state arbitration (ISA).[1] By providing a neutral forum in which to claim the protections and safeguards afforded to them in investment treaties and contracts, ISA gives foreign investors greater certainty and predictability in their legal rights as they pursue international deals.[2]

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1. Matthew Hodgson, Yarik Kryvoi, & Daniel Hrcka, *2021 Empirical Study: Costs, Damages, and Duration in Investor-State Arbitration*, BRIT. INST. OF INT'L AND COMPAR. L. (June 28, 2021), https://www.biicl.org/documents/136_isds-costs-damages-duration_june_2021.pdf.

2. Stephan Schill, *The Virtues of Investor-State Arbitration*, EUR. J. INT'L L. BLOG (Nov. 19, 2013), https://www.ejiltalk.org/the-virtues-of-investor-state-arbitration/.

However, an arbitration defense which uses corruption as a tool to defang these safeguards has become more common,[3] decreasing the predictability of ISA tribunals, reducing investor confidence in their protections, and deterring this critical investment. Arbitration rules and procedures are often inconsistent and opaque, creating uncertainties and risks which reduce the predictability of foreign projects. This Note concurs with this dissatisfaction with the corruption defense but contends that existing reform proposals are insufficient or would not be effective. Instead, it argues that the best option to address the abuse and asymmetry of the corruption defense in ISA is by codifying treaty language which creates an even playing field by proportionally allocating blame for corrupt practices. There are 2,500 existing investment treaties in the world today which would need to integrate these rules, so this reform is not an instant solution.[4] But if the international community hopes to reaffirm the stability and reliability of arbitration for foreign investors, this is the strongest option. The inconvenience of a long-term commitment to reform should not stand in the way of robust anti-corruption policy.

II. Background: Uncertainty and Corruption in International Arbitration

Investor-state arbitration is an international arbitration in which one party is a private investor and the other party is a state in which they are investing, or some organ of that state.[5] ISA can arise under a contract specifically between the investor and the state (contract-based ISA) or under an investment treaty which contains the host state's advance consent to arbitrate with any foreign investor from a given state (treaty-based ISA).[6] This Note will not delineate major differences between these forms because this Note's proposal equally impacts both treaty-based and contract-based ISA.[7]

There are three principal sources of law that guide a given arbitration: the applicable law of the dispute, the procedural rules controlling

3. *Arbitration and Corruption: Addressing the Elephant in the Room*, Morrison Foerster (May 13, 2021), https://www.mofo.com/resources/events/210513-arbitration-and-corruption-addressing-elephant.html.

4. Theodore Moran, *Combating Corrupt Payments in Foreign Investment Concessions: Closing the Loopholes, Extending the Tools*, Ctr. for Glob. Dev. 9 (Jan. 2008), http://www.cgdev.org/sites/default/files/15197_file_CombatingCorruption.pdf.

5. Jonathan Bonnitcha & Alisha Mathew, *Corruption in investor-state arbitration*, Transparency Int'l 2 (Sept. 28, 2020), https://knowledgehub.transparency.org/helpdesk/corruption-in-investor-state-arbitration.

6. *Id.*

7. The corruption defense has been utilized in both treaty-based and contract-based ISA. *Id.* at 16, 18–19.

the arbitration, and the law of the seat of arbitration.[8] Importantly, the applicable law of a given dispute, as well as other applicable legal principles such as international public policy, determine the consequences of any corruption that is discovered.[9] In treaty-based ISA, the most important applicable law is the language of the treaty itself, often in critical ways.[10] For example, some tribunals find and weigh "implied legality" requirements in investment treaties. This doctrine presumes that investment treaties apply only to contracts that are legal, meaning that contracts procured via corruption should not receive legal protection.[11] While no ISA has dealt with an investment treaty that contains explicit anti-corruption rules in regard to specific claims, the treaty itself would be the first source that tribunals would examine in the event that they needed to decide how corruption claims impact the proceeding.[12]

Corruption comes before ISA tribunals usually following some expropriation or interference by the host state. When foreign investors attempt to enforce the contract, the host state argues that the contract was procured corruptly in order to avoid enforcement of investor protections.[13] In this way, ISA seems to offer a forum to introduce costs on companies that engage in corrupt behavior.

However, using ISA as a vehicle for anti-corruption enforcement is inherently difficult because it relies on the nuances of intersecting laws of private agreements, host states, and home countries of investing businesses, requiring a delicate constellation of laws to achieve a coherent pattern of decisions.[14] ISA suffers from uncertainty and low uniformity for reasons including the discretion of arbiters in deciding the course of the case, inconsistent rules of evidence, a lack of precedent-setting power in previous arbitral decisions, and a lack of anti-corruption expertise among arbitrators.[15] This causes divergent interpretations and practices to persist, increasing the uncertainty for foreign investors and

8. *Id.* at 2.

9. *Id.* at 2–3.

10. *Id.* at 3.

11. Frederico Singarajah, *Corruption in International Arbitration*, GATEHOUSE CHAMBERS (Nov. 15, 2018), https://gatehouselaw.co.uk/corruption-in-international-arbitration/.

12. *See* Jason Webb Yackee, *Investment Treaties and Investor Corruption: An Emerging Defense for Host States?*, 52 VA. J. INT'L L. 723, 735 (2012).

13. Lucinda A. Low, *Dealing with Allegations of Corruption in International Arbitration*, 113 AJIL UNBOUND 341, 341 (2019).

14. Andrew Brady Spalding, *Deconstructing Duty Free: Investor-State Arbitration as Private Anti-Bribery Enforcement*, 49 U.C. DAVIS L. REV. 443, 452 (2015).

15. *See* Singarajah, *supra* note 11; Moran, *supra* note 4, at 9; Bonnitcha & Mathew, *supra* note 5, at 4.

host states as to how corruption claims would be considered in arbitration.[16] As opposed to corruption cases in domestic law, previous arbitrations offer little guidance to foreign investors and host states considering whether to trigger arbitration. And this is just those that are public. Because of the private and often obfuscated deliberations of arbitral panels, even though "approximately 20 ICSID and UNCITRAL cases have seen allegations of corruption, overt judicial reasoning addressing the corruption claims is scarce."[17] Finally, absent arbitrator misconduct, ISA cannot be appealed to domestic courts or any international body.[18] The lack of an appellate mechanism further increases investor uncertainty about the final results of a prospective arbitration and prevents the resolution of inconsistencies in the legal doctrines used by different ISA panels. As described in this Note, this uncertainty and instability forms a major, though not single, motivation for codifying ISA anti-corruption rules in investment treaties.

This Note argues that modifying treaty language concerning ISA treatment of corruption claims is the best available solution. Updating trade agreements to better integrate corruption concerns into ISA is a prescient proposal for three reasons. Firstly, many developing countries, including African countries, are increasingly seeking to renegotiate investment treaties to better deal with an array of investor claims against governments.[19] While many initial investment treaties sought merely to facilitate investment, developing countries are now sufficiently confident in their ability to attract capital that they are willing to try and manage investment more robustly. Secondly, arbitrators as a community have begun a "philosophical shift," viewing their roles "less as servants of the parties and more like guardians of the truth, protecting the international public order."[20] The implementing actors of such changes are primed for more investment governance. Third and finally, innovation in corruption clauses in trade agreements has already begun. The Trans-Pacific Partnership (TPP) took the impressive step of integrating party anti-corruption obligations into the dispute

16. Bonnitcha & Mathew, *supra* note 6, at 3.

17. Spalding, *supra* note 14, at 471.

18. *See* Ian Laird & Rebecca Askew, *Finality Versus Consistency: Does Investor-State Arbitration Need an Appellate System*, 7 J. APP. PRAC. & PROCESS 285, 290 (2005).

19. *See* Ignacio Torterola & Bethel Kassa, *The better way forward: investor-state dispute strategies*, INT'L COMP. LEGAL GUIDES: AFR. L. & BUS. (Aug. 13, 2021), https://iclg.com/alb/9937-the-better-way-forward-investor-state-dispute-strategies.

20. Singarajah, *supra* note 11; *see also* Moran, *supra* note 4, at 7.

settlement mechanism, allowing for the failure of anti-corruption measures to serve as a cause of action in dispute proceedings.[21] It was the first trade agreement to do so.[22] This includes the TPP consultation system, meaning that countries could request more informal meetings to push for the adoption of anti-corruption laws.[23] This "unprecedented move" has signaled that "anticorruption standards cannot be artificially separated from other international legal remedies," increasing public interest in how trade agreements can help fight corruption.[24]

This increased international attention reflects the importance of resolving questions over foreign investment and corruption. The investments litigated under ISA often hold billions of dollars in the balance.[25] One ISA case in Djibouti alone determined the future of the country's largest employer, and Africa's largest container terminal.[26] More robust and consistent ISA enforcement of anti-corruption could steady the waters for international investors and incentivize countries to prioritize anti-corruption, clearing the way for greater investments in the developing world.[27] The integrity and stability of international investment is critical to reaching any global goals concerning stability, economic growth, poverty reduction, or environmental protection.[28] Thus, the rules and mechanisms to fairly facilitate such investment are worthy of the world's immediate attention.

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21. *See* Kaitlin Beach, *A Trade-Anticorruption Breakthrough?: The Trans-Pacific Partnership's Transparency and Anticorruption Chapter*, GLOB. ANTICORRUPTION BLOG (Nov. 23, 2015), https://globalanticorruptionblog.com/2015/11/23/the-trans-pacific-partnerships-transparency-and-anticorruption-chapter/.

22. Danielle Young, *Is Corruption an Emerging Cause of Action in Investor-State Arbitration*, GLOB. ANTICORRUPTION BLOG (Jan. 22, 2016), https://globalanticorruptionblog.com/2016/01/22/is-corruption-an-emerging-cause-of-action-in-investor-state-arbitration-2/.

23. Beach, *supra* note 21.

24. Young, *supra* note 22.

25. Hodgson, Kryvoi, & Hrcka, *supra* note 1.

26. Asa Fitch, *Djibouti Files Arbitration Against DP World Over Alleged Corruption in Port Deal*, WALL ST. J. (July 9, 2014), https://www.wsj.com/articles/djibouti-files-arbitration-against-dp-world-over-alleged-corruption-in-port-deal-1404895724.

27. Moran, *supra* note 4, at 7.

28. *World Investment Report 2021: Investing in Sustainable Recovery*, U.N. CONF. ON TRADE & DEV. (2021), https://unctad.org/system/files/official-document/wir2021_en.pdf; *Global Investment Policy and Practice*, WORLD ECON. F. (2020), https://www.weforum.org/projects/investment; Robert Hormats, *Importance of Investment in the Global Economy*, U.S. DEP'T OF STATE (Sept. 6, 2010), https://2009-2017.state.gov/e/rls/rmk/20092013/2010/146894.htm.

III. Problem: The Corruption Defense

A. *Function and Impact*

ISA uses three primary sources of law in examining corruption allegations during disputes: domestic law, international law, and defective consent.[29] Domestic law concerns anti-corruption or anti-bribery laws on the books in the relevant jurisdiction, whether via a choice of law provision or in the host state itself.[30] International law is meant to give force to major international conventions against bribery under the theory that a "contract in conflict with international public policy cannot be given effect by arbitrators."[31] Lastly, defective consent draws on the notion that when corrupt deeds act as the primary motivation for the formation of a contract, the corrupt party—such as a host state government—did not truly consent to the contract, rendering it invalid.[32]

The corruption defense is a defense used by host states when they are accused of violating investor rights under either a contract or treaty in which the state uses allegations of corruption to convince the arbitrator to dismiss the claim against it entirely. The corruption defense can be used to urge dismissal at two stages of the proceeding: at the outset by attempting to void jurisdiction, and at the merits stage by voiding the underlying contract.[33]

The jurisdictional bar was invoked in the first use of the corruption defense in 1963, when Swedish judge Gunnar Lagergren acted as the sole arbitrator in a dispute in which a French power company was demanding payment from a well-connected Argentine businessman whom they had paid to assist with their expansion into Argentina, but whom had not fulfilled his contractual duties.[34] When the French investor admitted that the businessman had been retained in order to covertly lobby the Argentine government to grant the company state power contracts, Judge Lagergren determined that the corrupt acts being exchanged in the contract rendered it unenforceable in court.[35]

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29. Inan Uluc, *Corruption in International Arbitration*, Pa. St. Univ. Sch. L. 9 (Sept. 29, 2016), https://icsid.worldbank.org/sites/default/files/parties_publications/C3765/Claimants%27%20Reply%20%28Redacted%20per%20PO8%29/Legal%20Authorities/CL-0052.PDF.

30. *Id.*

31. *Id.* at 16.

32. *Id.* at 19–20.

33. Yoanna Schuch, *Tackling Corruption in International Arbitration – Key Issues and Challenges*, 32 Young Arb. Rev. 57 (Jan. 2019), https://www.wilmerhale.com/-/media/13f16ca46ccf41e38020d3e51a5e9734.pdf.

34. Yackee, *supra* note 12, at 727.

35. *Id.*

His decision pointed to both international public policy against corruption as well as the legal norm that illegal contracts cannot be enforced in a court of law.[36] Importantly, the specific mechanism of the decision was a denial of jurisdiction, not a ruling on the merits of either claim. The contract was precluded from a legal remedy, functionally voiding it. Just as a court would not offer a forum to contract disputes surrounding prostitution, drug sales, or other crimes, Judge Lagergren determined that a contract in which corrupt acts were part of the deal should receive no quarter in a legally binding arbitration.[37] This jurisdictional bar has become a highly popular claim for host states, enabling them to avoid resolution of any other questions about the dispute.[38]

Meanwhile, the contract nullification incarnation of the corruption defense was established in *World Duty Free v. Kenya*. *World Duty Free* concerned a 1989 agreement between British company World Duty Free and the government of Kenya in which the company would run two duty-free shopping complexes at Kenyan airports.[39] Later that year, the Kenyan government ordered that a court-appointed official take over management and control of the complexes, causing the company to file for arbitration as per the agreement's mandatory arbitration clause.[40] The government of Kenya revealed that World Duty Free had procured the agreement via a bribe to Kenyan President Daniel arap Moi, and the panel subsequently dismissed World Duty Free's complaint.[41] The decision contrasted in two important ways from the Lagergren jurisdictional bar. Firstly, rather than conclude that the tribunal had no jurisdiction to consider the claim due to the corrupt formation of the contract, the tribunal decided that international public policy (the same rationale as Judge Lagergren) created a significant interest of the international community in voiding the contract to deter corrupt behavior.[42] Secondly, in leveraging international public policy as a rationale for voiding the contract, the tribunal had many more international conventions to point to that had not been present in

36. *Id.*

37. *Id.*

38. *Arbitration and Corruption: Addressing the Elephant in the Room*, MORRISON FOERSTER (May 13, 2021), https://www.mofo.com/resources/events/210513-arbitration-and-corruption-addressing-elephant.html.

39. Lise Johnson, *World Duty Free v. Kenya*, INV. TREATY NEWS (Oct. 18, 2018), https://www.iisd.org/itn/en/2018/10/18/world-duty-free-v-kenya/.

40. *Id.*

41. Yackee, *supra* note 12, at 731–32.

42. *See id.* at 732.

1963.[43] Most notably, this included the United Nations Convention Against Corruption (UNCAC), which entered into force the year before *World Duty Free* and sought to fight corruption by requiring the criminalization of corrupt behavior and setting a framework for international assistance in anti-corruption capacity-building.[44] Since *World Duty Free*, a number of recent tribunals have voided claims using the corruption defense even while asserting jurisdiction over the dispute.[45] In *Kim v. Uzbekistan*, a Kazakh company alleged that the Uzbek government interfered in their investments in two cement plants in Uzbekistan when the government commenced a series of allegedly bad-faith criminal and regulatory investigations and expropriated company stock.[46] The tribunal refused to allow the use of the corruption defense as a jurisdictional bar.[47] The international public policy defense, while allowing for the arbitrator to hear the merits of the dispute, still results in the wholesale dismissal of the claim. As with Judge Lagergren's determination that the court should not offer quarter to corrupt agreements, the tribunal in *World Duty Free* agreed that it could not enforce a contract whose existence offended international public policy.

These major cases have caused an increase in the frequency of the corruption defense. Indeed, "allegations of corruption now seem to be par for the course in most international arbitrations involving states."[48] Furthermore, one of the only tribunals to reject the corruption defense did so in extreme circumstances, in which the state appeared to be invoking it in bad faith. In *Union Fenosa Gas v. Egypt*, a Spanish company running a liquified natural gas plant brought a claim against the government of Egypt when the country unexpectedly cut off its gas supply in 2011.[49] When Egypt alleged that the company had used local partners and a suspect subcontractor to corruptly secure the initial contract, the arbitral tribunal refused to void the contract because Egypt only alleged the corruption 15 years after the fact, had never

43. *See id.*

44. G.A Res. 58/4, United Nations Convention against Corruption (Dec. 9, 2003).

45. Young, *supra* note 22.

46. Julissa Reynoso et al., *The Corruption Defense: Practical Considerations for Claimants*, KLUWER ARB. BLOG (Jan. 22, 2019), http://arbitrationblog.kluwerarbitration.com/2019/01/22/the-corruption-defense-practical-considerations-for-claimants/.

47. *Id.*

48. *Arbitration and Corruption*, *supra* note 38.

49. Ksenia Koroteeva, *Egypt found liable for the shut-down of an electricity plant during the 2011 uprising*, INV. TREATY News (Dec. 21, 2018), https://www.iisd.org/itn/en/2018/12/21/egypt-found-liable-for-the-shut-down-of-an-electricity-plant-during-the-2011-uprising-ksenia-koroteeva/.

investigated or prosecuted any of the officials involved, and had rather transparently made the allegation purely for tactical reasons.[50]

The upshot of both of these incarnations is that the corruption defense is now a commonly accepted strategy for host states to void entire contracts when they are forced into ISA by foreign investors. Even so, there remain important uncertainties about how arbitral panels will apply the corruption defense. The following section describes how, as a result, the doctrine results in the chilling of international investment and an increased incentive for the tolerance of corruption by host states. These issues require further action by the international community if ISA is to retain an effective role in anti-corruption enforcement.

B. *Shortcomings, Criticisms, and Proposed Alternatives*

Critics of *World Duty Free* point out that the decision that modernized the corruption defense was not an ironclad example that other arbitral tribunals should have followed for reasons rooted in the tribunal's legal reasoning. For example, the decision did not consider that the quasi-contract could have been a basis for a claim of unjust enrichment, which might have allowed World Duty Free to recover for their losses under the contract's voiding.[51] Moreover, the tribunal failed to consider U.N. anti-corruption agreements as customary international law, which could have influenced any possible allocation of responsibility to Kenya.[52] Lastly, the panel considered President Moi to be acting in his personal capacity, not as a government official, when he accepted the bribe, which precluded any culpability for Kenya in the dispute.[53]

Outside of the legal shortcomings of the decision, critics also point to alarming public policy consequences of the corruption defense as utilized in *World Duty Free*. This stems from the fact that the decision provided a penalty only for the supply side of the corrupt transaction while leaving the demand side untouched: by voiding the contract, the decision left the expropriated property with the government of Kenya.[54] This hardline approach has been justified by the argument that "the severity of corruption and its heinous effect in countries where state officials have profited from it at the very expense of the citizens" means that "the law should be applied strictly to prevent bribery

50. *Id.*
51. Spalding, *supra* note 14, at 476.
52. *Id.* at 484.
53. Yackee, *supra* note 12, at 733–34.
54. Spalding, *supra* note 14, at 490–92.

and every other form of corruption in international investment."[55] The deterrence argument takes on a nearly moral sentiment, averring that "given that tribunals are dealing with such a wrongful conduct with respect to which there is a global interest for its eradication, investors should bear the consequences of being involved in such type of ominous act."[56] But the argument for this maximum deterrence collapses on both moral and practical grounds. Firstly, the corruption defense is not upholding the moral imperative of punishing corruption if it does so unevenly. Anti-corruption is rooted in the rule of law and the notion that the law should apply evenly to parties regardless of economic or political position; unequal enforcement offends the idea that no one is above the law. Equal condemnation of the supply and demand side of corruption is why the UNCAC requires the punishment of both parties to a corrupt transaction.[57] Secondly, the corruption defense likely results in a net *higher* amount of corrupt behavior by government officials. The availability of the corruption defense means that "states that receive inbound foreign investment have a perverse incentive to tolerate corruption in the officials who deal with foreign investors, because that corruption may help shield states from legal liability should the state subsequently renege on its agreement with the investor."[58] The corruption defense could even be invoked for willful treaty violations because the merits of the claim might not even be reached if the state can successfully preclude jurisdiction.[59] This could, in turn, incentivize the tolerance of corrupt acts by government officials, or disincentivize investment in countries where firms worry they may be coerced into corrupt transactions which could threaten their legal protections in the future.[60] Even some proponents of the corruption defense admit that the upshot of the doctrine is to send the message that "investors should prefer to withdraw from a prospective investment than incur in

55. Ayodeki Akindeire, *Corruption in Investor-State Arbitration: Balancing the Scale of Culpability*, AMERICAN UNIV. WASH. COLL. L. 8 (Oct. 4, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3464618.

56. Mariano de Alba, *Drawing the line: addressing allegations of unclean hands in investment arbitration*, 12 BRAZILIAN J. INT'L. L. 322, 328 (July 6, 2015).

57. G.A Res. 58/4, *supra* note 44, ¶ 15.

58. Sam Birnbaum, *Do Investment Arbitration Treaty Rules Encourage Corruption?*, GLOB. ANTICORRUPTION BLOG (Feb. 24, 2014), https://globalanticorruptionblog.com/2014/02/24/do-investment-arbitration-treaty-rules-encourage-corruption/.

59. José María de la Jara & Eduardo Iñiguez, *The Case Against the Corruption Defense*, EUR. FED'N INV. L. & ARB. BLOG (May 16, 2017), https://efilablog.org/2017/05/16/the-case-against-the-corruption-defense/.

60. Spalding, *supra* note 14, at 490–92.

corruption in order to move forward with their intended business."[61] This is not to say that private parties should never face the consequences of corrupt conduct; rather, a just and effective system would give both parties the significant disincentive the corruption defense offers. The lack of this incentive on governments in the status quo leaves a glaring gap in the contribution of ISA to anti-corruption. Giving governments an incentive to let corruption fester produces a measurable impact on investment: one statistical analysis of 16 Asian economies over 14 years concluded that a 1% increase in corruption reduces inbound foreign direct investment by 9.1%.[62] Simply put, "global anti-corruption policy condemns with equal force the supply and demand of bribes, and an arbitral jurisprudence that prohibits one while incentivizing the other does not advance that policy; indeed, it only makes current problems in anti-bribery enforcement worse."[63]

Law firms are aware of the danger that the corruption defense poses for their clients. One legal practice guide advises firms to only trigger arbitration for any reason after a full compliance sweep of the company because "any conceivably illicit payment that occurred after the investment was made will need to be considered, since a tribunal could always find that corruption in maintaining an investment is against international public norms or in violation of an investment treaty's text."[64] In the event any illicit payments occurred, the guide advises a negotiated resolution.[65] The chilling effect of the corruption defense on international investment, as well as the deterrent effect it produces on otherwise valid claims against host governments, should worry anyone interested in the health of the international investment environment.

Unfortunately, these policy considerations have not driven any alterations in the behavior of ISA tribunals. Indeed, as "corruption has become a very dominant issue in international investment arbitration, most arbitral tribunals have cultivated the culture of accepting corruption as a defense strategy of host-states even when both an investor and the host state have perpetrated the corrupt acts."[66] In *Metal-Tech v. Uzbekistan*, Israeli private company Metal-Tech entered into a joint

61. de Alba, *supra* note 56, at 328.

62. Aye Mengistu Alemu, *Effects of Corruption on FDI Inflow in Asian Economies*, 25 SEOUL J. ECON. 387 (2012). Alemu measures corruption using the Freedom From Corruption (FFC) index developed by the Wall Street Journal and the Heritage Foundation, which gives countries a score on corruption ranging from 0 to 100, with 100 being the highest amount of corruption.

63. Spalding, *supra* note 14, at 494.

64. Reynoso et al., *supra* note 46.

65. *Id.*

66. Akindeire, *supra* note 55, at 4.

venture with two Uzbek state-owned enterprises while also signing multiple consulting agreements worth $4.4 million with government-connected individuals, including both a government official and the brother of the Prime Minister.[67] The Uzbek government filed liquidation proceedings against the joint venture and distributed the proceeds only to the state-owned enterprises, and when Metal-Tech sought recourse for this expropriation, the Uzbek government successfully argued that the consulting agreements had functioned as bribes to secure the joint venture, causing the arbitral panel to dismiss Metal-Tech's claim.[68] The tribunal acknowledged the contribution of the Uzbek government to the corrupt conduct at hand, and yet only went so far as to force each party to pay their own legal fees as the tribunal voided the contract.[69]

Many critics of the corruption defense, and anti-corruption advocates more generally, have proposed several alternatives, none of which would be sufficient to address the issue. This Note responds to the two most prominent proposed solutions.

Firstly, some have proposed adopting corruption as a cause of action for investor lawsuits against host states. The tribunal in *EDF v. Romania* noted that if an official were to solicit a bribe from a foreign investor, that might violate the guarantee of "fair and equitable treatment" (FET) present in many investment treaties.[70] This FET violation may in turn allow an investor to wield the corruption allegation against the host state. However, this proposal falls short for a few reasons. First, it results in a similarly asymmetric allocation of blame, with foreign investors able to initiate actions based solely on the actions of sometimes low-level officials. While officials soliciting bribes should obviously face consequences, foreign investors should not receive an outsized claim against an entire host state because of the conduct of singular individuals; this is disproportionate and presents a similar asymmetry to the corruption defense itself, only this time in reverse. Second, it creates an irresolvable conflict with the logic of *World Duty Free*: In that case, the actions of an official (President Moi) in accepting the bribe were not attributed to the state on the basis that, by using their power for personal gain, officials soliciting bribes are not acting in their capacity as state

67. Stefanie Schacherer, *Metal-Tech v. Uzbekistan*, INV. TREATY NEWS (Oct. 18, 2018), https://www.iisd.org/itn/en/2018/10/18/metal-tech-v-uzbekistan/.

68. *Id.*

69. Reynoso et al., *supra* note 46.

70. Birnbaum, *supra* note 58.

officials.[71] But in an FET claim, the official would in fact be acting on behalf of the state. Different tribunals have different interpretations of when officials act on behalf of themselves versus the state, and thus this alternative would trade one confusing and volatile jurisprudential issue for another.[72] Third and most importantly, the FET argument is not very common due to the limited use cases in which corruption alone would be an independent cause of action.[73] For example, if a solicitation for a bribe is rejected and some retaliation, such as expropriation, occurs as a result, that retaliation becomes the subject of the dispute, and the initial corrupt offer is not a critical fact to the outcome of the case.[74] This use of an FET violation as a cause of action by foreign investors has only been raised in five tribunals and has never achieved success in allowing the investor to recover.[75] Even if this set of results is happening because tribunals are weighing the corruption defense prior to evaluating corruption as a cause of action, the discretion of arbitrators means that any proposal must present a preferable alternative to the corruption defense for ISA arbitrators. The "fair and equitable treatment" option has failed in this regard.

The second proposed alternative is the doctrine of estoppel, in which the state would be barred from utilizing the corruption defense in the event that it had "unclean hands," perhaps by not prosecuting the behavior or knowingly allowing it to occur.[76] On its face, this seems to be a fair solution: a government should not be able to raise an argument about counterparty behavior that was facilitated or tolerated by its own misconduct.[77] However, this alternative is not preferable for three reasons. First, it encounters the same problem as the fair and equitable treatment defense: it requires drawing a line around when officials are and are not acting on behalf of the state.[78] Second, there are likely scenarios where barring a host state from raising corruption as an issue will allow foreign investors to escape evidence or arguments about their own misconduct. Especially in countries with weak governance or anti-corruption infrastructure, allowing foreign investors to trample weak governments

71. *Id.*

72. de la Jara & Iñiguez, *supra* note 59.

73. Akindeire, *supra* note 55, at 5.

74. Florian Haugeneder & Christoph Liebscher, *Chapter V: Investment Arbitration – Corruption and Investment Arbitration: Substantive Standards and Proof*, KLUWER ARB. 21 (2012), https://law.yale.edu/sites/default/files/documents/pdf/sela/Haugeneder_Liebscher_Corruption.pdf.

75. Akindeire, *supra* note 55, at 5; Young, *supra* note 22.

76. de Alba, *supra* note 56, at 324.

77. de la Jara & Iñiguez, *supra* note 59.

78. *Id.*

would induce significant incentives for corruption by private companies. And third, the lack of a uniform standard around what conduct triggers the estoppel of the defense would still reduce the predictability of arbitration as an avenue available to investors.

Ultimately, both proposed solutions to the corruption defense have the same problem. They attempt to solve the issue of the corruption defense using exactly what is wrong with the corruption defense: the inconsistent and varied applications of different legal principles. In a way, these alternatives beat around the bush when the hard truth is that mitigating the harms of the corruption defense requires robust and clear changes to treaty language itself in order to provide stable and consistent rules for states and investors. The next section will explain why embedding proportional corruption blame into treaty language is the most stable and clear path forward.

IV. Proposal: Investment Treaty Language as a Viable Alternative

A. *Impact of Investment Treaty Language on Arbitration*

Codifying changes in treaty language is an important first step towards generating stable outcomes in ISA corruption claims.[79] Left to their own discretion, arbitrators have used varying legal tests and invoked contrary legal doctrines in evaluating the impacts of corruption claims. Because treaties act as the controlling applicable law in ISA disputes, creating consistent rules in treaties themselves would reduce this discretion and offer foreign investors a clearer picture of a given legal environment.

A useful example of how codification can benefit ISA proceedings concerning corruption is the question of standards of proof. No arbitration rules, laws, or conventions provide a uniform standard of proof for claims of corruption.[80] As a result, tribunals are often free to decide their own standards, sometimes with widely disparate results.[81] Different ISA tribunals have set standards ranging from "preponderance of the evidence," "clear and convincing evidence," to a "balance of probabilities."[82] Corruption can often only be proven by circumstantial evidence, and the reluctance of parties to be forthcoming with possible evidence means that a high evidentiary burden could preclude

79. Moran, *supra* note 4, at 7.

80. Haugeneder & Liebscher, *supra* note 74, at 6.

81. *Id.* at 6–7.

82. Bonnitcha & Mathew, *supra* note 5, at 6; Akindeire, *supra* note 55, at 7.

many claims entirely.[83] Some panels even weighed a presumption that no corruption occurred out of diplomatic concern, even though such a presumption has "no basis in the applicable substantive and procedural standards and would violate due process."[84] As a result, foreign investors cannot predict the measure under which corruption claims will be weighed, introducing additional legal certainty to each of their investments abroad.

Indeed, the stability offered by treaty language is why other areas of public welfare often rely on treaty language in order to provide necessary protections. In fact, "[a]nticorruption is one of the few public welfare principles to develop through arbitration without explicit treaty support."[85] The percentage of investment treaties including environmental language has grown from less than 10% in 2002 to over 80% in 2008.[86] The percentage of bilateral treaties mentioning sustainable development or responsible business conduct doubled between 2002 and 2013.[87] Treaty language has emerged as a significant tool for introducing social objectives into investment agreements, and anti-corruption should be no different.

Importantly, explicit treaty language, regardless of the specifics provided, solves some of the issues of the FET and estoppel alternatives by providing stable tests and standards for thorny legal issues normally subject to arbitrator discretion. Issues such as whether corrupt officials are acting on behalf of themselves or the state and the evidentiary bar for estoppel would have consistent meanings regardless of the arbitrator if they were encoded in treaty language. But stability and consistency can only go so far. As the next section explains, the asymmetric nature of these alternatives, as well as the corruption defense itself, can only be addressed with a proportional allocation of blame which can ascribe liability to either party. The next section explores the specifics of what this language would look like and how it would level the playing field of ISA in a way that maximizes incentives for public and private anti-corruption.

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83. Haugeneder & Liebscher, *supra* note 74, at 15.

84. *Id.*

85. Young, *supra* note 22.

86. Kathryn Gordon & Joachim Pohl, *Environmental Concerns in International Investment Agreements*, OECD WORKING PAPERS ON INT'L INV. 8 (2011), https://www.oecd.org/daf/inv/internationalinvestmentagreements/WP-2011_1.pdf.

87. Kathryn Gordon, Joachim Pohl, & Marie Bouchard, *Investment Treaty Law, Sustainable Development and Responsible Business Conduct: A Fact Finding Survey*, OECD WORKING PAPERS ON INT'L INV. 12 (2014), https://www.oecd.org/investment/investment-policy/WP-2014_01.pdf.

B. *A Proportional Proposal for Codifying Arbitral Procedures*

While treaty language alone can provide more stability and predictability for investors engaged in international investment, the specific framework of the language itself is also important to remedy the shortcomings of the corruption defense. Most notably, treaty language would need to address the asymmetric benefits of the corruption defense, in which host states can use corrupt conduct in which they might have been a participant in order to void a proceeding and eliminate their liability. However, as noted in Section III(B), some proposed alternatives could offer a similarly asymmetric tool for foreign investors, generating disproportionate liability for host states or barring them from raising any arguments about the foreign investor's misconduct. Thus, the best option for such treaty language would be to ascribe blame for corrupt behavior proportionally between the investor and the host state.

Proportionality analysis seeks to replace bright line rules with a more comprehensive approach that weighs the different interests colliding in a certain legal question.[88] It attempts to replace "all or nothing" conclusions with legal analysis that creates room for "more or less." Proportional analysis often seeks to weigh interests such as the importance of any rights affected, the degree of interference in those rights, and the length of time in which the interference occurred.[89] Professor Jason Webb Yackee, a primary critic of the corruption defense, has stated that the key change in incentives necessary to improve the corruption defense in ISA is allowing panels to "engage in an equitable balancing exercise that will put the state at risk of having its own blameworthiness used to offset or moderate the legal consequences of the investor's misbehavior."[90] The use of proportionality in the corruption context specifically is also supported by the fact that corruption is highly contextual and fact-specific: cross-applying bright line rules to different countries, business arrangements, and legal regimes is likely less effective than using a case-by-case inquiry that deals with a range of facts and addresses grey areas in each party's behavior.

Skeptics of proportional approaches often argue that these systems vest more power in the hands of judges or arbitrators and create more room for discretion in a way that reduces predictability and certainty

88. Benedict Kingsbury & Stephan W. Schill, *Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality, in* INT'L INV. L. & COMP. PUB. L. 75, 79–80 (Stephan Schill, ed., 2010).

89. *Id.* at 87.

90. Yackee, *supra* note 12, at 744.

for parties involved.[91] However, this counterargument fails for two reasons. First numerous legal regimes, including many treaties and conventions, have embraced proportional analysis, giving this system legitimacy and making it commonplace for legal practitioners.[92] For example, both the World Trade Organization and the International Court of Justice utilize proportionality in their analyses of barriers to trade and countermeasures, respectively.[93] The fact that the UNCAC condemns both the supply side and the demand side of corrupt transactions strengthens the case for a proportional blame system which can better ensure that consequences fall on both sides of a transaction and avoids asymmetric benefits to one party. But second, proportional analysis only raises uncertainty when it replaces a stable and consistent rule. In the realm of ISA, however, without precedential power between decisions and with diverging standards and practices, a proportional rule would offer a net increase in certainty to parties by setting a standard rubric that they know that arbitrators will follow.

A proportional approach to corruption claims would satisfy basic notions of fairness while rearranging the incentives of both parties to maximize public and private anti-corruption enforcement. On the issue of fairness, corruption inherently involves misconduct by two parties: the party providing the bribe or benefit and the party receiving it. Any approach that bars recovery or tilts advantage towards one of these parties offends the moral intuition that both parties participating in such conduct should bear some consequence and that all parties should be equal under the law. But more importantly, opening the inquiry to possible blame by both parties ensures that both investors and host governments retain significant incentives to police themselves with anti-corruption measures. A system where blame is allocated proportionally between both parties means that private companies will want to engage in internal controls in order to avoid costly liability under future arbitration. Moreover, by introducing possible penalties against states that engage in corrupt acts with foreign investment, such protections could push governments to crack down on corruption in their ranks.[94] Thus, a proportional system corrects for the perverse incentives offered to host states by the corruption defense without swinging the pendulum too far in the opposite direction.

Specifically, such language would require a few important components. Firstly, plain language that establishes ISA jurisdiction over

91. Kingsbury & Schill, *supra* note 88, at 103.

92. *Id.* at 79–80.

93. *Id.* at 83–84.

94. Spalding, *supra* note 14, at 495.

contracts procured via corruption. This is because a proportional blame approach requires analysis of the merits of the case, meaning that the tribunal first must be sure of its jurisdiction.[95] This would reduce concerns about jurisdiction from the perspective of the investor, as a trivial violation of the law would now no longer lead to the immediate dismissal of the case.[96] This would also eliminate the ability of corrupt states to make arguments about "implicit legality" clauses: no longer would foreign investors need to clear an entire compliance audit before being allowed to make claims about host states.[97]

Secondly, the language could include specific factors to proportionally compare in allocating blame and costs from the corrupt exchange. This could include weighing which party initiated the corrupt behavior, the amount paid, the involvement of the state, the internal monitoring and compliance regime of the investor, the ambiguity of a state's corruption law, and any faulty legal advice relied upon by foreign investors.[98] Others propose a purely bimodal framework that weighs the type and degree of the violation of the law committed by the investor against the relationship between that wrongdoing with the state's conduct in connection with the violation.[99] Under this framework, a state which knew of corrupt behavior occurring and did nothing to stop it would not be able to retain that information as a means of voiding a contract at a later date, when it saw fit.[100]

Perhaps the most complete set of principles comes from the International Institute for the Unification of Private Law (UNIDROIT), an organization dedicated to harmonizing and coordinating contractual principles among businesses and states across the world.[101] The UNIDROIT principles describe the factors which tribunals ought to consider when crafting restitutionary remedies, which seek to avoid unjust enrichment even when a party in a dispute has breached a mandatory rule.[102] These factors include the following:

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95. *Arbitration and Corruption*, *supra* note 38.

96. de Alba, *supra* note 56, at 330.

97. Yackee, *supra* note 12, at 744.

98. *See* de la Jara & Iñiguez, *supra* note 59; Yackee, *supra* note 12, at 741.

99. de Alba, *supra* note 56, at 322.

100. *Id.* at 333.

101. *Home*, INT'L INST. FOR THE UNIFICATION OF PRIV. L. (UNIDROIT), https://www.unidroit.org/.

102. *International Comparative Legal Guide to: International Arbitration 2014*, GLOB. LEGAL GRP. 10–11 (2014), https://www.sidley.com/-/media/files/publications/2014/07/corruption-as-a-defence-in-international-arbitra__/files/view-article/fileattachment/ia14_chapter2_sidleyaustin.pdf?la=en.

> (a) the purpose of the rule which has been infringed; (b) the category of persons for whose protection the rule exists; (c) any sanction that may be imposed under the rule infringed; (d) the seriousness of the infringement; (e) whether one or both parties knew or ought to have known of the infringement; (f) whether the performance of the contract necessitates the infringement; and (g) the parties' reasonable expectations.[103]

However, even the UNIDROIT Principles are vague and not sufficiently molded to the concerns present specifically in the anti-corruption context. Although the specific factors for this analysis will inevitably vary from treaty to treaty, this Note proposes the following set of factors for a proportional allocation of liability in ISA considerations of corrupt behavior:

- The seniority and rank of the specific individuals from each party who participated, aided, or abetted the corrupt transaction: this factor would help the panel to determine the degree to which either party's leadership knew or should have known of the corrupt behavior.
- The length of time which lapsed from the last corrupt transaction to the action which caused the invocation of the ISA mechanism: this factor would assist a panel in determining if the corruption issue is being raised in bad faith, or deciding if the nexus between the corruption and the present investment is sufficient to warrant penalties against the parties.
- Which party instigated or suggested the corrupt transaction: this factor provides insight into whether either party could have perceived themselves to have been coerced and threatened by the solicitation of corruption.
- The strength of the evidence that the corrupt transaction took place, was dispositive to acquire or maintain the relevant contract, and was clearly illegal under relevant law: this factor would allow the panel to hedge their finding on the uncertainty over certain facts or law in the dispute, and incentivize robust fact finding by each party.
- The nexus between the corrupt transaction and the current issue subject to ISA, and the relative magnitude and interests of the parties in the corrupt transaction and the current issue: this factor would allow the panel to consider whether

103. *Id.* at 11.

the harms caused by the corrupt behavior are sufficient to override distinct legal interests of the party, such as expropriation, at play in a given dispute.

- Each party's reliance interests in maintaining the business arrangement procured through the corrupt transaction: this factor would help the panel devise equitable remedies by considering the relative harms to each party that would follow from voiding the contract.
- The strength of the investor's internal compliance program and the host state's anti-corruption program: this factor would be considered individually for each party, and would prevent a moral hazard for investors and states to turn a blind eye to corrupt behavior.
- Each party's awareness or tolerance of the specific corrupt behavior alleged, and any steps taken to remediate the behavior and avoid such behavior in the future: this factor would both help avoid the moral hazard offered by the corruption defense and help the panel determine if one party is invoking corrupt behavior in bad faith.

This proportional approach would introduce a critical incentive to governments to police corrupt conduct within their ranks because the corruption defense would no longer offer them a mechanism to instantly defeat the case, and each aspect of their tolerance of a corrupt scheme would allocate to them more blame and loss in the proportional weighing of these factors.[104] Rather than incentivize a blind eye for corruption, this set of factors would realign the interests of the host government to coincide with anti-corruption principles. Even if a given treaty did not include all of these factors, any consistent set of criteria would increase the predictability of the legal environment for foreign investors relative to the status quo, facilitating investment while providing anti-corruption incentives for both private companies and host states.

Previously discussed examples of the corruption defense demonstrate how this list of factors could provide more equitable results. In *Union Fenosa Gas*, the government's failure to prosecute any of the government wrongdoers and the fifteen-year gap between the corruption and the arbitration would have pushed an arbitral panel to allocate some liability to the government. In *World Duty Free*, the high rank of the government official (President Moi), the failure of the government

104. *Id.*

to pursue any remedial action against him, and the heavy reliance interest of World Duty Free in reacquiring their expropriated business would similarly have allowed some allocation of liability to the government. Finally, in *Metal-Tech*, the role of high-ranking government officials in the corrupt scheme would have suggested that the government bear some of the burden of the corrupt transaction.

The proportional approach, and the wider inquiry that comes with it, could also open the door for participation from civil society organizations that can speak to corruption in host states, offering expertise to arbitrators in the form of amicus curiae briefs.[105] While the corruption defense closes the door on the actual analysis of the corrupt behavior, a proportional approach would enable an inquiry into corrupt practices.

V. Conclusion

This is an inherently long-term proposal.[106] Greater domestic anti-corruption enforcement and due diligence requirements in the home countries of foreign investors could offer more immediate anti-corruption enforcement for corruption-prone areas of the world. But in the realm of ISA specifically, there is no other viable alternative to treaty language in addressing the volatile and unpredictable decisions of ISA tribunals. If trade and investment leaders are serious about anti-corruption, or even if they solely wish to create a better investment environment for private parties, treaty language is the most stable and secure option. If anti-corruption advocates are serious about leveraging the potential of ISA for their cause, then the process of renegotiating the world's 2,500 active investment treaties should begin now.

105. Moran, *supra* note 4, at 7.

106. *Id.* at 9.