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MAPPING THE GOOD FAITH PRINCIPLE IN INTERNATIONAL INVESTMENT ARBITRATION: ASSESSMENT OF ITS SUBSTANTIVE AND PROCEDURAL VALUE*

Abstract: *International investment cases show the frequent use of good faith arguments by both investors and respondent states. These cases also illustrate how parties and tribunals tend to conceptualize the good faith principle which has become an important rule of international investment law. This article will explore recent trends in order to assess the importance of this argument for both parties and at different stages of the proceeding. This article will also provide an overview of responses given by the tribunals faced with good faith arguments. Whereas claimants have traditionally relied on this concept to argue the breach of fair and equitable treatment and legitimate expectations, recent cases such as Inceysa, Phoenix and TSA Spectrum, indicate a new defence strategy for respondent states. Given the fact that investment tribunals have shown willingness to treat the good faith principle as autonomous and as a self-standing standard, the possibilities for respondent states have increased. Respondent states can rely on good faith to deny the right of claimants to seize the tribunal (Article 41(5) of the ICSID Rules), to challenge the jurisdiction of the tribunal or admissibility, to contest the right of the claimant to have a decision in its favour, or to challenge the right to compensation.*

Key words*: Good faith – investment arbitration – fair and equitable treatment – legitimate expectations – jurisdiction and admissibility - unconscionable conduct – misrepresentations*

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I. INTRODUCTION

The principle of good faith hardly needs an introduction for international lawyers, even less so the proof of its entrenchment in international law. However, when it comes to its application in the course of an arbitral proceeding several issues may arise. The principle which is strongly rooted in the international legal scholarship can sometimes be too broad or too vague to gain significant value in deciding the case. On the other hand, few arbitrators would ignore the ramifications of this principle and consequences which the breach of this principle could produce. The aim of this article is to assess the substantive and procedural value of the principle of good faith and thereby to map the good faith principle in international investment arbitration.

II. THE GOOD FAITH PRINCIPLE IN GENERAL INTERNATIONAL LAW

The good faith principle is considered as one of the cornerstones of any legal system. It is inherent in the very concept of the law.[1] Good faith is more than argument for legitimacy of international law and fairness required for its legitimacy. The argument may go as far as to claim that it is the underlying premise for the functioning of any legal system, so its breach should necessarily provide remedies or some other form of response in order to preserve the system and the injured party. The good faith principle is well-known in international law having found its place in numerous instruments and pronouncements of international courts. Major international instruments, such as the *UN Charter* (1945)[2] and the *Vienna Convention on the Law of Treaties* (1969)[3] expressly incorporate the rule. The UN system envisages the obligation of the States to perform their duties in good faith as one of the UN principles of peremptory character. The *International Law Commission Draft declaration on rights and duties of States* (1949)[4] and *UN Declaration on Principles of International Law*

[1] C. Focarelli, *International Law as Social Construct: The Struggle for Global Justice*, Oxford University Press, Oxford, 2012, 323.

[2] Article 2(2) of the UN Charter: "All Members, in order to ensure to all of them the rights and benefits resulting from membership, shall fulfil in good faith the obligations assumed by them in accordance with the present Charter."

[3] Article 26 of the *Vienna Convention on the Law of Treaties*: "Every treaty in force is binding upon the parties to it and must be performed by them in good faith."

Article 31(1) of the *Vienna Convention on the Law of Treaties*: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. "

[4] "Every State has the duty to carry out in good faith its obligations arising from treaties and other sources of international law, and it may not invoke provisions in its constitution or its laws

concerning Friendly Relations and Cooperation Among States (1970)[5] unequivocally uphold the principle. Despite authoritative sources confirming the validity of the principle and its entrenchment in international law, its contours and contents, as well as possibility to use it either as a cause of action or defence, may still be unclear. The critical appraisal of the doctrine is that the principle itself is an empty shell and far from the legal certainty and predictability[6] which should be inherent to the very same principle.

Still, the international courts often make pronunciation on the good faith principle and rarely leave this argument unanswered. On the other hand, the international application of the good faith principle varies. International courts can make broad pronunciation on the general implications of the good faith principle or apply the good faith argument with another legal norm, which more than others, incorporate the *bona fides* in its contents, such as the prohibition of the abuse of right, estoppel or negligence. It is indeed true that there are many rules and principles which echo the good faith considerations, but the question remains: is the good faith principle an autonomous obligation or ancillary mechanism and an argument that can be deployed only in conjunction with an existing obligation?

International courts were much more willing to entertain the good faith argument as part of another international legal norm. In the absence of instructions stemming from the defined obligation, the courts may be ill at ease to grapple with the good faith argument. On the other hand, the good faith argument can prevent and sanction the abuse of the systems in the absence of clear authority to act. As the case law will show, the courts tend to push limits and employ the good faith argument for that purpose. International courts in general, and investment tribunals in particular, clear the way for the independent good faith argument as its frequent invocation could lead to the formation of autonomous and a directly applicable good faith rule.

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as an excuse for failure to perform this duty." Article 3 of the *Draft declaration on rights and duties of States,* G.A.Res. 375 (IV) of 6 December 1949.

[5] "The principle that States shall fulfil in good faith the obligations assumed by them in accordance with the Charter:

Every State has the duty to fulfil in good faith the obligations assumed by it in accordance with the Charter of the United Nations.

Every State has the duty to fulfil in good faith its obligations under the generally recognized principles and rules of international law.

Every State has the duty to fulfil in good faith its obligations under international agreements valid under the generally recognized principles and rules of international law." - *UN Declaration on Principles of International Law concerning Friendly Relations and Cooperation Among States,* G.A.Res. 2625 (XXV) of 6 December 1949.

[6] A.D. Miller, R. Perry, "Good Faith Revisited", 97 *Iowa Law Review* (2012).

The famous quotation of the International Court of Justice in the *Nuclear Tests* case rests on the broad definition of the good faith which here is understood as the underlying premise of substantive legal obligations:

"One of the basic principles governing the creation and performance of legal obligations, whatever their source, is the principle of good faith. Trust and confidence are inherent in international co-operation, in particular in an age when this co-operation in many fields is becoming increasingly essential."[7]

In the case that followed the ICJ took the position that good faith "is not in itself a source of obligation where none would otherwise exist."[8] Therefore, according to the ICJ the good faith principle has no teeth in the absence of another valid legal obligation and cannot be treated as a self-standing clause of international law equipped with its own remedy.

The ICJ had to entertain the good faith argument more often in the context of "good faith negotiations"[9] meaning that the Court tested the process in which the parties were involved, or were supposed to be involved, rather than the content of substantive obligation. Duty to negotiate in good faith is close to the well-known, but not fully accepted, classification of obligations as obligations of means and obligations of result where the negotiations would fall into the former category. Recent case between FYR Macedonia and Greece over the name of Macedonia[10] prompted the issue of good faith negotiations. The Court offered a set of criteria for a good faith standard during negotiations.[11] But more importantly, the Court found that "although Article 5, paragraph 1, contains no express requirement that the Parties negotiate in good faith, such obligation is implicit under this provision."[12]

Therefore, according to the ICJ, the answer to the question whether the good faith principle is an autonomous obligation or not, must be that it is only the ancillary mechanism and argument that can be deployed sdely in conjunction

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[7] *Nuclear Tests (Australia* v. *France), Judgment, I.C.J. Reports 1974,* 268, para. 46.

[8] *Border and Transborder Armed Actions* (Nicaragua v. Honduras), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1988,105, para. 94.

[9] *Delimitation of the Maritime Boundary in the Gulf of Maine Area* (Canada/United States of America), Judgment, I.C.J. Reports 1984, p. 292, para. 87; *Fisheries Jurisdiction* (United Kingdom v. Iceland), Judgment, I.C.J. Reports 1974, pp. 33-34, paras. 78-79; *Fisheries Jurisdiction* (Federal Republic of Germany v. Iceland), Merits, Judgment, I.C.J. Reports 1974, p. 202, para. 69; *Nuclear Tests* (Australia v. France), Judgment, I.C.J. Reports 1974, p. 268, para. 46; *Nuclear Tests* (New Zealand v. France), Judgment, I.C.J. Reports 1974, p. 473, para. 49; *North Sea Continental Shelf (*Federal Republic of Germany/Denmark; Federal Republic of Germany/Netherlands), Judgment, I.C.J. Reports 1969, pp. 46-47, para. 85.

[10] *Application of the Interim Accord of 13 September 1995* (the former Yugoslav Republic of Macedonia v. Greece), Judgment of 5 December 2011, I.C.J. Reports 2011.

[11] *Ibidem*, para. 132.

[12] *Ibidem*, para. 131.

with an existing obligation. This, however, will not prevent international courts finding the good faith implications in a number of international legal provisions.

International investment tribunals provide a good example of such practice. The good faith argument has played a significant role in investment arbitration. Due to the structure of international investment law, where rights and duties are clearly divided between the investors as beneficiaries of the rights and states as guarantors of these rights, the proceeding is identically organized so only investors are entitled to pursue claims and act as claimants while states are restricted to the position of respondents. The good faith argument therefore can potentially function either as the basis of claim for the investor or as a defence for the state.

III. THE GOOD FAITH PRINCIPLE AND INTERNATIONAL INVESTMENT LAW: FROM NORMATIVE VALUE TO PROCEDURAL ADVANTAGE

1. Good faith as a sword: fair and equitable treatment standard, legitimate expectations and estoppel

Although the international investment tribunals confirm the significance of the principle ("It is indisputable, and this Arbitral Tribunal can do no more than confirm it, that the safeguarding of good faith is one of the fundamental principles of international law and the law of investments."[13]) and although commentators subscribe to this view at least in principle ("good faith is a broad principle that is one of the foundations of international law in general and foreign investment law in particular."[14]) the investment tribunals still have shown less discipline in following the cautious approach of the ICJ, at least in two respects. First, the investment tribunals interpreted the good faith doctrine so as to enable its autonomous application: "the principle fulfils a complementary function; it allows for lacunae in the applicable laws to be filled, and for that law to be clarified by the specific application of existing principles"[15]. Secondly, the interpretation of good faith differs significantly when applied in relation to the claim as opposed to the defence. It seems that the investment tribunals tend to tie the good faith argument with the obligations which again lie solely with the states. In that sense the good faith argument will be mainly discussed in relation

[13] *Malicorp Limited v. The Arab Republic of Egypt*, ICSID Case No. ARB/08/18, Award of February 7, 2011, para. 116.

[14] R. Dolzer, C. Schreuer, Principles of International Investment Law, Oxford University Press, Oxford, 2008, p. 144.

[15] *Malicorp Limited*, *op. cit*. at n. 13, para. 116.

to the behaviour of the respondents than claimants. Dolzer and Schreuer justify this approach:

"In part, this emphasis on good faith reflects the fundamental significance of the concept for the understanding of all obligations in international law. More specifically, however, the subject matter of the field itself may direct tribunals to apply the principle, in view of the long-term relationship in which the investor provides most of the required resources at the outset of the project expecting to receive a fair return in a stable relationship within the legal order of the host state thereafter. The financial long-term risk of the investor finds its legal corollary in the protection of good faith without which investment flows would be hampered."[16]

Good faith gained broad application through the fair and equitable standard. There seems to be an understanding that investment tribunals interpreted good faith as inherent in fair and equitable standard.[17] The standard itself is broad, even vague, but still understood as the embodiment of the good faith required from the host states. The *MTD v. Chile* tribunal, when assessing the meaning and scope of the fair and equitable treatment standard, found that:

"The parties agree that there is an obligation to treat investments fairly and equitably. The parties also agree with the statement of Judge Schwebel that 'the meaning of what is fair and equitable is defined when that standard is applied to a set of specific facts'. As defined by Judge Schwebel, 'fair and equitable treatment' is 'a broad and widely-accepted standard encompassing such fundamental standards as good faith, due process, non-discrimination, and proportionality'."[18]

In *Tecmed v. Mexico* the arbitral tribunal clearly set that out:

"The Arbitral Tribunal finds that the commitment of fair and equitable treatment included in Article 4(1) of the Agreement is an expression and part of the *bona fide* principle recognized in international law, although bad faith from the State is not required for its violation."[19]

This interpretation rests upon the understanding that good faith is a substantive principle which forms that basis for a state's responsibility, although it is not expressly provided for in the FET standard. This interpretation, however, does not exclude another aspect of good faith, i.e. the way the obligation is performed, which seems to be independent and separate grounds for responsi-

[16] R. Dolzer, C. Schreuer, *op. cit*. at n. 14, p. 5.

[17] *Ibidem*, p. 145.

[18] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award of 25 May 2004, para. 109.

[19] *Tecnicas Medioambientales Tecmed v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award of 29 May 2003, para. 153.

bility. The opinion of some authors, such as Dolzer, according to which the good faith principle is part of the substantive obligation to provide fair and equitable treatment ("Good faith, as the underlying principle, is guiding all of these obligations and…it is relied on as the common guiding beacon that will orient the understanding and interpretation of obligations…".)[20] was so persuasive for some arbitrators that it was *verbatim* introduced in the *Sempra v. Argentina* award.[21]

The *Sempra* award is relevant for the *bona fide* approach also because it explicitly goes over the boundaries proposed by the ICJ:

"There remains, however, a requirement of good faith that permeates the whole approach to the protection granted under treaties and contracts. Even if the standard were restricted to a question of reasonableness and proportionality not entailing objective liability, as the Respondent argues in the light of *Tecmed*, there are nevertheless expectations arising from promises that must be respected when relied upon by the beneficiary."[22]

A fair and equitable standard provides an excellent ground for arguing the breach of good faith and in that respect good faith has a considerable substantive value for the claimants. It also offers several avenues for pursuing this claim. First, as it has been already illustrated, good faith is a substantive obligation under the FET standard. Further, the way other obligations are performed can be again tested against the good faith principle. Finally, and more importantly, good faith is further developed and rooted in another standard within FET, the legitimate expectations of the investor.

The concept of legitimate expectations have significant place in international investment law. Although bilateral investment treaties (BITs) generally do not include the protection of legitimate expectation of an investor, the investment tribunals showed disciplined willingness in creating the standard as an actionable right within BITs provisions, both under the prohibition of expropriation and standard of FET. In *Saluka v. Czech Republic* the tribunal described both the contents of the legitimate expectations and its basis in the FET standard:

"301. Seen in this light, the 'fair and equitable treatment' standard prescribed in the Treaty should therefore be understood to be treatment which, if not proactively stimulating the inflow of foreign investment capital, does at least not deter foreign capital by providing disincentives to foreign investors.

[20] R. Dolzer, "Fair and Equitable Treatment: A Key Standard in Investment Treaties", 39 *The International Lawyer* (2005) 87, 90.

[21] *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award of 28 September 2007, para. 297.

[22] *Sempra*, *op. cit*. at n. 21, para. 299.

An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host State subsequent to the investment will be fair and equitable.

302. The standard of 'fair and equitable treatment' is therefore closely tied to the notion of legitimate expectations34 which is the dominant element of that standard. By virtue of the 'fair and equitable treatment' standard included in Article 3.1 the Czech Republic must therefore be regarded as having assumed an obligation to treat foreign investors so as to avoid the frustration of investors' legitimate and reasonable expectations.''[23]

Another investment tribunal gave its definition of the legitimate expectations clearly pointing out to the good faith principle:

"Having considered recent investment case law and the good faith principle of international customary law, the concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.''[24]

The legitimate expectation has become the normative and more defined expression of the good faith obligation of the host states. Leaving aside the concern that the legitimate expectations have not been as such envisaged in the BITs, which could cast doubt on the predictability of obligations undertaken by investment agreements, the good faith considerations are accepted to be at the heart of legitimate expectations.[25]

The problem is if the good faith considerations are to be judged only in relation to states obligations without examining the good faith obligations of the investor. A separate but related issue is whether the content of the legitimate expectations is to be determined by reference to investor's expectations which removes the interpretation from the ambit of the BIT and parties who signed it.

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[23] *Saluka Investments B.V. (the Netherlands) v. Czech Republic*, Permanent Court of Arbitration, Partial Award of 17 March 2006, paras. 301-302 (references omitted).

[24] *International Thunderbird Gaming Corporation v. United Mexican States*, NAFTA/UNCITRAL, Award of 26 January 2006, para. 147 (references omitted).

[25] Other international courts also confirmed the close link between good faith principle and legitimate expectations. E.g. the European Court of Justice, in the *Opel Austria GmbH v. Council of the European Union* opined: "the principle of good faith is the corollary in public international law of the principle of protection of legitimate expectations which, according to the case-law, forms part of the Community legal order (see Case 112/77 Töpfer v Commission [1978] ECR 1019, paragraph 19)." – Case T-115/94, Judgment of the Court of First Instance (Fourth Chamber) of 22 January 1997, para. 93.

One of the interpretation of legitimate expectations seem to be precisely on this course: "Legal rules and regulations are only able to create the basis of an environment beneficial to long-term investment when they are applied according to how a reasonable investor would expect them to be applied. The investors' perception and their expectations towards the government activity becomes an essential element of their perception of the host country's ordering function of law."[26]

Due to a vague and ambiguous wording of the FET in general, and inclusion of a separate substantive obligations under its chapeaux in particular, the good faith argument is closer to an autonomous standard in the international investment law. Whether good faith principle produced legitimate expectations standard, or *vice versa*, becomes irrelevant as neither of them has been explicitly envisaged in a number of BITs.

The concept of legitimate expectations is close to the concept of estoppel in general international law. The considerations of estoppel indeed found its place in arbitral practice despite the general silence of BITs on the issue. Estoppel can be viewed either as a rule of evidence or as a rule of substantive law which "operates so as to preclude a party from denying before a tribunal the truth of a statement of fact made previously by that party to another whereby that other has acted to his detriment or the party making the statement has secured some benefit."[27] Estoppel is based on the principle of good faith.[28] Estoppel, however, can work either as a defence or as a basis of a claim. If estoppel is pursued as the basis of substantive obligation, it heavily relies on the principle of consistency to be found in the fair and equitable treatment standard. Having tied up the principle of consistency with the legitimate expectations of the investor, the investment tribunals created the possibility to claim the breach of substantive obligations under the BITs, more precisely the breach of the fair and equitable standard. In the *Oko Pankki* case the ICSID tribunal opined:

"In conclusion, having taken into account generally the object and purpose of the Estonia-Finland BIT and, in particular, the wording of Article 3, the Tribunal considers that a breach of its FET standard can be established by reference (*inter alia*) to an investor's expectations of even-handed and just treatment by the host state induced by that state's unequivocal representation directed at

[26] K. Yannaca-Small, "Fair and Equitable Treatment Standard: Recent Developments", in: *Standards of Investment Protection* (ed. A. Reinisch), Oxford University Press, Oxford, 2008, at 124.

[27] D.W.Bowett, "Estoppel Before International Tribunals and Its Relation to Acquiescence", 33 *British Yearbook of International Law* (1957), 176.

[28] *Ibidem*; I.C. MacGibbon, „Estoppel in International Law", *International and Comparative Law Quarterly* 7/1958, 468, 472.

that investor, provided that these expectations are reasonable and justifiable. It follows that, where such a representation is made by the host state under this BIT, the factual issue is whether in all the circumstances it was reasonable and justifiable for the investor to rely upon that representation; and, if so, whether there was in fact such reliance. This follows not merely as part of the FET standard as regards breach of the BIT, but also because the Tribunal is required to identify, as regards any decision on compensation, the actual loss suffered by the investor as a result of the host state's breach of this FET standard. In a case where there is no reliance, the investor may have suffered no loss when the host state acts inconsistently with its representation. By contrast, where on the basis of an unequivocal representation made by the state, the investor makes or maintains its investment, or otherwise acts to its detriment, there may be a loss to the investor where the state acts inconsistently."[29]

Therefore, the good faith claim can be successfully pursued by investors in a variety of ways. The claim can rest on substantive understanding of good faith as part of the FET standard, on the performance of other BIT commitments and legitimate expectations of the investor. The good faith argument has increasingly gained importance and come close to an autonomous standard in international investment law, at least when it comes to judging the performance of obligations of host states.

2. Good faith as a shield: from abuse of the process to unconscionable conduct of an investor

The issue remains whether the respondent state may invoke inconsistent behaviour of the investor, or some other *mala fide* aspect of the investment, as its defence in the absence of clear provisions in the BIT. International obligations are generally imposed on state parties whereas the individual rights and benefits are entrusted to persons who fulfil the conditions to be treated as foreign investors within the meaning of the applicable BIT. The lack of reciprocity of rights and obligations as between investor and state, under the BIT, becomes obvious when an investor initiates international proceeding against the state on the basis of BIT. In addition, the fact that the good faith is usually associated with the obligations, which under the BITs belong to states, at the outset leaves less space for a good faith defence. However, since good faith does have the character of the principle and thus underpins the whole treaty regime, there still must be place for its enforcement, either through the existing norms and conditions set forth in the applicable BIT, or even independently as a self-standing standard.

[29] *Oko Pankki Oyj et al. v. The Republic of Estonia*, ICSID Case No. ARB/04/6, Award of 19 November 2007, para. 247.

Generous latitude given to the good faith principle in assessing the obligations of host states could, or should, work equally for both sides. The tribunal in the *Inceysa* seems to have adopted such an approach: "Good faith is a supreme principle, which governs legal relations in all of their aspects and content…"[30]

Also, the conditions under which an investment is protected (e.g. legality and nationality requirements) and under which the claim can be submitted (jurisdiction and admissibility) can be viewed either as obligations for investors and potential claimants or as restrictions on both substantive and procedural rights of BIT beneficiaries.

A good faith defence could play a significant role in all these and similar aspects during the proceeding. The breach of good faith raised by the respondent state could potentially affect substantive and procedural aspects of the claim.[31] If viewed from the perspective of a respondent together with the development of the proceeding, the good faith argument may be used to deny the right of the claimant to seize the tribunal (Article 41(5) of the ICSID Rules), to challenge the jurisdiction of the tribunal or admissibility of the claim (Article 41(1) of the ICSID Rules), to contest the right of the claimant to have decision in its favour, or to challenge the right to compensation.

A. Article 41(5) of the ICSID defence

Article 41(5) of the ICSID Rules, introduced in 2006, provides for an expedited procedure to dismiss claims manifestly without legal merit.[32] Since the objecting party is expected to file such an objection at the outset of the proceeding and not later than 30 days after the constitution of the arbitral tribunal, even before the time limit for regular preliminary objections and without prejudice to the right of the state to raise such an objection at the later stage of the proceeding, this is a "pre-preliminary objection".[33] Although Rule 41(5) on its face

[30] *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Decision on Jurisdiction of 2 August 2006, para. 230.

[31] See generally: A. Cohen Smutny, P. Polášek, "Unlawful or Bad Faith Conduct as a Bar to Claims in Investment Arbitration", in: *A Liber Amicorum: Thomas Wälde – Law Beyond Conventional Thought* (eds. Jacques Werner & Arif Hyder Ali), London, 2009, pp. 277-296.

[32] Article 41(5) of ICSID Rules: "Unless the parties have agreed to another expedited procedure for making preliminary objections, a party may, no later than 30 days after the constitution of the Tribunal, and in any event before the first session of the Tribunal, file an objection that a claim is manifestly without legal merit. The party shall specify as precisely as possible the basis for the objection. The Tribunal, after giving the parties the opportunity to present their observations on the objection, shall, at its first session or promptly thereafter, notify the parties of its decision on the objection. The decision of the Tribunal shall be without prejudice to the right of a party to file an objection pursuant to paragraph (1) or to object, in the course of the proceeding, that a claim lacks legal merit."

[33] The term used by the tribunal in the *Global Trading Resource Corp. and Globex International, Inc. v. Ukraine*, ICSID Case No. ARB/09/11, Decision on the Respondent's Objection under Rule 41(5) of the ICSID Arbitration Rules, 1 December, 2010, para. 34.

seems to be directed against manifestly frivolous claims, its wording does not place many limitations regarding the object of the complaint as long as it is addressed against the legal merit which arguably can involve both jurisdictional and meritorious issues. Does it also involve the issues of good faith and abuse of the right to file a claim and seize the tribunal? It seems so precisely because a manifestly unmeritorious claim represents the abuse of the protection system. According to some authors:

"Before the introduction of the new rule, various tribunals had already faced claims that were manifestly unmeritorious, and had decided the issue during the regular phases of the proceedings. The principles of 'good faith' and 'abuse of process' in assessing the submissions of investment treaty claims have often been used in these cases, essentially to avoid abuses of the direct access to investment arbitration. Both principles are increasingly taking a prominent role in investment arbitration. The rule contained in Article 41(5) of the ICSID Arbitration Rules can be seen as a clear emanation of this idea. Although the objective of Rule 41 (5) is not explicitly aimed at targeting claims that constitute an 'abuse of process', it is likely that the rule will prevent, or at least offer an adequate procedure to assess the submission of such claims, since it provides arbitral tribunals operating under the ICSID Convention with a procedure to assess the claims, inter alia on these grounds in an early stage in the proceedings."[34]

To date, only four objections on the basis of Rule 41(5) were submitted.[35] In the last of these four cases, *Rachel Grynberg et al v Grenada*, the respondent state placed emphasis on the good faith principle arguing *inter alia* that the claimants engaged in the abuse of the process. The claimants here approached the ICSID for the second time after their first contractual claim was dismissed as unfounded. In their second attempt the claim was framed as a treaty-based claim on the basis of the U.S.-Grenada BIT. The second tribunal agreed with the respondent state that it was an attempt to re-litigate the issue already decided by an ICSID tribunal. Although Article 53 of the ICSID Convention figures as the

[34] E. De Brabandere, "The ICSID Rule on Early Dismissal of Unmeritorious Investment Treaty Claims: Preserving the Integrity of ICSID Arbitration", *Manchester Journal of International Economic Law*, Volume 9, Issue 1, pp. 23-44, 2012, at 24 (references omitted).

[35] *Trans-Global Petroleum, Inc. v. Hashemite Kingdom of Jordan,* ICSID Case No. ARB/07/25, Decision on the Respondent's Objection under Rule 41(5) of the ICSID Arbitration Rules, 12 May 2008); *Brandes Investment Partners, LP v. Bolivarian Republic of Venezuela,* ICSID Case No. ARB/08/3, Decision on the Respondent's Objection under Rule 41(5) of the ICSID Arbitration Rules, 2 February 2009); Global *Trading Resource Corp. and Globex International, Inc. v. Ukraine*, ICSID Case No. ARB/09/11, Decision on the Respondent's Objection under Rule 41(5) of the ICSID Arbitration Rules, 1 December, 2010; *Rachel* S *Grynberg, Stephen M Grynberg, Miriam Z Grynberg, and RSM Production Corporation v. Grenada,* ICSID Case No. ARB/10/6, Decision on the Respondent's Objection under Rule 41(5) of the ICSID Arbitration Rules, 10 December 2010.

most prominent reason for not allowing the claimants to have access to the ICSID system, the good faith underpinnings of the decision still stand out.

Rule 41(5) therefore protects the good faith in investment arbitration in a very specific and effective manner. Here the initiation of the claim is the breach of good faith and abuse of process. The good faith argument here has considerable procedural value for the state: it is effective as it removes the case at the very outset and saves substantial time and resources for the respondent state.

B. Good faith preliminary objections to jurisdiction of the tribunal and admissibility of the claim

The next opportunity to raise a good faith defence comes with the preliminary objection procedure. The respondent state can challenge the jurisdiction of the arbitral tribunal or admissibility of the claim on the grounds that conditions set out in the ICSID Convention, relevant BIT or generally accepted rules[36] have not been met so that the case cannot proceed to the merits. Different rules and arguments can be used to that end, but more importantly, the breach of good faith can accompany each of them. However, there are some grounds which will more than others feature good faith arguments.

(i) Legality requirement

The good faith argument has been often invoked in relation to the legality of investment requirement, then whether the claimants fall into the category of protected investors within applicable BIT or whether some other agreed method of dispute settlement prevents the investment arbitral tribunal from hearing the case. The first two grounds are issues of jurisdiction whereas the third one could be treated either as jurisdictional or admissibility criterion.[37]

The legality requirement is a common standard in BITs. The fact that this condition is expressly provided for in the binding instrument, with the aim to exclude illegal investments from the states' obligations to protect,[38] facilitates

[36] The case law of investment tribunals confirms that generally accepted principles, such as good faith, are applicable as recognized source of international law: "[g]eneral principles of law are an autonomous and direct source of International Law, along with international conventions and custom."- *Inceysa*, *op. cit*. at n. 30, para. 226.

[37] In *SGS v. Philippines* the tribunal explicitly found that objection based on the dispute settlement clause in the original contract is objection to admissibility of the claim: *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, Decision of the Tribunal on Objections to Jurisdiction of 29 January 2004, ICSID Case No. ARB/02/6, para. 154.

[38] "It could be argued that the admission clause plays the important role of the filter to the protection under the BIT to ensure that no investment made in violation of the laws and regulations of the host State can benefit from the treaty protection." – A. Joubin-Bret, "Admission and

the position of the respondent State. The common understanding of this clause, however, is that legality clause covers only the lawfulness of the acquisition of the investment, i.e. whether the investment was acquired lawfully, but it does not cover the performance of the investment and will not exclude the BIT protection if some unlawful conduct on behalf of the investor occurred in the course of its performance. The breach of good faith is easily associated with the unlawful acquisition of the investment, so the accusation of corruptive practices or fraudulent behaviour, if proven correct will deny the protection and thereby jurisdiction of the investment tribunal.[39]

Since the legality requirement is in itself sufficient to remove the jurisdiction of the tribunal (although interpreted narrowly by the investment tribunals), the good faith principle may not be even necessary but still reminds us of the rationales of the investment protection system. In that line the issue arises whether the good faith principle can serve as a parallel and autonomous legality requirement, i.e. whether the breach of good faith can remove the case even if the legality requirement has been met. In another words, whether dishonesty, which still falls short of domestic illegality, could play a role in the state's preliminary defence. The investment tribunals seem to have divergent views on this point. In the *Inceysa v. El Salvador*, the tribunal explicitly confirmed this:

"[g]eneral principles of law are an autonomous and direct source of International Law, along with international conventions and custom. (…) Based on the above, we analyze the Inceysa's investment in light of the general principles of law, which the Arbitral Tribunal considers to be applicable to the case. (…) Good faith is a supreme principle, which governs legal relations in all of their aspects and content. (…) The conduct mentioned above constitutes an obvious violation of the principle of good faith that must prevail in any legal relationship. (…) By falsifying the facts the principle of good faith from the time it made its investment and, therefore, it did not make it in accordance with Salvadoran law. Faced with this situation, this tribunal can only declare its incompetence to hear Inceysa's complaint, since its investment cannot benefit from the protection of the BIT."[40]

Establishment in the Context of Investment protection", in: *Standards of Investment Protection* (ed. A. Reinisch), Oxford University Press, Oxford, 2008, pp. 9-28, at 27.

[39] E.g. *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, Award of 16 August 2007; *World Duty Free Company Limited v. The Republic of Kenya*, ICSID Case No. ARB/00/7, Award of 4 October 2006; *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Decision on Jurisdiction of 2 August 2006. For a comprehensive overview of treatment of corruptive practices in the investment arbitration, see: J.W.Yackee, "Investment Treaties and Investor Corruption: An Emerging Defense for Host States", 52 *Virginia Journal of International Law* (2012), no. 3, pp. 723-745.

[40] Inceysa, op. cit. at n. 30, paras. 226, 229, 230, 237, 239.

The strong uphold of the autonomous application of good faith in relation to all aspects of an investment, but applied here in relation to legality requirement for the purposes of jurisdiction, was openly rejected in the case that was heard several years later. In the *Saba v. Turkey* the tribunal explicitly disagreed with the *Inceysa* proposition: "an investment might be 'legal' or 'illegal', made in 'good faith' or not; it nonetheless remains an investment."[41] The same tribunal also rejected the proposition that a good faith requirement was implicit in Article 25(1) of the ICSID Convention.[42] However, the same tribunal declined jurisdiction in this case having found that the claimant did not make any investment so no protection under the BIT could have been granted.

Again, the strong wording of the *Inceysa* tribunal in favour of the good faith principle is not limited to the legality of investment although the jurisdiction was denied on that ground. The legacy of the *Inceysa* award is in its thorough examination of all aspects of the investment, including not only its acquisition but also its performance. As the tribunal remained unimpressed by the overall conduct of the investor it decided to remove the case at an early stage of the proceeding.

The requirement that only investments within the meaning of a relevant BIT are protected within the international investment arbitration system means that first of all there must be an investment. In cases where the investors pursued claims on the assumption of existence of an investment, the tribunals were willing to invoke a good faith argument in order to establish the abuse of the procedure as soon it was proven that no investment was actually acquired. Attempts of the claimants to pursue the claim despite the lack of investment were prevented by the investment tribunals within the good faith framework. Two recent cases prove this point: *Europe Cement v. Turkey*[43] and *Cementownia v. Turkey*.[44] In both these cases, which actually involved the same investors, tribunals heavily relied on good faith argument in relation to decision of the claimant to pursue the claim despite the non-existence of an investment:

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[41] *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award of 14 July 2010, para. 112.

[42] "Likewise, the principles of good faith and legality cannot be incorporated into the definition of Article 25(1) of the ICSID Convention without doing violence to the language of the ICSID Convention: an investment might be 'legal' or 'illegal,' made in "good faith" or not, it nonetheless remains an investment. The expressions 'legal investment' or 'investment made in good faith' are not pleonasms, and the expressions 'illegal investment' or 'investment made in bad faith' are not oxymorons." - *Ibidem* (references omitted).

[43] *Europe Cement Investment & Trade SA v. Turkey*, ICSID Case No. ARB (AF)/07/2, Award of 13 August 2009.

[44] *Cementownia 'Nowa Huta' SA v. Republic of Turkey*, ICSID Case No. ARB (AF)/06/2, Award of 17 September 2009.

"In the above cases [Inceysa, Phoenix], the lack of good faith was present in the acquisition of the investment. In the present case, there was in fact no investment at all, at least at the relevant time, and the lack of good faith is in the assertion of an investment on the basis of documents that according to the evidence presented were not authentic. The Claimant asserted jurisdiction on the basis of a claim to ownership of shares, which the uncontradicted evidence before the Tribunal suggests was false. Such a claim cannot be said to have been made in good faith. If, as in *Phoenix*, a claim that is based on the purchase of an investment solely for the purpose of commencing litigation is an abuse of process, then surely a claim based on the false assertion of ownership of an investment is equally an abuse of process."[45]

The respondent also asked the tribunal to adopt a declaration that the claim was manifestly ill-founded but the tribunal denied this request. The respondent also asked for monetary damages for the moral damage it had suffered to its reputation and international standing. Although the tribunal concluded that "conduct that involves fraud and an abuse of process deserves condemnation"[46] it did not order damages which it found to be applicable only in extreme situations not present in this case. It went on to say that the present judgment was adequate form of satisfaction for the respondent state.[47]

However, this type of declaration was granted by the tribunal in the twin case, *Cementownia*, decided a few weeks later. Although this case was on many points similar to the *Europe Cement* case, here the claimants and their representatives engaged in a series of procedural manipulations including the claim which could not prove the ownership in the company whose expropriation was argued on the basis of which the 4 billion USD in damages were sought. The tribunal found: „As the present case concerns an accumulation of liabilities – abuse of process and procedural misconduct – there is good cause for the Arbitral Tribunal to go beyond the general sanction and to declare that the Claimant has brought a *fraudulent* claim against the Republic of Turkey."[48] The good faith principle is at the heart of this decision:

"In light of all the above-stated considerations, the Arbitral Tribunal is of the opinion that the Claimant has intentionally and in bad faith abused the arbitration; it purported to be an investor when it knew that this was not the case. This constitutes indeed an abuse of process. In addition, the Claimant is guilty of procedural misconduct: once the arbitration proceeding was commenced, it has caused excessive delays and thereby increased the costs of the arbitration."[49]

[45] *Europe Cement*, *op. cit*. at n. 43, para. 174.
[46] *Ibidem*, para. 180.
[47] *Ibidem*, para. 181.
[48] *Cementownia*, op. cit. at n. 44, para. 159. (emphasis original)
[49] *Ibidem*, para. 159.

The Cementownia award takes international investment arbitration to a new level. The formal declaration („the finding by the Tribunal that the Claimant's claim is fraudulent and was brought in bad faith.“[50]) is in the operative part of the award. The ambition of the *Cementownia* tribunal was to prevent the same claimant from pursuing this claim before other international jurisdictions.[51]

(ii) Investment restructuring

At the preliminary stage a good faith argument can play a significant role in assessing whether the claimant fulfils the requirement of the protected investor. This argument is usually engaged in relation to the restructuring of an investment in order to gain benefits of the desired BIT and thereby access to the investment protection system. Indirect investments and restructuring are not uncommon, but the issue here is how to draw a fine line between different types of restructuring in order to establish whether it was done for the sole purpose of gaining access and thereby breaching the good faith principle underlying the investment protection system.

The organization of an investment so as to have connections with several national jurisdictions is not a rare phenomenon in international business. In the context of procedural protection it raises the issues of protection of indirect investors and access to international forums. The question which will be briefly addressed here is whether re-organization and restructuring of an investment before and during the performance of this investment can affect claimants' access to investment arbitration, in light of the good faith principle.

One group of cases revolve around the respondents' arguments that restructuring was conducted solely for the purpose of getting access to the international arbitration which was foreclosed under the previous structuring regime, either because the original nationality did not provide for BIT protection or the BIT protection was seen as less promising, or because the original nationality was one of the host state which *per definitionem* is not protected under the international investment system.[52] The responses of investment tribunals vary.

In the *Phoenix v. Czech Republic* the tribunal declined jurisdiction and severely penalized the restructuring of the investment having found that this manoeuvre was undertaken solely for the purpose of gaining access to the ICSID arbitration. Here the tribunal found that the restructuring occurred after the dispute had arisen which amounted to the breach of good faith and to the abuse of process. The *Phoenix* decision is relevant not only because the bad timing of the

[50] *Ibidem*, para. 179.
[51] *Ibidem*, para. 162.
[52] For discussion on this issue (in Serbian), see: M. Stanivuković, „Domaći ulagač kao tužilac u međunarodnom investicionom sporu“, *Pravna riječ*, 33/2012, pp. 127-143.

restructuring led the tribunal to deny jurisdiction but also because the tribunal relied heavily on the principle of good faith as an autonomous standard[53] and an independent condition for jurisdiction:

"In the Tribunal's view, States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments not made in good faith. The protection of international investment arbitration cannot be granted if such protection would run contrary to the general principles of international law, among which the principle of good faith is of utmost importance."[54]

"Tribunal is concerned here with *the international principle of good faith as applied to the international arbitration mechanism of ICSID*. The Tribunal has to prevent an abuse of the system of international investment protection under the ICSID Convention, in ensuring that only investments that are made in compliance with the international principle of good faith and do not attempt to misuse the system are protected."[55]

The *Phoenix* tribunal devoted much of its arguments to the good faith underpinnings of the investment protections system and now stands as a landmark decision for good faith argumentation.

In *Exxon Mobil v. Venezuela*[56] the respondent state argued that the restructuring occurred after the investments were made with allegations that it was done for the sole purpose of gaining access to the ICSID arbitration system. The tribunal disagreed and found that restructuring in order to get better investment protection was a justifiable measure and that the investors had in mind a range of benefits coming from the BIT and not only the dispute settlement provisions. The tribunal first found that restructuring for the primary purpose of accessing treaty protection was perfectly legitimate because it was designed to protect against future unfavourable Venezuelan measures.[57] On the other hand, restruc-

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[53] "The importance of the Phoenix decision lies in its application of the sole international legal principle of good faith' outside the formal context of the question whether the investment was in accordance with the national laws of the host State." – E. de Brabandere, "Good Faith, Abuse of Process, and the Initiation of Investment Treaty Claims", 3(3) *Journal of International Dispute Settlement* (2012), pp. 1-28, at 17.

[54] *Phoenix Action Ltd. v. The Czech Republic,* ICSID Case No. ARB/06/6, Award of 15 April 2009, para. 106.

[55] *Phoenix*, para. 113. (emphasis original)

[56] *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petróleos, Inc*., ICSID Case No. ARB/07/27, Decision on Jurisdiction of 10 June 2010.

[57] "As stated by the Claimants, the aim of the restructuring of their investments in Venezuela through a Dutch holding was to protect those investments against breaches of their rights by the Venezuelan authorities by gaining access to ICSID arbitration through the BIT. The Tribunal considers that this was a perfectly legitimate goal as far as it concerned future disputes. " *Mobil Corporation*, *op. cit*. at n. 56, para. 204.

turing an investment to obtain the jurisdiction of an international tribunal over pre-existing disputes would constitute "an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs."[58] As the latter was not the case the tribunal upheld its jurisdiction. One question remains: if the restructuring was conducted in order to obtain a better protection not having in mind any particular dispute *in nascendi*, why did the investors not reorganize their corporation before the investment?[59]

(iii) Nationality requirement

There are cases where the restructuring of an investment was tackled from the position that investors restructured their investment in order to circumvent the nationality impediment and gain access to investment arbitration as foreign investors. Nationals of the host state are not protected by the bilateral investment treaties system. The question is whether a national investor can gain access to this system by organizing investment in jurisdictions covered by the BITs and respondent states are likely to challenge the claim on this ground.

Such challenge was submitted in *Tokios Tokelės v. Ukraine*,[60] *Rompetrol v Romania*[61] and *TSA Spectrum v Argentina*[62] but was successful only in the latter of these cases. Here the good faith principle also plays a prominent role because the investment protection system is designed to provide protection only to foreign investors so if the restructuring is conducted to the opposite end it clearly was done in bad faith. In the *Tokios Tokelės* the respondent state argued that the claimant company with the Lithuanian nationality, could not submit the case as it was wholly owned by Ukrainian nationals who would not have access to the BIT protection and ICSID system. This argument rests on the requirements of Article 25 which offers protection only to foreign investors, i.e. the claimants were not, in the opinion of the respondent, a 'genuine' investor so the task of the tribunal was

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[58] *Ibidem*, para. 205 (citing *Phoenix* award).

[59] Some authors distinguish between so-called 'back-end' and 'front-end' restructuring for the purpose of treaty shopping. 'Back-end' restructuring is the scenario from the *Phoenix v. Czech Republic* case where the restructuring occurred after the dispute had arisen. 'Front-end' restructuring is the organization of the company before the investment, or at least before the dispute, solely for the purpose of gaining access to a more favourable treaty protection or to treaty protection which otherwise would not be available, such is the case for nationals of the host state. See: M. Skinner, C. A. Miles, S. Luttrell, "Access and advantage in investor-state arbitration: The law and practice of treaty shopping", *Journal of World Energy Law & Business*, 2010, Vol. 3, No. 3, pp. 260-283.

[60] *Tokios Tokelės v. Ukraine* (ICSID Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2004.

[61] *The Rompetrol Group N.V. v. Romania,* ICSID Case No. ARB/06/3, Decision on Jurisdiction and Admissibility of 18 April 2008.

[62] *TSA Spectrum de Argentina S.A. v. Argentine Republic*, ICSID Case No. ARB/05/5, Award of 19 December 2008.

to pierce the corporate veil in order to find impediment for the jurisdiction. The tribunal rejected this request finding that the claimant fell within the definition of the BIT and refused to impose further restrictions on this definition.[63] The tribunal then used the good faith argument but to the detriment of the respondent: the *Tokios* tribunal was of the opinion that there was no abuse of legal personality as the company was established six years before the BIT entered into force.[64] Here the tribunal mixes up the offered criterion, applicable to foreign investors in general, with the nationality requirement. The answer it offered was not to the question asked: one thing is for a foreign investor to pick and choose the most promising BIT and engage in more favourable treaty shopping whereas it is completely the other whether a national may have access to ICSID under any circumstance. The presiding arbitrator submitted a very strong dissenting opinion precisely on the points discussed above and concluded:

"What *is* decisive in our case is the simple, straightforward, objective fact that the dispute before this ICSID Tribunal is not between the Ukrainian State and a foreign investor but between the Ukrainian State and an Ukrainian investor—and to such a relationship and to such a dispute the ICSID Convention was not meant to apply and does not apply."[65]

In the *Rompetrol v. Romania* case the issues and decision were similar to the *Tokios Tokelės*. The respondent state argued that the claimant, formally possessing Dutch nationality, was effectively a Romanian national "on the basis of its ownership and control, the source of its capital, and the nature of its commercial operations."[66] Here the tribunal found that the language of the BIT in defining 'foreign investor' was clear and unambiguous[67] and concluded that: "[t]he Tribunal accordingly finds that neither corporate control, effective seat, nor origin of capital has any part to play in the ascertainment of nationality under The Netherlands-Romania BIT, and that the Claimant qualifies as an investor entitled to invoke the jurisdiction of this Tribunal by virtue of Article 1(b)(ii) of the BIT."[68] The respondent state employed yet another good faith

[63] "This method of defining corporate nationality is consistent with modern BIT practice and satisfies the objective requirements of Article 25 of the Convention. We find no basis in the BIT or the Convention to set aside the Contracting Parties' agreed definition of corporate nationality with respect to investors of either party in favor of a test based on the nationality of the controlling shareholders. While some tribunals have taken a distinctive approach, we do not believe that arbitrators should read in to BITs limitations not found in the text nor evident from negotiating history sources."- *Tokios Tokelės*, *op. cit*., para. 54 (references omitted).

[64] *Ibidem*, para. 56.

[65] Dissenting opinion of Prosper Weil, para. 21 (emphasis original). Dissenting opinion is attached to the Decision on Jurisdiction of 29 April 2004, *op. cit.* at n. 60.

[66] *Rompetrol*, *op. cit*. at n.61, 2008, para. 100.

[67] *Ibidem*, para. 108.

[68] *Ibidem*, para. 110 (references omitted).

argument claiming that the investor engaged in the abuse of the ICSID procedure with a view of obstructing criminal investigations launched against the owner in Romania[69] which rendered the claims inadmissible. The tribunal rejected this request.

In the *TSA Spectrum v. Argentina* the tribunal was faced with the similar set of facts and objections of the respondent state. Here, unlike in the *Tokios* and *Rompetrol* cases, the tribunal read object and purpose of the relevant BIT and relied on the good faith principle when assessing both the purpose of the investment protection system and requirements for investors who can have access to the ICSID procedural mechanisms. Against the critique of the *Tokios* and *Rompetrol* decisions, and with supporting authorities, the *TSA Spectrum* tribunal decided to pierce the corporate veil in order to establish the real and effective control, which in this case was not foreign but national, so the investor could not benefit from the ICSID protection due to the wording of Article 25 of the ICSID Convention. Although a good faith argument had not been raised or used as such, it still can be said that *bona fide* principle is the underlying rationale of the award.

C. Good faith defence on the merits: misrepresentation, unconscionable conduct and unlawfulness under domestic law

The use of good faith argument on the merits is common but still considerably varies in terms of grounds in relation to which it is invoked and remedies sought for the breach thereof. Good faith is usually associated with the fair and equitable treatment standard which, as broad and flexible as it is, requires the host state to treat foreign investors and their investments fairly and equitably which necessarily implies good faith.[70] For the issue discussed here is whether the good faith argument can also work in the opposite direction so that the respondent state can use it as a defence argument on the merits. According to Muchlinski this is not only possible but central for establishing responsibility of the state: "Thus it is said that the person who comes to equity must do equity and that the person who comes to equity must come with clean hands. The conduct of the claimant is central to the application of equitable principles."[71]

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[69] Ibidem, para. 111.

[70] "The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment." - *Tecmed v. Mexico*, ICSID Case No ARB (AF)/00/2, Award, 29 May 2003, para. 154.

[71] P. Muchlinski, "Caveat Investor? The Relevance of the Conduct of the Investor under Fair and Equitable Treatment Standard", 55 *International and Comparative Law Quarterly* 2006, pp. 527-558, at 532.

Another approach, or at least attempt to systemize the application of good faith in investment procedure, was undertaken by the tribunal in the *Abaclat v Argentine* case. Here the tribunal made distinction between 'material' and 'procedural' good faith where the breach of both usually leads to the denial of jurisdiction or, if considered at the later stage, of denial of BIT protection. This tribunal, however, did not shed much light on different aspects of the breach of 'material' good faith but only related it to the broad notion of 'legality' of an investment and only in relation to the question of how the investment was made,[72] which naturally shifts the issue back to the preliminary rather than the merits stage.

There are numerous examples of where states used good faith strategy to dismiss claims on the merits on the good faith grounds but examples of successful good faith defences also do not come in small numbers.[73] In several cases the misrepresentations of investors were at stake. In *Azinian v. Mexico* the claimants challenged the annulment of the concession contract that was granted to its Mexican enterprise DESONA in which the claimants were shareholders. The Mexican authorities annulled the concession contract *inter alia* on the grounds of misrepresentations of DESONA in obtaining the contract. The Tribunal agreed with the findings of Mexican agencies and courts and rejected the claim. The Tribunal equally confirmed the *bona fides* of Mexican judgments:

"To reach this conclusion it is sufficient to recall the significant evidence of misrepresentation brought before this Arbitral Tribunal. For this purpose, one need to do no more than to examine the twelfth of the 27 irregularities, upheld by the Mexican courts as a cause of nullity: that the Ayuntamiento was misled as to DESONA's capacity to perform the concession."[74]

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[72] "648. With regard to breaches of material good faith, different tribunals have followed two different approaches.210 Either they have dealt with the question of material good faith within the context of the examination of the Tribunal's jurisdiction or within the context of the examination of the legality of the investment:

(i) It can be seen as an issue of consent and thus of jurisdiction, where the consent of the Host State cannot be considered to extend to investments done under circumstances breaching the principle of good faith;

(ii) It can be seen as an issue relating to the merits, where the key question is whether the circumstances in which the relevant investment was made are meant to be protected by the relevant BIT." - *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5 (formerly *Giovanna a Beccara and Others v. The Argentine Republic*), Decision on Jurisdiction and Admissibility of 4 August 2011.

[73] For an overview of successfully argued good faith defences (including those at preliminary stage) see: A. Cohen Smutny, Petr Polášek, Unlawful or Bad Faith Conduct as a Bar to Claims in Investment Arbitration, in: A Liber Amicorum: Thomas Wälde – Law beyond Conventional Thought (eds. Jacques Werner & Arif Hyder Ali), London, 2009, pp. 277-296.

[74] *Robert Azinian et al. v. The United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award of 1 November 1999, para. 104.

The unconscionable conduct was noted[75] and penalized by the Tribunal which rejected the claim on the merits. However, the Tribunal still chose not to make award of costs for the reasons which seem to be more of practical than legal nature.[76] The consequence was that arbitration costs were shared equally.

In *Genin v. Estonia* the tribunal took cognizance of the investor's "concealment, right up until his cross-examination by Respondent's counsel during the hearing, of his ownership of the companies in question was an element of both substantive and procedural significance, with effect on the conduct of the arbitration."[77] As the investor witheld the required information which eventually led to the revocation of the license, where the information became available only during the hearing, the tribunal was convinced that all actions of the respondent and its agencies were justifiable. So the claim was rejected as the misrepresentations of the claimants, in the opinion of the Tribunal, justified the state measure.

A good faith defence on the basis of investor's misrepresentation can be successful at the merits stage as the two previous cases illustrate. During the jurisdictional stage of the *Plama v. Bulgaria* case the respondent argued that investor's misrepresentation led to an illegally acquired investment which could not benefit from the BIT protection. The tribunal decided that this aspect of the case did not deprive it of jurisdiction but still did not exclude the possibility to take it into consideration later at the merits stage. When the issue was raised again at the merits stage the tribunal established that misrepresentations of the investor led Bulgarian authorities to believe that investor remained qualified to run the privatized company and on that basis provided him with the approval to obtain shares from another company. As it turned out later, the investor went through changes which, had they existed at the time of privatization, would not have made him qualified for the purchase. He argued that he was not under the duty to reference all changes after the original privatization contract had been executed. The tribunal disagreed and found that investor had duty to inform the state of changes. So, since the investor failed to inform the state of relevant

[75] "121. By way of a final observation, it must be said that the Claimants' credibility suffered as a result of a number of incidents that were revealed in the course of these arbitral proceedings, and which, although neither the Ayuntamiento nor the Mexican courts would have been aware of them before this arbitration commenced, reinforce the conclusion that the Ayuntamiento was led to sign the Concession Contract on false pretences. It is hard to ignore the consistency with which the Claimants' various partners or would-be partners became disaffected with them. (...)

122. The list of demonstrably unreliable representations made before the Arbitral Tribunal is unfortunately long. (...)"

[76] *Ibidem*, paras. 126-127.

[77] *Alex Genin Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2, Award of 25 June 2001, para. 380.

changes, despite the fact that such an obligation was not explicitly envisaged in the law, this failure precluded the protection of the Energy Charter Treaty.[78] There is direct reference to good faith principle: "If a material change occurred in the investor's shareholding that could have an effect on the host State's approval, the investor was, by virtue of the principle of good faith, obliged to inform the host State of such change. Intentional withholding of this information is therefore contrary to the principle of good faith."[79]

Good faith of the investor in conducting investment or pursuing an international claim will take different shapes at the merits stage. Misrepresentation is just one of them. Very often the issue will be the performance and termination of the contract where the respondent state will be deprived of the right to raise the counter-claim in relation to non-performance or breach of the contract by investor who in turn will usually claim that the performance, breach or termination of the contract of its counter-party gives rise to a BIT claim. Although international investment tribunals generally do not have jurisdiction over contractual claims it can happen that tribunals still find it necessary to discuss contractual issues which may involve the non-actionable performance of the contract by investors. The issue here is to what extent bad faith on part of the investor, against whom no international investment claim may be raised, can have relevance for the state's defence. In the *Bayindir v Pakistan* case the claimant argued that Pakistan breached standard provisions of the BIT, i.e. fair and equitable treatment standard and prohibition of expropriation, by terminating the contract on the motorway construction project. The tribunal reminded the parties that it did not have jurisdiction over contractual matters but examined the whole period of contractual performance. It finally concluded that Pakistan never stepped out of its contractual position, which left the issue of a sole contractual liability outside its jurisdiction, but still examined the performance of Bayindir under the contract and found that Pakistan was justified in terminating the contract.[80]

The lack of good faith can be also presumed if the investor deliberately chooses not to use national or contractual legal remedies. Although this argument also runs against the evidence of breach of the BIT,[81] it can help in providing an overall assessment of the claimant's behaviour.

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[78] *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, paras. 135, 145-146.

[79] *Ibidem*, para. 145.

[80] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Award of 27 August 2009, paras. 301-315, 461.

[81] *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award of 16 September 2003; *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award of 11 September 2007.

The findings of the tribunal in the *Malicorp v. Egypt* case fall within the same context of good faith and remedies but is equally relevant for the fact that it echoes the old dilemma: whether a good faith argument of the respondent state should be dealt with at the jurisdictional or merits stage of the proceeding?[82] The tribunal goes on to conclude that "[t]he distinction between the two approaches is not of merely theoretical significance, if only because of the remedies available against the decision. Undoubtedly there are good reasons for choosing one or the other approach, and it is possible that the circumstances in which the issue arises can justify different solutions."[83] Here the tribunal, due to the circumstances of this particular case (which involved the issues of the validity of contracts) opted for the merits and thereby rejected the good faith preliminary objection. At the merits stage the tribunal had to examine „whether the Contract was validly entered into, whether it was void from the outset because the circumstances in which it was concluded contravened the principle of good faith, or whether it was capable of being rescinded because of a defect in consent, namely misrepresentation or mistake."[84] The assessment of these issues did not prove to be too difficult as they had already been decided in another arbitration. The tribunal decided to rely on the other award which found that the respondent state had the right to discharge itself from the contract. The tribunal chose not to re-examine these issues and dismissed all claims in the arbitration.

Although the history of investment arbitration shows that investment tribunals initially gave more significant substantive value of the good faith argument to the investors by virtue of fair and equitable treatment standard, cases show a new trend according to which the good faith argument at the merits stage gain increasingly more substantive value for respondent states.

IV. CONCLUSION

The good faith principle has found its place in international investment law. Although it will more often shape states' obligations in general, and the fair and equitable treatment standard in particular, there is sufficient evidence of the emerging trend of good faith defence by respondent states. The good faith argument can be used to deny the right of claimants to seize the tribunal (Article 41(5) of the ICSID Rules), to challenge the jurisdiction of the tribunal or admis-

[82] *Malicorp Limited v. The Arab Republic of Egypt*, ICSID Case No. ARB/08/18, Award of 7 February 2011, para. 117.

[83] *Ibidem*, para. 118.

[84] *Ibidem*, para. 130.

sibility of the claim, to contest the right of the claimant to have decision in its favour, or to challenge the right to compensation. The success of such a defence will depend on a number of factors but its success will be more prominent if the good faith is treated as a supreme principle, which governs legal relations in all of their aspects and content, and not only as one-sided rule. The times of good faith hopefully lie ahead.

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Начело добре вере у међународној инвестиционој арбитражи: његов супстанцијални и процесни значај

Сажетак

Међународна инвестициона пракса указује на чињеницу да и инвестотори и државе често користе начело добре вере као основ својих захтева. Арбитражне одлуке илуструју начине на које обе стране користе начело добре вере које је постало важно процесно и суптанцијално правило међународног инвестиционог права. У овом раду ауторка истражује новије трендове да би установила стварни значај које ће ово начело имати у конкретном случају. Рад такође пружа преглед новије праксе и налаза арбитражних судова када поступају по захтевима на основу начела добре вере. Закључак је да иако тужиоци имају бољих изгледа да остваре своје захтеве коришћењем начела добре вере путем стандарда поштеног и правичног третмана и оправданих очекивања, новија пракса можда упућује на промену овог тренда. Примери из новије праксе, у предметима *Инсејса*, *Феникс* и *ТСА Спектрум*, указују на могућу промену раније праксе и настанак новог основа за одбрану држава у инвестиционој арбитражи. Имајући у виду чињеницу да инвестициони арбитражни судови показују став да је начело добре вере самосталан и аутономан правни стандард, положај држава у поступку се захваљујући овоме побољшава. Тужене државе ће, пракса показује, користити начело добре вере да би оспориле могућност вођења поступка на основу члана 41 став 5 ИКСИД Арбитражног правилника, надлежност трибунала и допуштеност тужбе, као одбрану у меритуму и ради оспоравања права тужиоца на накнаду.

Кључне речи: Начело добре вере – инвестициона арбитража – начело поштеног и правичног третмана – начело оправданих очекивања – надлежности суда и допуштеност тужбе – несавесно поступање