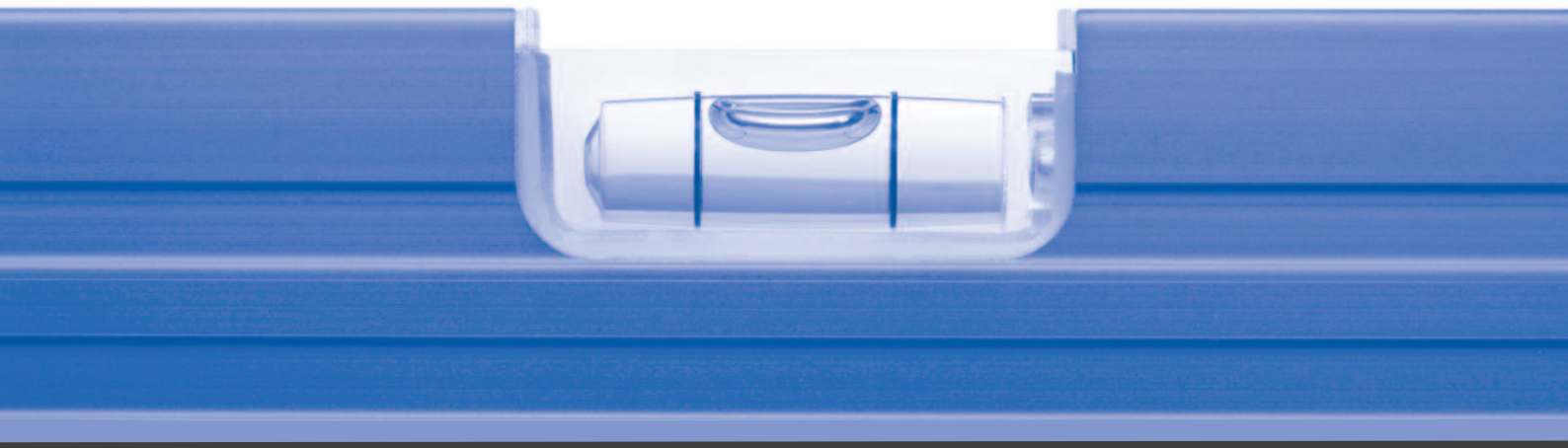

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Corruption as a Defence in International Arbitration: Are there Limits?

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I. Introduction

No one disputes in today's world that corruption is "contrary to international public policy."[1] This has had an impact on international arbitration, where parties are increasingly invoking corruption as a defence to contractual claims. Despite this trend, there is little commentary or jurisprudence to indicate what the consequences of a successful corruption defence should be, whether there are limits to the defence and, if so, where these limits lie. Arbitral tribunals thus face a dilemma: where corruption is present in the procurement or performance of a commercial contract, should tribunals invoke public policy considerations and deny relief to the claimant, or should they nevertheless recognise, in appropriate circumstances, that the equities may demand that the claimant may be granted some form of relief, absent which the respondent would be unjustly enriched?

There are two key stages at which tribunals have the potential to limit a corruption defence: (i) at the stage of establishing/proving corruption; and (ii) at the stage of determining the consequences of a finding of corruption. This chapter explores approaches to proving corruption, the legal consequences once corruption has been established, and potential remedies which may be open to the claimant despite such a finding.[2]

II. Proving Corruption

Matters of evidence play a key role in cases involving corruption because such cases, at least as regards the corruption element, are inevitably heavily fact dependent.[3] There are three important considerations when seeking to prove corruption: (i) burden of proof; (ii) standard of proof; and (iii) causation. Each of these elements is discussed in turn below.

A. Burden of Proof

As a general rule, the burden of proof rests with the party alleging a claim or affirmative defence.[4] The same applies to corruption allegations, with the party alleging corruption bearing the burden of proving its allegation. Some tribunals and commentators, however, argue that this traditional burden of proof may not always be appropriate in cases involving corruption allegations, and have advocated for a shift in the burden of proof under certain circumstances to the party accused of engaging in corruption. In most cases, there is an inherent challenge in proving allegations of corruption and bribery due to the clandestine nature of this conduct.[5] Corruption may be even more difficult to prove in the context of international arbitration due to unavailability of full-blown discovery/document production procedures. The inherent difficulty for a claimant to prove corruption has been used to argue that, where a party has established a *prima facie* case of corruption, the tribunal should consider shifting the burden of proof to the accused party to disprove the allegations. Disproving corruption allegations, however, may also be very difficult – even when such allegations are false – and a shift in the burden may also result in injustice. For example, where allegations relate to a bribe paid by one party to the other, there will often be only hearsay evidence of the corruption. This could mean that the corruption will either be proven or disproven on the basis of witness testimony alone. In such a case, burden shifting may not be appropriate.

An example of circumstances in which the burden of proof may be shifted is *ICC Case 6497*, which concerned a dispute over the provision of consultancy services in the Middle East:

> The 'alleging Party' may bring some relevant evidence for its allegations, without these elements being really conclusive. In such case, the tribunal may exceptionally request the other party to bring some counter-evidence, if such task is possible and not too burdensome. If the other party does not bring such counter-evidence, the arbitral tribunal may conclude that the facts alleged are proven (Art. 8 Swiss Civil Code). However, such change in the burden of proof is only to be made in special circumstances and for very good reasons.[6]

In the absence of direct evidence of corruption, a party invoking a corruption defence will likely try to build a circumstantial case based on so-called "indicia of corruption", in the hope that a sufficient number of "red flags" will convince the tribunal that corruption must have been present. While perhaps not directly relevant to international arbitration, one point of reference is the U.S. Foreign Corrupt Practices Act (the "FCPA"). In a recent Resource Guide to the FCPA,[7] the U.S. Department of Justice and Securities and Exchange Commission identify a number of red flags to determine whether there is a risk of corruption. Such red flags include:

- unusual payment patterns/financial arrangements;
- history of corruption in the country;
- unusually high commissions;
- lack of transparency in expenses and accounting records; and
- lack of qualifications or resources on the part of a joint venture partner or representative to perform the services offered.[8]

According to the Resource Guide, these red flags are illustrative of situations in which corruption may be present and are not intended to serve as exhaustive indicia of corruption. One purpose of the Resource Guide, however, is to influence companies to implement

aggressive compliance programmes. The mandate of an arbitrator is far more limited, and at its core involves determining rights and liabilities under a specific contract. As stated by one leading commentator, where the illegality is irrelevant to the claims and defences at issue, arbitrators should not engage in their own investigations.[9] In effect, arbitrators should avoid taking on the role of a "roving commission" when dealing with corruption claims. Nevertheless, once sufficient indicia or red flags have been raised, a tribunal may decide to ask the other party to demonstrate the legitimacy of the actions or transactions giving rise to the red flag.

B. Standard of Proof

There is no universally accepted standard of proof to be applied to corruption allegations raised in international arbitration proceedings.[10] The applicable legal standard will generally depend on the applicable law. Since, however, claims brought before arbitrators are civil, not criminal, claims, the standard of proof applied should be in line with civil standards of proof, as opposed to the higher standards of proof required in criminal cases. After all, "in an arbitration we are talking about who's going to hand over money, not who's going to jail".[11] In particular, the argument that tribunals need to set a higher standard of proof to take into account the seriousness of corruption allegations should be balanced with the inherent difficulty of proving corruption.[12]

C. Causation

Causation is not frequently raised in discussions regarding proof of corruption. While this element may be considered ancillary in that it arises once there is actual proof of corruption, it is nevertheless essential in order for a tribunal to decide the impact or legal consequences of the corrupt conduct. This is because corruption by itself is not enough to invalidate a contract. There must be a causal link between the alleged corrupt conduct and the contract in question. For example, under Swiss law, if a party seeks to invalidate a contract based on a claim that its terms are impossible, unlawful or immoral under Article 20 of the Swiss Code of Obligations, it will need to demonstrate that the corrupt conduct had a direct, substantial and material effect on the terms of the contract.[13] If a party has not established the causal link between the corrupt conduct and the agreed terms of the contract, then the contract will remain in force.

The absence of a causal link may not mean that the corrupt conduct is ignored. For example, in the case of *Gustav F Hamester GmbH & Co KG v Republic of Ghana*,[14] an ICSID tribunal held that where there was no proof that the alleged fraud was decisive in securing the parties' contract, it would not affect the existence itself of the contract or the investment, but would be "an issue bearing upon the balance of equities between the two parties".[15] Interestingly, fraud can be considered "even worse" than corruption, with the difference being that fraud is perpetrated by one party against another, whereas corruption is a "two-way transaction",[16] which necessarily requires the offer *and acceptance* of a bribe.

Some commentators have warned that arbitral tribunals should tread cautiously as regards patterns of corruption – they should not infer that because a party has previously engaged in corrupt conduct that corruption is present in the case before them. Indeed, Cremades argues that tribunals "should not investigate, or allow the other party to adduce evidence relating to, other contracts, transactions or activities of one of the parties or their representatives. It should firmly reject the argument that illegal activities in other contracts or circumstances are evidence that similar conduct taints the contract in dispute".[17] On this view, regardless of whether corruption is established, it will only be relevant if it goes to a matter in dispute.[18]

III. Corruption Established: End of the Story?

Assuming corruption and causation have been established in an arbitration, what are the consequences of such a finding, and what is the proper remedy? Does a finding of corruption necessarily mean that the claimant should be denied any relief whatsoever? Can and should a tribunal take into account the particular circumstances of the case? In other words, once corruption is proven, is that the end of the story?

First, a distinction can be made between a contract providing for corruption (a contract for a corrupt purpose) and a contract procured by corruption. The former will normally be considered void, while the latter will be considered voidable.[19] While the consequences for contracts providing for corruption, if proven, are thus straightforward, a more difficult set of questions arises concerning the appropriate consequences of findings that a contract was procured by corruption.

In one of the leading cases on the subject, *World Duty Free Company Limited v The Republic of Kenya ("World Duty Free v Kenya")*, the approach taken by the tribunal was to affirm that bribery is contrary to transnational public policy and that parties should not be allowed to rely on the arbitral process to uphold contracts procured by corruption.[20] Nevertheless, as discussed further below, the *World Duty Free v Kenya* panel itself recognised the unfairness of the decision, and remarked that an unjust enrichment claim had not been asserted. Along these lines, while acknowledging that the general premise that corruption is reprehensible is obviously correct, some cases and commentators argue that its translation into a blanket policy of denying relief to parties who have engaged in corrupt conduct, regardless of the circumstances, may lead to an outcome which is unfair and which, despite appearances, may not assist in fighting corruption on a public policy level.[21]

A. UNIDROIT Principles: Recognising the "Grey Area"

A more flexible approach is clearly reflected in the UNIDROIT Principles of International Commercial Contracts (2010) (the "UNIDROIT Principles"), which seek to recognise and address the grey areas relating to corruption defences. The UNIDROIT Principles set out general rules for international commercial contracts. While they are not directly applicable unless parties agree to their use or have not chosen a law to govern their contract,[22] they capture international trends and approaches and are therefore a very useful guide. Chapter 3 of the UNIDROIT Principles sets out the rules with respect to the validity of international contracts and includes the grounds for their avoidance. By way of a series of example scenarios which may occur in the course of international business transactions (including those involving bribery and corruption), the UNIDROIT Principles adopt a more flexible approach, which takes into account what is reasonable under the circumstances, and rejects the application of a strict policy which automatically denies any relief on the basis that corruption has been established.

Of particular interest are the provisions on restitutionary remedies where there has been performance of a contract infringing a mandatory rule (whether of national, international or supranational origin). The prevailing view at the national level is that illegality generally defeats a claim in restitution or unjust enrichment.[23] This

means that where, as a consequence of the infringement of a mandatory rule, the parties are denied any contractual remedies, they should also not be entitled to recover the benefits conferred. The UNIDROIT Principles, on the other hand, provide for a flexible approach by making restitution dependent on what is reasonable in the circumstances. Accordingly, where there has been part performance under a contract infringing a mandatory rule, restitution may be available where this would be reasonable. The following scenario is provided to illustrate this point:

> Contractor A of country X enters into an agreement with agent B ("the Commission Agreement") under which B, for a fee of USD 1,000,000, would pay USD 10,000,000 to C, a high-ranking procurement advisor of D, the Minister of Economics and Development of country Y, in order to induce D to award A the contract for the construction of a new power plant in country Y ("the Contract"). In both countries X and Y bribery of public officials is prohibited by statute.
>
> (…) A, having been awarded the Contract, had almost completed the construction of the power plant when in country Y a new Government comes to power which claims that the Contract is invalid because of corruption and refuses to pay the outstanding 50% of the price. Under the circumstances it would not be fair to let D have the almost completed power plant for half the agreed price. A may be granted an allowance in money for the work done corresponding to the value that the almost completed power plant has for D and D may be granted restitution of any payment it has made exceeding this amount.[24]

The case for providing monetary restitution to Party A for the work performed in the above scenario would arguably be even stronger if there had been no change in government and the same government that accepted the bribe was now seeking to avoid paying for the remainder of the work because of corruption in procuring the contract. According to the UNIDROIT Principles, in determining whether the granting of restitutionary remedies is reasonable, the tribunal should consider the following factors:

(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.[25]

Although the UNIDROIT Principles make clear that in the above scenario, neither party would be entitled to remedies under the contract, the Principles do allow for restitutionary remedies in cases involving corruption. According to Professor Bonell, Chairman of the Working Group for the preparation of the UNIDROIT Principles, this approach is justified for at least two reasons. First and foremost, it would not be fair to allow the Government in the above scenario to keep the valuable completed or almost completed works for much less than the agreed price. Second, "Governments, far from being dissuaded from accepting bribes when awarding important contracts, may even be encouraged to do so if they know that by invoking at a later stage the bribery they are able to shift the entire loss resulting from the illegal transaction to the foreign company".[26]

These are not only important considerations in practice, but provide the basis for an argument that the application of a strict policy against corruption, with the result that losses lie where they fall, may not only be unjust to one party, but may also be unwise as a matter of the very public policy that tribunals are seeking to promote.

B. No Uniform Approach by Tribunals: Examples of Potential Outcomes

This section, while not an exhaustive summary of the cases involving corruption decided by international arbitral tribunals, seeks to demonstrate the various approaches that are open to (and taken by) tribunals when faced with a contract procured by corruption. It also demonstrates that there is no uniform approach in this regard, and parties may have a relatively wide scope for argument depending on the applicable law and the way in which the claim itself is framed.

(a) The Swiss Law Approach

Perhaps the most flexible position is taken under Swiss law, which is widely recognised as "business-friendly" and is often chosen as the law governing international contracts.[27] Swiss law arguably provides that where a contract procured by corruption is invalidated with *ex tunc* effect (i.e., from the outset), the parties to the contract potentially have (reciprocal) claims for unjust enrichment.[28] In the leading Swiss decision on the effects of bribery on contracts, *City of Zurich v ABZ Recycling AG*,[29] the Federal Court recognised an important exception to the principle that contracts procured by corruption will be void from the outset. The Court held that long-term contracts which have been partly or fully performed are to be invalidated with *ex nunc* effect (i.e., from the date of avoidance). In this regard, the Federal Court stated:

> The fact of considering the invalidation of a contract with a term already partly or fully performed as an extraordinary termination with *ex nunc* effect means, *a priori*, that it does not have retroactive effect and that the *part of the contract that has been performed is considered as perfectly valid*, which means that for the term that has elapsed, the intentions independently determined through an agreement between the parties are not altered.[30]

The legal consequences of invalidity *ex nunc* are as follows: (i) the parties to the contract would not have any claims for restitution or unjust enrichment based on performance prior to the date of avoidance because the contract was in place and valid up to that date; and (ii) since the contract was valid up to the date of avoidance, the parties would continue to have valid contractual claims based on any failure of performance up to that date. In addition, the parties would potentially have claims for unjust enrichment based on any performance after the date of avoidance of the contract.

Accordingly, Swiss law appears to go beyond the UNIDROIT Principles, by allowing for a long-term contract procured by corruption which has been partly or fully performed to remain valid concerning the part of the contract already performed.

(b) *World Duty Free v Republic of Kenya*

In apparent direct contrast to the Swiss approach is the approach taken by the tribunal in the well-known case *World Duty Free v Kenya*.[31] In a nutshell, the dispute arose out of an investment contract for the construction, maintenance and operation of duty free complexes at two Kenyan airports. The ICSID Tribunal ultimately dismissed the claims brought by World Duty Free against the Republic of Kenya for violation of the investment contract, holding that, as a matter of *ordre public* international, public policy and English and Kenyan law, Kenya had the right to avoid the contract on the grounds that its conclusion had been procured by a U.S. $2 million bribe to former Kenyan president, Daniel arap Moi.[32] That was the end of the story for World Duty Free and its claim for approximately U.S. $500 million was dismissed. Although the tribunal recognised the unfairness of such an outcome, it justified its approach by stating that "the law protects not the litigating parties but the public".[33]

Despite the widespread commentary in relation to *World Duty Free v Kenya*, there is little reference to the fact that World Duty Free's claim was based in contract only and did not raise non-contractual proprietary or restitutionary claims. In fact, World Duty Free did not even plead the legal consequences following the avoidance of the contract.[34] The tribunal made specific reference to this, leaving open the question of whether World Duty Free would have been able to successfully seek non-contractual proprietary or restitutionary remedies.[35] While this question was not decided, the fact that it was mentioned and left open by the tribunal, suggests that the outcome in *World Duty Free v Kenya* may not have been quite as harsh if World Duty Free had brought a non-contractual claim for restitution or unjust enrichment.

(c) Recent Decisions: *Metal-Tech v The Republic of Uzbekistan*

Metal-Tech Ltd v The Republic of Uzbekistan[36] is the second ICSID case where a tribunal dismissed a claimant's claims in their entirety on the basis that the underlying contract was procured by corruption. The dispute arose out of the Uzbek Government's actions in relation to Uzmetal, a joint venture between Metal-Tech (an Israeli company) and two state-owned Uzbek companies. Uzmetal was ultimately liquidated and its assets were allegedly transferred to state-owned Uzbek companies without any compensation to Metal-Tech. On this basis, Metal-Tech brought an ICSID claim for compensation for, *inter alia*, unlawful expropriation and breach of the fair and equitable treatment standard. Uzbekistan argued that the tribunal lacked jurisdiction to hear the case because, as a result of a number of bribes, the investment was implemented in violation of Uzbek law.

Information regarding the corruption was brought to light during a hearing in January 2012, which prompted the tribunal to order further disclosure. Acting on its own motion, the tribunal considered the "red flags" arising from Metal-Tech's evidence and noted that, given the difficulties of establishing direct evidence of corruption, it could be shown through circumstantial evidence.[37] In particular, the corruption in question related to consultancy contracts where the consultants: (i) did not have any of the requisite qualifications; (ii) were closely related to government officials (one of the consultants was the Prime Minister's brother); and (iii) received a disproportionately high remuneration (approximately U.S. $4 million). The tribunal held that the corruption was established with "reasonable certainty" under Uzbek law, that the investment was therefore not a protected investment within the meaning of the relevant BIT and, as a result, that the tribunal lacked jurisdiction over the treaty claims.[38]

The tribunal in *Metal-Tech* acknowledged that findings on corruption "often come down heavily on claimants, while possibly exonerating defendants that may have themselves been involved in corrupt acts".[39] Similarly to the tribunal in *World Duty Free v Kenya*, however, the *Metal-Tech* tribunal noted that the idea "is not to punish one party at the cost of the other, but rather to ensure the promotion of the rule of law, which entails that a court or tribunal cannot grant assistance to a party that has engaged in a corrupt act".[40] This is a clear example of the strict approach to the defence of corruption in arbitration.

IV. Conclusion

While denial of a remedy may be the appropriate outcome in certain cases involving corruption, it may not necessarily be a foregone conclusion as soon as corruption rears its ugly head. While the limits to corruption as a defence in international arbitration are far from fixed or clear, it is at least arguable that some limits do exist. Absent a uniform approach or set of rules on the issue, tribunals will continue to apply different standards, both in relation to the proof required, as well as the remedies available (if any) following a finding of corruption. Practitioners should be aware that a finding of corruption in procuring a contract may very well be the end of the story for their client, but this is far from certain.

Endnotes

1 Alan Redfern and others, *Law and Practice of International Commercial Arbitration*, (4th ed., Sweet & Maxwell 2004) paras. 3-20.

2 It is important to note that there are certain key differences in the way in which arbitral tribunals approach corruption issues. It is largely settled in international commercial arbitration that by virtue of the principles of separability and competence-competence, arbitral tribunals have jurisdiction to decide the merits of the dispute *(see e.g.: Fiona Trust & Holding Corporation v Privalov* [2007] UKHL 40; and *National Power Corporation (Philippines) v Westinghouse (USA)* (Swiss Federal Tribunal Judgment of 2 September 1993)). This issue, however, is less settled in international investment arbitration, where there are often significant differences between tribunals' characterisation of the corruption issue raised, either as a matter of jurisdiction, admissibility or the merits.

3 Christian Albanesi and Emmanuel Jolivet, "Dealing with Corruption in Arbitration: A Review of ICC Experience," (2013) ICC International Court of Arbitration Bulletin, Vol. 24 Special Supplement 2013, p. 31.

4 Alan Redfern, "The Practical Distinction Between the Burden of Proof and the Taking of Evidence – An English Perspective," (1994) 10 Arbitration International 317, p. 321.

5 Michael Hwang and Kevin Lim, "Corruption in Arbitration – Law and Reality," (2012) 8 Asian International Arbitration Journal, Issue 1, pp. 14-16.

6 *ICC Case 6497* (1999) XXIV Y B Comm Arb 71.

7 *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (November 2012) http://www.justice.gov/criminal/fraud/fcpa/guide.pdf accessed 6 June 2014.

8 *Ibid*, pp. 22-23; *see also*: Vladimir Khvalei, "Using Red Flags to Prevent Arbitration from Becoming a Safe Harbour for Contracts that Disguise Corruption," (2013) ICC International Court of Arbitration Bulletin, Vol. 24 Special Supplement 2013, p. 23.

9 Richard Kreindler, "Is the Arbitrator Obligated to Denounce Money Laundering, Corruption of Officials, etc? The Arbitrator as Accomplice – Sham Proceedings and the Trap of the Consent Award," (CDG Working Group on Corrupt Payments, Washington, February 2007), p. 3.

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11 Douglas Thomson, "How to Deal with Corruption Allegations," Global Arbitration Review (11 February 2014), quoting Paul Cohen.

12 Constantine Partasides, "Proving Corruption in International Arbitration: A Balanced Standard for the Real World," (2013) 10 (issue 3) Transnational Dispute Management 47, p. 57.

13 *See: City of Zurich v ABZ Recycling AG* (Swiss Federal Tribunal Judgment of 21 February 2003).

14 ICSID Case No. ARB/07/24, 18 June 2010.

15 *Gustav F Hamester GmbH & Co KG v Republic of Ghana* ICSID Case No. ARB/07/24, 18 June 2010, para. 138.

16 Douglas Thomson, "How to Deal with Corruption Allegations," *Global Arbitration Review* (11 February 2014).

17 Bernardo Cremades and David Cairns, "Corruption, International Public Policy and the Duties of Arbitrators" (2003) 58 (No. 4) American Arbitration Association Dispute Resolution Journal 76.

18 Douglas Thomson, "How to Deal with Corruption Allegations," *Global Arbitration Review* (11 February 2014), quoting Yves Derains.

19 Michael Hwang and Kevin Lim, "Corruption in Arbitration – Law and Reality," (2012) 8 Asian International Arbitration Journal, Issue 1, pp. 44-45.

20 *World Duty Free Company Limited v The Republic of Kenya* ICSID Case No. ARB/00/07, 4 October 2006, paras. 156-157.

21 Paul Cohen and William Katz, "Public Harms, Moral Qualms and Greasy Palms," *Global Arbitration Review* (3 May 2013).

22 International Institute for the Unification of Private Law, UNIDROIT Principles of International Commercial Contracts (2010) Preamble, Article 4.

23 Michael Joachim Bonell, "The UNIDROIT Principles 2010: An International Restatement of Contract Law," (2011) http://www.law.georgetown.edu/cle/materials/UNIDROIT/2011.pdf accessed 3 June 2014, p. 13.

24 *Ibid*, Chapter 3, Articles 3.3.1 and 3.3.2, Illustration 1.

25 *Ibid*, Article 3.3.1(3).

26 Michael Joachim Bonell, "The UNIDROIT Principles 2010: An International Restatement of Contract Law," (2011) http://www.law.georgetown.edu/cle/materials/UNIDROIT/2011.pdf accessed 3 June 2014, pp. 13-14.

27 Bernd Ehle and Samuel Moss, "Changes to the Swiss Law on General Terms and Conditions: What do Construction Practitioners Need to Know?" (2012) International Bar Association http://www.ibanet.org/Article/Detail.aspx?ArticleUid=be914905-9bdb-4f25-b37f-142ede078a12 accessed 13 June 2014.

28 *See e.g.* Swiss Code of Obligations, Article 62.

29 (21 February 2003), DFT 129 III 320.

30 *City of Zurich v ABZ Recycling AG* (21 February 2003), DFT 129 III 320, 7.1 [unofficial English translation], emphasis added.

31 ICSID Case No. ARB/00/07, 4 October 2006.

32 *World Duty Free Company Limited v The Republic of Kenya* ICSID Case No. ARB/00/07, 4 October 2006, paras. 136, 157 and 170.

33 *Ibid*, paras. 180-181.

34 *Ibid*, para. 186.

35 *Ibid*, paras. 179 and 186.

36 ICSID Case No. ARB/10/3, 4 October 2013.

37 *Metal-Tech Ltd v The Republic of Uzbekistan* ICSID Case No. ARB/10/3, 4 October 2013, paras. 243, 293.

38 *Ibid*, paras. 372-374.

39 *Ibid*, para. 389.

40 *Ibid*.

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