



**THE 'RED FLAG' OF CORRUPTION
IN INTERNATIONAL ARBITRATION**

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Abstract

International arbitration is a private dispute resolution, founded by an agreement to arbitrate in a trans-border dispute. It is a time-efficient form of dispute resolution which allows extensive discretion to the parties in the conduct of the arbitral proceedings. On the contrary, corruption comes up with a very disturbing frequency in the context of international arbitration. Even today, there is no consensus as to how the issues of corruption be tackled. Allegations and suspicions pose a challenge to international arbitration, which the arbitrators are called to encounter. First, in the absence of any binding rules, the tribunal, in the respect of evidentiary matters had found a balance the competing parties and preservation of their rights while evaluating the evidence of corruption. Secondly, the tribunal while determining the applicable law to the merits of the dispute has to determine as to whether the foreign mandatory laws or rules of public policy at the place of performance or seat of arbitration contrary to the parties, chosen laws, override the chosen law and according to which conflict of law arises. Thirdly, when the corruption is established, the legal consequences of such finding has to be determined by the tribunal. Due to the disruptive nature and strong criticism of

corruption, there is a need to address these issues by the arbitral tribunal. Earlier the jurisdiction and power to adjudicate the corruption allegations and suspicions were unambiguous but later with time and development of the cases and various international conventions and treaties, the issue was resolved to a certain extent. Still we need to have international norm or law or guidelines that specifically says that the arbitral tribunal has the jurisdiction and power to hear allegations of corruption and can investigate in the matter and also it can self-initiate investigation if it appears to the tribunal that there is indication of corruption by the evidences produced.

Introduction

The controversies between the different sovereign states which are not settled by diplomatic negotiations and conciliations are most often referred, by the agreement of both the parties, to the consideration of the third disinterested party who arbitrates the issue with a legally binding force upon the parties in dispute. Such arbitration between states has a very ancient history. It was used between the cities and states in ancient Greece and also in the middle ages when the pope often acted as the sole arbitrator. So, Lord Mustill was very right in saying, "Commercial arbitration must have existed since the dawn of commerce".¹ Though there is a rapid growth in the utilization of international arbitration in the modern era, the problem of corruption is posing a serious challenge. Although the concepts of breach of warranty and force majeure are globally recognized concepts that are legally enforceable by parties, issues of corruption

¹ Born, International Arbitration, Cases and Materials, p. 10ff.



are yet to be conclusively and statutorily forbidden in the field of international arbitration. Allegations of bribery by one party upon other party may lead to unfavorable consequences as it may not only hamper the performance but also may impair the friendly relationship between the nations. Though there are neither specific set of restrictions nor the pronouncement of any rules that strictly condemn the same. The global aversion to such misconduct is palpable. This has raised the international concern and to eradicate it there has been the ratifications of various international conventions that prohibits corruption in international arbitration. To curb this situation, the nation themselves have incorporated various acts. For instance, the US Foreign Corrupt Practice Act, 1977 and the UK Bribery Act, 2010 impose obligations upon state parties that have an extra-jurisdictional reach up to a certain extent. This directly implies that the arbitrators who act outside the domestic jurisdiction in such countries may need to take into account the criminal offenses that have been stated under such legislation. The US Foreign Corrupt Practice Act, 1977 strictly prohibits anyone acting within the territorial limits of the United States from making or even offering to make corrupt payments to a foreign public official in order to gain an inappropriate benefit. In the year 1989, the Organization for Economic Cooperation and Development (OECD) began discussing the issue of combating illegal payments in international business transactions. Various committees were also set up to study the different facets of corruption.

Despite the continued efforts at both national and international levels, corruption still remains a very serious problem in international

arbitration. According to Transparency International's latest Corruption Perceptions Index, if we measure on a scale from zero (highly corrupt) to one hundred (very clean), over two-thirds of the 180 evaluated countries scored below 50. This approximately implies that over six billion people live in countries that are corrupt. According to the World Bank Group's report it is estimated that approximately \$1.5 trillion in bribes are paid by businesses and individuals each year to gain an unfair advantage. These tragic figures prove that corruption still continues to be a very big problem for all the nations as the various institutions, including political parties, judiciary, parliament, legislature etc. are corrupted to a large extent. An inevitable effect of this situation is that corruption is also quite prevalent in arbitration. How corruption can be tackled is a complex matter, so it is necessary on both national and international levels to work efficiently with common tools and force.

International Arbitration and its Boon and Bane

International arbitration has been used for resolving disputes from a very long time. Due to its private and adjudicative nature, arbitration is a much preferred form of the dispute resolution. In arbitration people are free to choose the arbitrators as well as the rules, place, and language of the proceedings. In international commercial arbitration, companies usually desire a neutral process to avoid being subject to another country's judicial system, which could potentially give the other party a home-court advantage. The most preferred and widely used tribunal for settlement of commercial disputes is the ICC (International Chamber of Commerce in



Paris). The LCIA (London Court of International Arbitration) and the AAA/ICDR (International Chamber for Dispute Resolution of the American Arbitration Association) are the other two, most popular dispute tribunals in international arbitration. Further, the decisions made in an arbitral process is usually a final decision, and it is binding on both the parties. A higher court of appeal does not exist, which in theory, results in a shorter legal process as well as a quicker and facilitated international enforceability of the award. On the other hand, engaging in a process where the parties do not have the right to appeal, the decision can be seen as a risk taken by the parties, since they agree on settling with any decision that is granted to them. Another disadvantage is the cost of arbitration. The cost-efficiency of arbitration used to be one of the main advantages, but today, it is regarded as less true. As arbitration has become bigger and more common, parties have developed more and more tactics which they use to delay the procedures and increase the cost. Another advantage of arbitration is the confidentiality, which ensures that the party's sensitive company records are not made public. This is an attractive factor for those companies who want to protect their reputation. Though positive for the parties, the principle of confidentiality can have a negative impact and prevent the development of the arbitral process and arbitration as a legal institution. Arbitral awards are generally not made public, which means that there is a very narrow and common practice within arbitration. Confidentiality, naturally, does not allow for transparency within the arbitral institution. Consequently, an area with little transparency is more prone to corruption taking place.

Legal Framework of International Arbitration

Recently, arbitration has become one of the most preferred dispute resolution mechanisms when it comes to international commercial activities. According to article 1 clause 3 of the Model Law, the international element of commercial arbitration is constituted by parties having their places in different states, or when the place of arbitration, performance under the contract, or the subject matter relates to more than one nations. The Model Law provides a wide interpretation of the word "commercial", covering all forms of relationships which are commercial in nature. Different examples of "commercial" relationships are stated in an explanatory note under Model Law, but the list is not too exhaustive. An internationally recognized definition for the term "commercial" has not been established, due to the difficulty of creating an exclusive range of relationships, which fall under the term. The legal framework of international arbitration is very wide. The applicable laws for each specific arbitration settlement will depend on the choices of the parties. The whole framework of the arbitral process along with the agreement and laws, can be seen as a pyramid. The point facing downward is the arbitral agreement, exclusively between the parties. The entire framework relies on the legality of this level. If the agreement is invalid, the rest of the framework is invalid. On the second level, above the agreement, are the rules chosen by the parties, or the institutional rules, which are provided by the arbitral institution. National arbitration law lies above these institutional laws. These provide for substantive issues, such as the interpretation of the contract, and determining the merits of



the dispute. The UNCITRAL Model Law on International Commercial Arbitration was found quite authentic and therefore, it has been embraced by many nations. It is the equivalent of the Arbitral Rules of the Stockholm Chamber of Commerce, as a comparison. The third level of this pyramid is established by the international arbitral practice. This practice can serve as rules which develop from the practice or as guidelines. The International Bar Association on the Rules of Ethics is one example of the international practice. The top layer of pyramid is covered by international treaties. The New York Convention is one of these treaties. Another important treaty is the Convention on International Commercial Arbitration (The European Convention). The entire arbitral framework provides parties with protection and secures a fair process. The New York Convention, along with the Model Law is in large extent, the reason for commercial arbitration's great popularity. The conventions are adopted by many countries in the world and have created a common ground for dispute resolution in international trade and business.

The Curse of Corruption

Corruption does not only includes bribery but it is the composition of different acts and in different forms. The various categories are as follows:

- Petty Corruption – It is the smaller amount of money paid for frequent transactions.
- Administrative Corruption – It includes the bribes that are paid to escape taxes, regulations, or to win a procurement contract.
- Corporate Corruption – This type of corruption happens within private corporations.

- Political Corruption – This type of corruption happens within public sector and political arena.

Usually corruption occurs at all levels of the society but the big or grand corruption involves ministers, politicians, head of the state, senior officials etc. It is also an established fact that bribery permits the people to inadequately influence the areas of business and governance such as judiciary, criminal justice as well as media. It is not possible to give a unified definition of corruption as it happened in various forms. Different nations have their different approaches when it comes to corruption. It does not make it easy rather it complicates more. Whatever be the awards raised by the national court would be different depending upon how that particular nation has adopted the approach in the matters of corruption. Even various international organizations like the Organization for Economic Cooperation and Development (OECD), the Council of Europe and UN conventions haven't defined corruption rather they have included corrupt offences in their legal framework. Transparency International however, has given a definition in regard to corruption and states that "the abuse of entrusted power for personal gain". It has been witnessed that the majority of allegations against corruption are made in infrastructure projects like energy plants or telecommunication landfills. The second most affected sectors by corruption is reported regarding the purchase of ornaments and construction of military training facilities. The third most affected area by corruption is associated with exploitation of natural resources. These days, corruption is considered as the major hindrance force to the economic and social development all over the globe. If we compare the cost of corruption and global GDP, it is estimated



that more than 5% of the global GDP that is around US\$ 2.6 trillion to be the cost of corruption. It is very tragic that more than US\$ 1 trillion per year is paid only for bribe. Thus, the funds that were intended for public investments end in a private pocket due to which it negatively affects the growth and development.

International Organizations in Tackling Corruption

However, in the past decades, the international organization has shown commitment to eradicate corruption. They have formulated and implemented hardened laws, regulations and penalties for the same. The aim of these organizations is not only to eradicate corruption but also to spread public awareness. The fight against corruption can be witnessed from 1977 when the American Foreign Corrupt Practices Act (FCPA) was adopted as the first cross-border regulation which was aimed at prohibiting corrupt practices abroad, by American businessman. After this, various other treaties on anti-corruption were signed and ratified by several nations. Some of the major treaties were the Organization for Economic Cooperation and Development (OECD), Convention on Combating Bribery of Foreign Public Officials in International Transactions, 1999, the United Nations Convention Against Corruption (UNCAC), the United Kingdom Bribery Act, which is applicable to bribery worldwide.

While considering what law would be applicable in the case of corruption and whether it nullifies the contract, the tribunal has considered various laws. Some of the major laws that are adopted are as follows:

- Lex Fori (Governing law that is generally referred as seat of the arbitration)

- Lex Locus Solutiones (Law of the place of performance that implies that where the contract was performed)
- Law of enforcement jurisdiction
- Loi de Police (Mandatory law)
- Principle place of business of parties
- Laws connected to parties or contract

The arbitral tribunal usually relies upon the substantive laws of the contract that are chosen by the parties based on the principle of party autonomy. This very principle permits the parties to choose the law and the relevant rules that would be applicable to their contract. A major question that arises here is that what should an arbitrator do in the case when the contract does not explicitly mention the substantive law of the contract or the parties may have deliberately chosen a law of a single country that condones corruption (if it exists). In this scenario, the agreed substantive law should be applied except to the extent it does not violate the accepted international norms. Additionally, the tribunal, where the agreed substantive law is that of single country may conclude that the tribunal will disregard any governing law if it would contravene international public policy.

Consequences of Corruption

The consequences of the corruption, if found guilty, has to be harsh so that it creates fear in the minds of the people who indulge in this heinous act. The ICC International Court of Arbitration (ICC Court) was formulated under the International Chamber of Commerce. It is the world's leading arbitral institution. It plays a role in resolving disputes in international commercial and business disputes to support trade and investment. Traditionally, there has been a reluctance by the ICC court in dealing with the matters of bribery and corruption issues.



Arbitrators do not feel comfortable investigating the signs of corruption where none of the parties has raised the issue. Thus, they cannot self-initiate such investigations. Also the arbitrators lacked the authority to force parties to hand over the incriminating materials. Earlier, even the ICC courts were of the view that the allegations of bribery and corruption are best to be left to domestic courts.

However, this attitude has changed with time. It appears that international consensus is strengthening on the fact that the corruption needs to be tackled and some necessary positive steps to be taken to stamp it out. The ICC courts are now reflecting more willingness to deal with the corruption issues whenever they arise. Additionally, the concern has increased on the arbitrators that they should not be seen endorsing the corrupt contracts.

Moreover, they are given a recognition that they have the necessary powers to self-initiate investigations where it appears the obvious signs of corruption and declare such contracts unenforceable and all the claims of that particular case as inadmissible provided that, where the allegations of corruption can be proved. In the case of *National Power Corp. vs Westinghouse*², the Swiss Federal Tribunal rendered decision that an arbitral tribunal is entitled to exercise its jurisdiction over the matters involving allegations of corruption under which the concept that tribunals are entitled to adjudicate allegations

of corruption began to gain acceptance. Further, In the case of *Himpurna California Energy Ltd vs PLN*³, the tribunal made a comment that the members of an arbitral tribunal do not live in an ivory tower and the arbitral process cannot be divorced from reality. By this comment, the tribunal implied that the tribunal should be vigilant and should keep a check on any signs of corrupt dealings.

In ICC Case No 1110. Judge Lagergren, who was the sole arbitrator of the case said that he has no jurisdiction after concluding that the case involved corruption and further said that the case that implicates corruption to any extent “can have no countenance in any court, either in the Argentine or in France, or, for that matter, in any other civilized country, nor in any arbitral tribunal.”⁴

In the ICC Case 8891, the court held that “a contract instigating or favoring the corruption of public officials is contrary to transnational public policy and if this seems or appears to be the object of the consultancy contract, there would be no other option than to find it null and void.”⁵

World Duty Free Co. Ltd vs Kenya⁶ was another important case where the court observed that both under Kenya and English law, the contract was considered voidable for illegality due to corrupt conduct and the claim was dismissed.

Further, in the case of *Metal-Tech vs Republic of Uzbekistan*⁷, corruption was

² 949 F.2d 653 (3d Cir. 1991)

³ UNCITRAL Ad Hoc-Award of 4 May 1999, YCA XXV (2000), 13 et seq.

⁴ ICC Case No. 1110 (1963), para 23, re-printed by: Wetter, J. Gillis, “Issues of Corruption before International Arbitral Tribunals: The Authentic Text

and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110”, *Arbitration International*, Vol. 10, No. 3, LCIA 1994

⁵ ICC Award 8891, Re-printed in part by Martin, p. 49

⁶ ICSID Case No ARB/00/7, IIC 277 (2006)

⁷ ICSID Case No. ARB/10/3



alleged by the respondent and the court was able to deduce corruption on the basis of strong evidence and therefore, declined the jurisdiction.

There are two major circumstances where the courts may need to take into account the corruption issues.

1. Red Flags – When the courts themselves are of the opinion that there is something suspicious from the evidence that are produced before them which leads to presence of corruption and where the issue has not been raised by either parties to the dispute then, in those circumstances the court may initiate investigation themselves either to make sure that their award will be enforceable or out of public duty to investigate corruption. There are also some concerns as to whether they have the required procedural powers to do so or what evidence and standard of proof is required for making any factual findings of corruption or whether the conclusion of finding such corruption will have the result that one party gets benefitted from an unconscionable windfall.

2. Allegations of Corruption – The mere allegation on an international level by either party to arbitration provides gravity as it deals with the reputation of the state parties. The burden of proof shall lie on the party alleging for corruption. In ICC Case No. 6497⁸, the tribunal provided that the burden of proof can be shifted on the other party under certain circumstances that is if the alleging party brought the relevant evidences before the court which is not conclusive in nature then, the tribunal may request the other party to bring counter evidence and if the other party fails to do then the tribunal will conclude that the allegations were true.

When it comes to examining of evidences, three points have to be considered:

- i. That there exists a chance of inappropriate effect on the rule of burden of proof.
- ii. That the indirect evidence needs to be critically examined and thereafter shall be brought before the court.
- iii. That there is an emergency to make strict and high standard of proofs in the cases which involve serious allegations especially in the matters of public policy, fraud and corruption.

Standard of Evidence

There has been a widespread debate on the issue of evidence that are brought up by the parties to the court. Moreover, the higher standard of proof that needs to be discharged in order to prove the case of corruption needs to be critically determined as the integrity and fairness of the arbitral proceeding is of paramount importance. In the case of *Waguih Elie George Siag & Clorinda Vecchi v. Arab Republic of Egypt*⁹, it was held that the standard should be as high as “beyond doubt” for the mere reason that this would allow the wrongdoers to escape the law. Therefore, the procedure of submitting and disclosing the evidence plays an important role in international arbitration. At international level, certain rules have been formulated for the evidence taking mechanism irrespective of legal system. According to UNICETRAL Arbitration Rules, the tribunal may direct the parties to produce documents, exhibits and other evidences within a specified period of time which shall be determined at the discretion of the tribunal. Further, International Bar Association (IBA) has also laid emphasis on the quality of the evidence brought before the court and has formulated

⁸ Yearbook Comm. Arb. XXIV (1999) 71

⁹ ICSID Case No. ARB/05/15, Award (June 1, 2009).



and implemented rules regarding evidence taking mechanism in the cases of international arbitration. Article 3 of International Bar Association rules (IBA rules) provides for the discovery and production of documents before the tribunal. Article 4 of IBA rules allows the parties to the proceeding to obtain the testimony of voluntary witnesses or the persons who won't appear voluntarily. Article 9 clause (1) of the IBA rules stated that the arbitral tribunal shall have the power and authority to determine the materiality, admissibility, relevance and the weight of the evidence that are produced before the tribunal. Also article 9, clause (2), clause (b) and (c) of the IBA rules provides that privilege and confidentiality as the grounds for denying the request to produce the documents, provided that, the party requested to produce the document before the court has to show or indicate that such requested documents include privileged and confidential.

Whenever there is an allegation that an arbitration agreement is tainted by corruption before the arbitral tribunal, the first issue that has to be determined is whether the tribunal has the jurisdiction for such claims or not. The approach to this issue is based on the well-established principle of 'Kompetenz-Kompetenz', according to which an arbitral tribunal owns jurisdiction to rule on its own jurisdiction when the validity of the arbitration agreement is challenged and the doctrine of 'Separability' under which the arbitration agreement is considered independent from the actual contract and therefore, remains valid even if the actual contract is found illegal. The leading case on

the modern approach towards the arbitration for resolving disputes is *Westacre Investments Inc. vs Jugoimport SPDR Holding Co Ltd.*¹⁰ In this case despite the allegations that the underlying agreement has been procured by corruption, the tribunal declared jurisdiction over the dispute and conducted investigation and dismissed the allegations of corruption and granted the award based on the merits of the case. The award was then challenged in the United Kingdom at the stage of *exequatur*. The issue of corruption was once again raised. The English Court adjudicated the *Westacre's* argument by seeking the enforcement of the award which was not enforcing an allegedly illegal contract, but a separate arbitration agreement. The court while dealing with the issue made a distinction based on the degree of illegality involved. Finally, the court held that the award was enforceable based on the separability of the arbitration clause, the principle of *kompetenz-kompetenz* and the public policy encouraging the enforcement of the international arbitral award, all of which went in the favor of upholding the award. According to the reasoning of the court, the *Westacre's* decision, which was upheld by the court of appeal laid down the fact that the arbitrability of the dispute would hinge on the subjective valuation of the degree of illegality involved. But in order to conclude whether the fraud is more or less in the scale of illegality, the arbitrator necessarily needs to have the jurisdiction to assess the merits, which implies a valid arbitration agreement. It is, therefore, desirable to apply the principle of separability in a strict manner and to adopt a methodology according to which allegations based on illegality such as

¹⁰ Com C ([1999] QB 740, [1998] 3 WLR 770, [1998] 4 All ER 570, [1998] 2 Lloyd's Rep 111, [1998] CLC 409)



corruption or bribery may not be admissible and hence, would not be decided on the merits, are nevertheless arbitrable. There is also a more recent award which leads us safely to the conclusion that it is no further in doubt that the separability presumption retains its full vigor even where it is alleged that corruption taints the contract underlying an arbitration agreement, namely the Fiona Trust & Holding Corporation v Privalov award (Fiona Trust)¹¹. In this case the House of Lords clarified the operation of the separability doctrine, by virtue of which the invalidity or rescission of the main contract does not necessarily involve the invalidity or rescission of the arbitration agreement. The arbitration agreement must be considered as a separate agreement and can be both void or voidable only on the grounds which are directly associated to it. Therefore, the allegation that the contract in Fiona Trust was procured by corruption could only be linked to the main contract, but not to the arbitration agreement in particular. The arbitration agreement was found to be valid and the court proceedings stayed in the favor of arbitration.

Admissibility and Merits of Claim

Issues related to admissibility and merits of a claim shall be determined according to the applicable law selected by choice of law analysis. Although national legal regimes differ as to what is deemed as corruption, once it is established that a contract aimed at corruption, its legal treatment is uniform virtually under every legal order. Under most legal orders, there is a clear distinction between contracts providing for corruption and contracts procured through corruption. Generally, contracts which provide for corruption may be considered as null and

void whereas contracts procured through corruption are merely voidable at the instance of the innocent party. The difference between these two legal consequences is that a voidable contract is fundamentally valid until the innocent party does an act or omission towards setting it aside, whereas a contract which is null and void need not to be set aside, since it is void from its inception. The case of World Duty Free v Kenya¹² is the perfect example of a contract which was voidable in nature because it was acquired by corruption and was finally set aside by the victim of corruption, Kenya. The investor in this case initiated ICSID arbitration against the host state pursuant to an arbitration clause in a contract to run duty-free operations in Kenya's international airports in Nairobi and Mombasa where it was alleged that Kenya had breached the contract by, inter alia, engaging a receiver over its operations. During the proceedings, the investor filed a memorial in which the investor admitted to paying a US\$2 million personal donation to the former President of Kenya, in order to do business with the Government of Kenya. The tribunal had no doubt that this constituted a bribe to obtain the contract. Consequently, it was held under English law, as it was governing the contract, that the contract was voidable at the instance of Kenya, as it was found that the contract had been procured through its agent's corruption. Moreover, Kenya did not relinquish its right to annul the contract, instead of that Kenya officially delivered the notice of its avoidance of the contract through its counter-memorial. Soon, after its former President's acceptance of the bribe from the investor came to limelight in the investor's memorial. The contract was appropriately set aside, and as a result, the

¹¹ [2007] UKHL 40

¹² Supra Note 6



investor's claim for breach of contract was discharged.

As for cases where it is established that the underlying arbitration agreement provides for corruption, without any party having to take any positive steps, the tribunal will neither enforce it nor will it provide any other non-contractual remedy arising out of it since such a contract will be regarded as null and void due to its illegality under the applicable law. Moreover, the parties are precluded from maintaining any claims deriving from the contract whether contractual or restitutionary in nature by virtue of the equitable maxims, in pari delicto potior est conditio possidentis and nemo auditur turpitudinem allegans or ex turpi causa non oritur action. These maxims give the expressions of the Clean Hands Doctrine. The doctrine derives from the general common law principle of equity under which the party who seeks equity, is supposed to do equity.

Conclusion

International arbitral courts have faced complex challenges when it comes to allegations or suspicions of corruption. The methodology of approach towards these allegations or suspicions is not consistent rather they vary in different circumstances. This reflects the complexity that the tribunals go through when grappling with this problem. With time, the picture has been cleared about the standard for international public order in the area of corruption. These standards have been fixed by various anti-bribery conventions and by ratifying it within national laws. However, for these conventions to be effective, international arbitrators must be vigilant about their

obligations and properly adjudicate them while making decisions. From the cases mentioned above, it is quite clear that the more proactive the tribunal, the more likely that indicators or signs of corruption can be traced and proved. But for doing so, the most challenging area for the courts are to address the requirement of sufficient evidentiary proof. It is quite obvious that the unambiguous evidentiary rules need to be established and implemented to ensure that the facts are properly examined. Also the arbitrator shall be given the power to conduct suo-moto investigation and it needs to be properly expressed in the form of regulations and guidelines. In future, it appears legitimate to hold that this problem needs to be deliberated in order to give clarity, at least to some extent.
