



ICLG

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Arbitration of Corruption Allegations

Arif H. Ali



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A primary goal of the investor-state arbitration regime is to encourage development by providing investors recourse to a neutral forum for resolving disputes concerning lawfully made investments, separate and independent from the host state's judiciary. At the same time, in some countries where such investments are made, corruption may occur. Thus, it is occasionally contested whether an investment that is the subject of an international dispute has been tainted with corruption.

In such cases, a host state could face claims for tens or hundreds of millions of dollars due to alleged violations of investment treaty protections. In recent years, it has become apparent that corruption in the making of an investment can serve as a complete bar to recovery by the claimant. This development has been accompanied by an evolution regarding the burden of proof and the standard of proof in corruption cases. In other words, such corruption may serve to completely immunise the state from liability for violations of treaty protections. As such, allegations of corruption have proliferated as a result of state parties raising a so-called "corruption defence" to the admissibility of the investors' claims and the tribunal's jurisdiction.

1 International Policy Toward Corruption

Generally speaking, corruption is "the abuse of entrusted power for private gain".ⁱ That umbrella encompasses many types of conduct. Although many variations of alleged corruption arise in the international arbitration context, it is the alleged bribery of public officials that has garnered the most attention.

The international legal community strongly condemns corruption, which has a host of ill-effects on the societies in which it occurs. Corruption, and in particular bribery of public officials, redistributes assets so that resources are diverted into the personal pockets of those in power. Projects tainted by corruption may be of subpar quality and a country's citizens may have to cope with lower-quality infrastructure than would have been implemented in a fair tender. Certain externalities are inevitable, such as environmental degradation or excessive offshoring of profits and resources.

Thus, Judge Lagergren concluded in an oft-quoted passage from the 1963 arbitral award in ICC Case no. 1110 that bribery "is an international evil; it is contrary to good morals and to an international public policy common to the community of nations". Parties engaged in such conduct have thus "forfeited any right to ask for assistance of the machinery of justice...in settling their disputes".ⁱⁱ

The bribery of foreign public officials is today proscribed by multilateral treaties and national laws. Among these treaties are the Organisation for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions ("OECD Convention"); the

United Nations Convention Against Corruption; and the Council of Europe Civil Law Convention on Corruption. Among national laws forbidding corruption, perhaps the most well-known are the Foreign Corrupt Practices Act in the United States and the UK Bribery Act, but a host of other national laws exist in various jurisdictions, mainly as a result of the incorporation into domestic legislation of the obligations undertaken by states that are signatories to the treaties mentioned above. In addition, other domestic laws, such as civil and commercial codes, often contain provisions providing for the nullity of agreements procured by corrupt activities.

2 Legal Consequences of Corruption

The 2006 award in the ICSID case *World Duty Free v. Kenya* marked the first time a respondent state successfully rebuffed an investor's claims by showing that it had corruptly procured its investment.ⁱⁱⁱ There, the tribunal concluded that the claimant had paid a USD 2 million cash bribe to the President of Kenya to obtain its investment in duty-free stores. Since then, parties have raised corruption allegations in dozens of investor-state cases.

These cases have established unanimously that corruption may bar recovery by an investor. However, they demonstrate different avenues of legal reasoning to reach the same conclusion.

Firstly, tribunals have held that corruption may invalidate a respondent state's consent to arbitration as embodied in an investment treaty. Investment treaties frequently contain provisions indicating that consent to arbitration extends only to investments made "in accordance with the law" of the host state (the Energy Charter Treaty is a notable exception). Tribunals have disallowed claims on the basis that corruptly made investments violate legality provisions under applicable law or treaty. Such provisions generally require that an investment must be made in accordance with the host state's law in order to qualify for investment protections.

For example, in *Fraport v. Philippines*, which dealt with allegations of fraud on the part of the investor (and so not technically a corruption case), the tribunal found that the claimant had intentionally circumvented the host state's "anti-dummy" law by way of secret shareholding agreements.^{iv} The tribunal therefore lacked jurisdiction because Fraport did not make its investment in accordance with the law.

Secondly, where there is no such legality requirement, tribunals have invoked transnational public policy as a basis for disallowing claims tainted by corruption. In *World Duty Free v. Kenya*, which arose from an investment contract rather than a treaty, the contract contained no explicit legality requirement.^v Accordingly, the tribunal held that the claimant's payment of a bribe violated the

transnational public policy against corruption and that it therefore deprived the tribunal of jurisdiction to hear the dispute.^{vi}

However, a finding of corruption is not necessarily outcome-determinative. *Niko Resources v. Bangladesh* charted a different path: if the act of bribery fails to procure an investment contract, a tribunal may still uphold jurisdiction.^{vii}

There, the claimant gave the respondent's minister of energy and mineral resources a Toyota Land Cruiser worth CAD 190,000 and invited him to attend a conference in Calgary for which it paid CAD 5,000 of his "non-business-related" expenses. Notwithstanding the tribunal's findings on corruption, it also found that the bribes had not affected the outcome of the two contracts at issue, as one was signed two years before the bribe took place and the second was concluded after the resignation of the minister. Thus, the *Niko* tribunal upheld jurisdiction despite a finding of corruption because the corruption did not succeed in procuring the investment contract.

A tribunal may also reject corruption allegations if it is not clear (i) who the intended beneficiary of the bribe was, or (ii) whether that beneficiary was considered a government official at the time. In *Kim v. Uzbekistan*, the failure to prove that the payments were made to an Uzbek official was one of the key reasons for not upholding the bribery objection. It was established by the tribunal that a bribe had been paid to the Uzbek President's daughter, but it was not clear that she was an Uzbek government official at the relevant time.^{viii} To the contrary, both *Spentex* and *Metal Tech* upheld corruption allegations even though no bribed official was identified.

Claimants have also levelled allegations of corruption against host states. In *EDF v. Romania*, the claimant alleged that host state officials had attempted to solicit or extort bribes. However, the state was not held accountable for the alleged bribe solicitation.^{ix} The tribunal concluded that in order to trigger the host state's liability, the claimant would need to demonstrate that the solicitation was made "not in the personal interest of the person soliciting the bribe, but on behalf and for the account of the Government authorities in Romania, so as to make the State liable in that respect".

3 Evaluating Evidence of Corruption

3.1 Burden of Proof

The default position *vis-à-vis* corruption allegations, as with other claims and defences generally, is that each party must prove the facts on which it wishes to rely. Thus, it is widely acknowledged that a party alleging corruption as an objection to jurisdiction or admissibility bears the burden of proving the allegedly corrupt conduct.

The question sometimes arises, however, as to whether it is permissible to shift that burden to the opposing party upon a *prima facie* showing of corruption. According to the *Metal Tech* tribunal, whether it is permissible to do so depends on the law governing the dispute:

Here, the question is whether for allegations of corruption, the burden should be shifted to the Claimant to establish that there was no corruption. Rules establishing presumptions or shifting the burden of proof under certain circumstances, or drawing inferences from a lack of proof are generally deemed to be part of the *lex causae*. In the present case, the *lex causae* is essentially the BIT, which provides no rules for shifting the burden of proof or establishing presumptions. Therefore, the Tribunal has relative freedom in determining the standard necessary to sustain a determination of corruption.^x

Ultimately, the tribunal drew "inferences" from the claimant's failure to substantiate the payments made to Uzbek consultants, but it did not formally shift the burden of proof to the claimant.

Rather, the evidence was sufficient to establish corruption "with reasonable certainty":

As in *World Duty Free*, the present factual matrix does not require the Tribunal to resort to presumptions or rules of burden of proof where the evidence of the payments came from the Claimant and the Tribunal itself sought further evidence of the nature and purpose of such payments.^{xi}

In *Karkey v. Pakistan*, the tribunal confirmed that the burden of proof rested on the party asserting corruption; however, that burden could shift in the presence of "unequivocal (or unambiguous) *prima facie* evidence".^{xii} There, the respondent accused a Turkish investor of corruption for hiring a politically-connected representative. Ultimately, the tribunal declined to shift the burden as the evidence presented by the respondent did not rise to the level sufficient to justify such a shift in the standard of proof.

Apart from the question of which party has the burden of proving corruption, there is an important question as to the standard of proof that must be satisfied to meet that burden. The standard of proof is a question of the amount of evidence needed to make out the allegation. Tribunals evaluating corruption allegations have reached divergent conclusions regarding the appropriate standard of proof for corruption allegations.

On the one hand, most tribunals have applied a heightened standard of proof to corruption allegations. This is due largely to the severity of such allegations, which may entail loss of claim, reputational harm, and even criminal prosecution. According to the *ECE Projektmanagement v. Czech Republic* tribunal, corruption allegations, if true, inevitably involve individual criminal liability and "implicate the reputation, commercial and legal interests" of business ventures, often including undertakings and individuals who are neither party to nor represented in the proceedings.^{xiii}

As articulated by several tribunals, "the graver the charge, the more confidence must there be in the evidence relied on".^{xiv} As such, tribunals have demanded "clear and convincing" proof,^{xv} a high standard of proof,^{xvi} near certainty,^{xvii} irrefutable proof,^{xviii} or proof beyond a reasonable doubt.^{xix}

The presumption of good faith is another reason tribunals may require more convincing evidence for corruption allegations. According to the tribunal in *Croatia v. MOL*, "the presumption of good faith means that the starting point is, in effect, a presumed preponderance against the claim".^{xx} Put differently, even if an allegation of fraud or other serious wrongdoing did not require a heightened standard of proof, it might "require more persuasive evidence, in the case of a fact that is inherently improbable, in order for the Tribunal to be satisfied that the burden of proof has been discharged".^{xxi}

On the other hand, some tribunals have evaluated corruption allegations according to the same standard of proof applicable to other claims. This is generally referred to as the "balance of probabilities" or "preponderance of evidence" standard. These tribunals (and commentators) reason that this standard is appropriate because corruption is notoriously difficult to prove, intended to be concealed. Moreover, they argue, corruption is not meaningfully different from other kinds of allegations, which require proof only on the balance of probabilities. This was the position taken in *Tokios Tokelés v. Ukraine* as well as in *Churchill Mining v. Indonesia*.

A third category of cases has declined to articulate a precise standard but has evaluated corruption allegations on the basis of "reasonable certainty". *Metal-Tech* was one such case; the *Croatia v. MOL* tribunal followed the same approach. In the latter case, Croatia was the claimant, marking the first time a state had used corruption allegations as a "sword" as opposed to a "shield". It sought to nullify contracts with the investor on the basis that the contracts had been obtained by a bribe paid by the investor's CEO

to the state's prime minister. The tribunal applied a "reasonable certainty" standard and rejected the bribery allegation, finding the state's key witness to be thoroughly unreliable.

Thus, even those tribunals that have eschewed "specific levels of proof or of rebuttal in respect of particular factual allegations" have emphasised that adjudicators confronting allegations of bad faith, fraud, or corruption may well "be reluctant to find the allegation proved in the absence of a sufficient weight of positive evidence—as opposed to pure probabilities or circumstantial inferences".^{xxii}

In assessing the appropriate standard of proof, local law is a relevant consideration. According to the tribunal in *Kim v. Uzbekistan*, where the allegation is that the alleged act violated a provision of a particular host state's law, the standard and burden of proof to be employed is that provided for in that law.

3.2 Inferences and "Red Flags"

Although arbitral tribunals lack the police powers available to domestic investigators and prosecutors, they do have a number of fact-finding tools at their disposal in order to evaluate corruption allegations. First, tribunals may draw adverse inferences from non-production of evidence. Second, tribunals may draw conclusions from circumstantial evidence. One formulation of this approach relies on identifying and assembling recognised *indicia* of corruption sometimes called "red flags". Another formulation seeks to connect "dots" to draw a complete picture.

The adverse inference is among the most powerful tools in the arbitrator's toolbox. The threat of adverse inferences incentivises parties to produce evidence and can aid a party in satisfying its burden of proof. However, it is hotly contested when precisely it may be appropriate to deploy this tool.

The *Metal-Tech* tribunal relied on recognised *indicia* of corrupt activity, coupled with adverse inferences, to establish corruption through circumstantial evidence. There, the respondent first raised corruption allegations with its rejoinder, indicating that Uzbek authorities were investigating allegations of bribery against the claimant. At the evidentiary hearing, the claimant's CEO admitted on examination that the company had paid approximately USD 4 million to several consultants in connection with its purported investment. The tribunal requested the claimant provide documentation regarding the reasons for those payments, but the claimant was unable to provide it. Thus, the tribunal inferred that the evidence was either non-existent or adverse to the claimant.

It may also be possible for the tribunal to draw conclusions from circumstantial evidence, looking to "red flags" or "connecting the dots". Relying on circumstantial evidence may allow a tribunal to overcome the deficits of evidence that sometimes occur in corruption cases, but at the risk of finding corruption where there is none.

The *Metal-Tech* tribunal is also a notable example of a tribunal that based its conclusions on circumstantial evidence. Its adverse inferences coupled with numerous "red flags" were enough, in the view of that tribunal, to support a conclusion that the USD 4 million paid to the consultants had constituted a bribe by which Metal-Tech procured its investment in Uzbekistan. Although noting this was only one of several such lists, the tribunal relied upon a list of "red flags" authored by Lord Woolf, former Chief Justice of England and Wales:

"(1) an Adviser has a lack of experience in the sector; (2) non-residence of an Adviser in the country where the customer or the project is located; (3) no significant business presence of the Adviser within the country; (4) an Adviser requests urgent payments or unusually high commissions; (5) an Adviser

requests payments be made in cash, use of a corporate vehicle such as equity, or be paid in a third country to a numbered bank account, or to some other person or entity; (6) an Adviser has a close personal/professional relationship to the government or customers that could improperly influence the customer's decision."^{xxiii}

Other tribunals have reasoned that tribunals may be empowered to "connect the dots", or to draw inferences based on available evidence. In *Methanex v. United States*, the claimant argued that the evidence gave rise to certain inferences; it requested that the Tribunal infer "malign intent" by connecting certain "dots" that arose from the available evidence. The tribunal rejected the claimant's request because the "dots" it chose presented a "self-serving" selection and interpretation of events:

"[I]t is critical, first, that all the relevant dots be assembled; and, second, that each be examined, in its own context, for its own significance, before a possible pattern is essayed. Plainly, a self-serving selection of events and a self-serving interpretation of each of those selected, may produce an account approximating verisimilitude, but it will not reflect what actually happened..."^{xxiv}

In *ECE v. Czech Republic*, the Tribunal rejected the notion that generalised allegations regarding a climate of corruption in a host state can support a finding of bribery. Rather, the evidence must be particularised and must rise to more than mere insinuations. Further, the tribunal acknowledged that while "connect[ing] the dots" may sometimes be necessary in light of the covert nature of corruption, the serious nature and consequences of such allegations requires that they be established either by direct evidence or "compelling circumstantial evidence.... The mere existence of suspicions cannot, in the absence of sufficiently firm corroborative evidence, be equated with proof".

By contrast, it has been reported that the tribunal in *Spentex v. Uzbekistan* (in a still-unpublished award) adopted a "connect-the-dots" approach of the sort advocated by the claimant in *Methanex*. There, the tribunal held that an eleventh-hour payment of USD 6 million to consultants made on the eve of the public tender gave rise to a presumption that the funds were intended as a bribe for public officials, even though the parties had not identified a particular recipient of the alleged bribe.^{xxv}

Although unlike "red flags", the "dots" to be assembled according to this approach can signal illicit or innocent conduct, in practice, it is unclear whether there is any appreciable difference between this "connect-the-dots" methodology and the technique of assembling "red flags".

3.3 Arbitrators' Duty To Inquire

While arbitral practice has not been entirely consistent, some believe that where genuine suspicions of corruption arise (beyond baseless allegations), arbitrators have a duty *ex officio* to investigate. An investigation may be needed in order to protect the enforceability of an eventual award, and from an obligation to the public of the host state and the international community. *Metal-Tech*, as described previously, is the marquee example of this exercise of arbitral authority.

In *Spentex*, the tribunal reprimanded the respondent for failing to cooperate in the tribunal's fact finding. The respondent had declined to provide the tribunal with the names of officials who may have been involved in the corruption that the respondent was alleging had occurred. The tribunal, suggesting that it has an apparent duty to investigate, chastised the respondent for its failure to cooperate.

4 Future Directions in Addressing Corruption

There remain lingering concerns regarding the bluntness of available remedies when corruption is found. The fact that a finding of corruption often allows states to avoid liability entirely based on their own officials' bad conduct raises questions of state responsibility for its own conduct as well as fairness to investors. Some commentators have called for a remedy for findings of corruption in the form of an obligation on the part of states to prosecute state officials who are identified as having been involved in corruption. They argue that there should be a cost to alleging corruption and that requiring prosecution may avoid corruption allegations that are made-for-arbitration claims with no basis in reality.^{xxvi}

Cases like *World Duty Free* highlight that the state may invoke the corrupt actions of its officials in order to avoid liability for acts that may otherwise constitute breaches of investment treaty protections. This can lead to perverse situations in which, rather than triggering the state's liability under international law, a state official's illicit act serves to immunise the state from such liability. State parties that have failed to conduct a *bona fide* investigation of the allegations of corruption, will also face an uphill task in discharging their burden.

In particular, concerns of fairness arise because of the dual role of the official, acting both officially and illicitly, implicated in the allegations of corruption that the state lodges as a defence in arbitration. The state's defence indeed depends on disclaiming the action of the official in accepting a bribe, even though he or she will have generally been exercising a measure of discretion by virtue of his or her official position. If a tribunal did consider the official's conduct to be that of the state, it could conceivably invoke either the common-law rule of estoppel or the doctrine of contributory fault to prevent the state from asserting the defence.

One interesting approach recently adopted by the *Spentex* tribunal "urged" the respondent to make a substantial donation (USD 8 million) to a United Nations anti-corruption fund. The tribunal warned that Uzbekistan's failure to make such a payment would lead to an adverse cost order in the case, with the government held liable for the costs of the proceedings, as well as reimbursing the claimant for 75% of more than USD 17 million in legal fees and expenses. (Conversely, if Uzbekistan made the contribution, it would bear only its own legal costs, and half the cost of the proceedings.) The *Spentex* tribunal's approach is an example of a unique way of dealing with corruption allegations that also takes into consideration the respondent state's involvement in the corruption.

In conclusion, arbitral jurisprudence makes clear that the applicable principles are still in flux. It is now acknowledged that corruption can serve as a bar to recovery, but the reasoning behind this conclusion has varied. As corruption allegations are invoked more and more frequently, tribunals will likely refine the way in which they address, analyse, and provide remedies for these defences.

Endnotes

- i. Transparency International, *What is Corruption*, available at <https://www.transparency.org/what-is-corruption> (last accessed on 27 Sept. 2018).
- ii. ICC Case No. 1110, Final Award (1963), reprinted in 21 Y.B. Comm. Arb. 52, ¶¶ 20, 23.
- iii. *World Duty Free Company v. Republic of Kenya*, ICSID Case No. Arb/00/7, Award (4 Oct. 2006).

- iv. *Fraport AG Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, Award (16 Aug. 2007).
- v. The underlying contract was governed by English law, which provides that contracts procured by an illegality are voidable at the election of an innocent party. Contracts procured by an illegality are not automatically void and unenforceable. See *National Iranian Oil Company v. Crescent Petroleum Company International Ltd & Crescent Gas Corporation Ltd*, [2016] EWHC (Comm) 510.
- vi. Most tribunals treat allegations of corruption as an issue of jurisdiction when it is alleged that the corruption induced the investment and the underlying agreement dictates that an investment must be made legally, and as an issue of admissibility when the corruption arises after the agreement has been procured and executed.
- vii. *Niko Resources (Bangladesh) Ltd. v. Bangladesh Petroleum Exploration & Production Company Limited ("Bapex"), and Bangladesh Oil Gas and Mineral Corporation*, ICSID Case Nos. ARB/10/11 and ARB/10/18, Decision on Jurisdiction (19 Aug. 2013).
- viii. *Vladislav Kim and others v. Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction (8 Mar. 2017), pp. 122–123, 126.
- ix. *EDF (Services) Ltd. v. Romania*, ICSID Case No. ARB/05/13, Award (8 Oct. 2008).
- x. *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award (4 Oct. 2013), ¶ 238.
- xi. *Id.*, ¶ 243.
- xii. *Karkey Karadeniz Elektrik Uretim A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/13/1, Award (22 Aug. 2017).
- xiii. *ECE Projektmanagement v. The Czech Republic*, UNCITRAL, PCA Case No. 2010–5, Award (19 Sept. 2013), ¶ 4.876.
- xiv. See *Libananco Holdings Co. Ltd. v. Republic of Turkey*, ICSID Case No. ARB/06/8, Award (2 Sept. 2011), ¶ 125; *Rompotrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Award (6 May 2013), ¶ 182 (both relying on the Separate Opinion of Judge Higgins in *Oil Platforms (Islamic Republic of Iran v. United States)*, *Judgments*, 1996 I.C.J. Reports (12 Dec.), p.856).
- xv. See, e.g., *Getma Int'l v. Republic of Guinea*, ICSID Case No. ARB/11/29, Award (16 Aug. 2016), ¶ 184 ("[This Arbitration Court] will verify whether the evidence submitted by the Defendant is clear and convincing and whether it can provide this Court with reasonable certainty that the Concession Agreement was obtained by the active corruption of Getma International."); *Metal-Tech*, ¶ 237 ("Instead, the Tribunal will determine on the basis of the evidence before it whether corruption has been established with reasonable certainty").
- xvi. See, e.g., *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, ICSID Case No. ARB/07/14, Award (22 Jun. 2010), ¶ 422; *ICC Case No. 13384*, Final Award (2005) ¶¶ 67, 71; *ICC Case No. 4145*, Interim Award (1983), ¶ 28 ("high probability").
- xvii. See, e.g., *ICC Case No. 14470*, Award (2008) ("more than likely or almost certain"); *ICC Case No. 12472*, Final Award (2004), ¶ 95 ("certainty").
- xviii. See, e.g., *African Holding Co. of America, Inc. and Société Africaine de Construction au Congo S.A.R.L. v. La République Démocratique du Congo*, ICSID Case No. ARB/05/21, Award on Admissibility (20 Jul. 2008), ¶ 52 ("irrefutable proof").
- xix. See, e.g., *Oil Field of Texas, Inc. v. Gov't of the Islamic Republic of Iran and National Iranian Oil Co.* (NIOC), Award No. 258-43-1 (8 Oct. 1986), 12 IRAN-U.S. CL. TRIB. REP. 308 (1986), ¶ 25.

- xx. *Republic of Croatia v. MOL Hungarian Oil and Gas Plc*, PCA Case No. 2014–15, Award (23 Dec. 2015), ¶ 118.
- xxi. *Rompotrol*, ¶ 182 (citing *Libananco*, ¶ 125).
- xxii. *Id.*
- xxiii. *Metal-Tech*, ¶ 293 (citing Woolf Committee Report on Business Ethics, *Global Companies and the Defence Industry: Ethical Business Conduct in Bae Systems Plc* (2008) 25–26).
- xxiv. *Methanex v. United States*, In the Matter of An Arbitration under Chapter 11 of the North American Free Trade Agreement and the UNCITRAL Arbitration Rules, Final Award (7 Aug. 2005).
- xxv. *Spentex Netherlands B.V. v. Republic of Uzbekistan*, ICSID Case No. ARB/13/26, Final Award (27 Dec. 2016).
- xxvi. In *World Duty Free*, the bribe recipient was identified as the president of the state. He was not prosecuted, and his receipt of the bribe nonetheless immunised the state from the investor’s claims. This struck many commentators as unfair. In contrast, in *Croatia v. MOL*, the state did prosecute the alleged bribe recipient – its former prime minister – but the conviction was overturned by the state’s constitutional court for violation of the right to a fair trial. The tribunal found that the evidence underlying that conviction was insufficient to meet any applicable standard of proof.

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He is Co-Chair of the IBA Arbitration Committee and has published dozens of books and articles on international arbitration and other matters.

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