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# Using Red Flags to Prevent Arbitration from Becoming a Safe Harbour for Contracts that Disguise Corruption

By Vladimir Khvalei\*

Parties involved in bribery and corruption in international commerce invariably hide their unlawful dealings under the cover of a seemingly legitimate contract such as an agency or consultancy agreement. Disputes arising from such deals are often referred to arbitration in the belief that arbitration is less likely to expose the true nature of their dealings than if the dispute were referred to the courts. This article alerts arbitrators to this trend and discusses the circumstances that in a given case may point to the possible existence of bribery and corruption in the underlying transaction. Known as 'red flags', such circumstances relate, *inter alia*, to the identity of the parties (typically state or publicly-owned entities whose real owners are difficult to identify), the location of the parties' dealings (in a country or a sector prone to corruption), remuneration (timing, excessively high rates of commission, payments overseas), the services to be provided (ill-defined and intangible), the parties' business activity (no evidence of real or prior activity, lack of qualified personnel and actual offices). The author argues that on the basis of these and other red flags arbitrators may make a procedural presumption that the parties' transaction is unlawful and shift the burden of proof to the party accused of corruption to present counter-evidence of the legitimacy of their contract. In the appendices to the article, the author proposes three checklists indicating typical circumstances that (i) should prompt arbitrators to investigate corruption, (ii) justify a presumption of corruption and (iii) disprove suspicions of corruption.

*Les acteurs du commerce international impliqués dans la corruption, qu'elle soit active ou passive, effectuent invariablement leurs transactions illicites sous le couvert de contrats, par exemple d'agence ou de conseil, en apparence légitimes. Les différends qui surgissent à l'occasion de telles transactions sont souvent soumis à l'arbitrage, car les parties considèrent que cette solution risque moins de mettre au jour leur véritable nature que ne le ferait une action en justice. Cet article met les arbitres en garde contre cette tendance*

*et détaille les circonstances qui peuvent, dans une affaire donnée, laisser présager qu'il y a eu corruption dans le cadre du contrat en cause. Ces circonstances, qualifiées de « drapeaux rouges », sont liées, entre autres, à l'identité des parties (le plus souvent des entreprises d'État ou des entreprises publiques dont les véritables propriétaires sont difficiles à identifier), le lieu de la transaction des parties (dans un pays ou un secteur où la corruption est endémique), la rémunération (calendrier, taux de commission excessivement élevé, paiements à l'étranger), les services fournis (mal définis et incorporels), l'activité économique des parties (pas de preuve d'activité réelle ou antérieure, absence de personnel qualifié et de véritables bureaux). L'auteur estime qu'en se fondant sur ces drapeaux rouges et d'autres, les arbitres peuvent émettre la présomption procédurale de l'illégitimité de la transaction des parties, inverser la charge de la preuve et demander à la partie accusée de corruption de démontrer la légitimité du contrat. En annexe à l'article, l'auteur propose trois listes de contrôle des circonstances qui, normalement, (i) devraient inciter les arbitres à s'interroger sur une éventuelle corruption, (ii) justifient une présomption de corruption et (iii) écartent les soupçons de corruption.*

*Las partes implicadas en hechos de soborno y corrupción en el comercio internacional ocultan invariablemente sus actividades ilícitas al amparo de un contrato aparentemente legítimo, como un acuerdo de agencia o de consultoría. Las controversias derivadas de estos negocios muchas veces se someten al arbitraje con la convicción de que es menos probable de que este último descubra la verdadera naturaleza de sus relaciones que si se someten a la justicia estatal. Este artículo previene a los árbitros sobre esta tendencia y examina las circunstancias que, en un caso determinado, pueden indicar la posible existencia de soborno y corrupción en la transacción subyacente. Tales señales de alarma están relacionadas, inter alia, con la identidad de las partes (habitualmente, entidades estatales*

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*o entes públicos cuyos verdaderos propietarios son difíciles de identificar), la localización de las transacciones entre las partes (en un país o un sector propenso a la corrupción), la remuneración (calendario, tipos de comisión excesivamente elevados, pagos en el extranjero), los servicios previstos (mal definidos e inmateriales) y la actividad comercial de las partes (sin evidencia de una actividad real o anterior, falta de personal cualificado y oficinas reales). El autor sostiene que, basándose en estas y otras señales de alarma, los árbitros pueden hacer una presunción procesal de que la transacción entre las partes es ilícita y trasladar la carga de la prueba a la parte acusada de corrupción para que esta presente una evidencia contraria de la legitimidad de su contrato. En los apéndices del artículo, el autor propone tres listas de control que indican las circunstancias típicas que (i) deberían incitar a los árbitros a investigar la presencia de corrupción, (ii) justifican una presunción de corrupción y (iii) refutan las sospechas de corrupción.*

## 1. Introduction

Despite continuing efforts at both national and international levels, corruption remains a serious problem in commerce worldwide. The number of contracts, especially in the public sector, that have been concluded by means of corruption – be it through bribery of the government officials responsible for awarding the contract, by awarding contracts to companies whose beneficial owners are those very government officials or members of their families, or some other form of corruption – is considerable. Bribes paid to government officials in such situations sometimes amount to huge sums of money.

Yet, it is no simple matter to pay a bribe. Banks monitor suspicious transactions, customs authorities watch out for international transfers of unusually large amounts of money, and major multinational companies have implemented internal compliance policies to guard against suspicious transactions. Measures such as these have forced those involved in corruption to cover up bribe payments through transactions that appear lawful, such as agency and consultancy contracts, or partnership and cooperation agreements.

Such transactions, like all business deals, are not immune to disputes. Below are some illustrations of conflicts that typically occur between the givers and the receivers of bribes (or their intermediaries).

1. An employer fails to pay a contractor the amount expected by the contractor for increased construction costs. Forced into losses, the contractor refuses to pay the 'agency fee' to the agent who had set up a fixed-price contract between the employer and the contractor by means of bribery.
2. Following a change of leadership in a government or company acting as project owner, a contractor sees no point in continuing to pay bribes to the intermediary engaged to obtain contracts on account of his relations with and influence over the ousted leaders.
3. A company that is required to pay fees to an agent conducts an internal audit during which the contract with the agent is torn up due to a suspicion that it is a cover-up for bribes.

Situations such as these often result in the agent's suing the principal over the latter's failure to pay the contracted fee. Occasionally, it is the principal that initiates proceedings to recover money previously paid to an agent, with whom a contract suspected to mask bribery is terminated as a result of an internal investigation. In such disputes neither party will wish to refer the matter to the state courts for understandable reasons: court proceedings are public, can attract the attention of the mass media and lead to a scandal. However, their ultimate fear is that the judge will refer the case to the police causing their private dispute to end in criminal proceedings. Instead, they will be more inclined to submit the dispute to arbitration in the expectation that they will be guaranteed the confidentiality they seek and that, as many arbitrators do not see themselves under any obligation to investigate suspicious contracts or report them to law enforcement bodies, they will escape the risk of criminal prosecution. Unfortunately, this expectation is sometimes met.

This article looks at how international arbitration has in this way become known as a safe harbour for corruption-related disputes and how things can be changed.

## 2. How corruption has found a safe harbour in arbitration

Although the limited number of published arbitral decisions means that any conclusions drawn must be subject to some circumspection, arbitrators' and parties' attitudes and the nature of corruption would appear to explain why corruption has found a refuge in arbitration.<sup>1</sup>

### A. Arbitrators' attitudes

In cases where corruption has remained unexposed, this may have been because the arbitral tribunal (i) considered itself to be under no obligation to investigate corruption issues ex officio, (ii) required the party alleging corruption to prove its allegations beyond doubt, or (iii) applied a higher-than-normal standard of proof.

ICC case 7047 provides an example of an arbitral tribunal refusing to investigate corruption when the issue had not been raised by the parties and there was no convincing evidence of improper conduct:<sup>2</sup>

The majority also holds that bribery renders an agreement invalid. *In arbitration proceedings, however, bribery is a fact which has to be alleged and for which evidence has to be submitted, and at the same time constitutes a defense, nullifying the claims arising from a contract. The consequences of this are decisive.*

If a claimant asserts claims arising from a contract, and the defendant objects that the claimant's rights arising from the contract are null due to bribery, it is up to the *defendant* to present the fact of bribery and the pertaining evidence within the time limits allowed to him for presenting facts. *The statement of facts and the burden of proof are therefore upon the defendant.* The word 'bribery' is clear and unmistakable. *If the defendant does not use it in his presentation of facts, an arbitral tribunal does not have to investigate.* It is exclusively the parties' presentation of facts that decides in what direction the arbitral tribunal has to investigate. If the claimant's claim based on the contract is to be voided by the defense of bribery, the arbitral tribunal, as any state court, must be convinced that there is indeed a case of bribery. A mere 'suspicion' by any member of the arbitral tribunal, communicated neither to the parties nor to the witnesses during the phase to establish the facts of the case, is entirely insufficient to form such a conviction of the arbitral tribunal.

The lack of any convincing evidence of corruption has also led arbitral tribunals to dismiss allegations of corruption in other ICC cases.<sup>3</sup>

The application of a higher standard of proof is illustrated by ICC case 6401, where the tribunal stated that 'fraud in civil cases must be proven to exist by clear and convincing evidence amounting to more than a mere preponderance, and cannot be justified by a mere speculation'.<sup>4</sup>

By imposing a higher standard of proof, an arbitral tribunal may make it impossible for corruption to be proven, leaving it with no choice but to dismiss the allegation.<sup>5</sup> In case 6401, even though there was evidence that the claimants had intended to bribe a public official through payments made to a local agent associated with that official, the arbitral tribunal decided that the respondents had failed to provide sufficient evidence. The US District Court for the District of New Jersey<sup>6</sup> disagreed with the application of a higher standard of proof than would be applied in the courts and ruled that there was sufficient evidence to show that the agent's commission was intended to be used in whole or in part to make payments to the public official and was in fact used to this end.

### B. Parties' attitudes

If a party makes an allegation of corruption in arbitration but fails to prove it, that party effectively forfeits the chance to prove the same allegation later in a state court where it might challenge the award. The reluctance of state courts to review awards on the merits has deterred them from re-opening corruption issues that have already been dealt by an arbitral tribunal, despite the fact that combatting corruption is in the public interest. The proceedings initiated in England to enforce the award in ICC case 7047 illustrate this tendency. The respondents produced an affidavit pointing to the existence of bribery, yet the English Court of Appeal held that the award should be enforced:

The court is in this instance performing a balancing exercise between the competing public policies of finality and illegality; between the finality that should prima facie exist particularly for those that agree to have their disputes arbitrated, against the policy of ensuring that the executive power of the English court is not abused. It is for those reasons that the nature of the illegality is a factor, the strength of case that there was illegality also is a factor, and the extent to which it can be seen that the asserted illegality was addressed by the arbitral tribunal is a factor. The judge performed the balancing exercise and narrowly came down on the side of upholding the finality of the award.<sup>7</sup>

- 1 The most informative source of information on cases involving corruption is A. Crivellaro, 'Arbitration Case Law on Bribery: Issues of Arbitrability, Contract Validity, Merits and Evidence' in K. Karsten & A. Berkeley, eds., *Arbitration - Money Laundering, Corruption and Fraud*, Dossier of the ICC Institute of World Business Law (ICC, 2003) 109.
- 2 (1996) XXI Y.B. Comm. Arb. 79 at 93–94. Emphasis added, except for the word 'defendant' in the fourth sentence.
- 3 e.g. ICC case 4145, second interim award, (1987) XII Y.B. Comm. Arb. 97 ('The defendant's accusation is not supported by direct evidence or even circumstantial evidence to be retained as convincing.').; a 1989 ICC award, [1993] ASA *Bulletin* 216 ('Aucune indication probante d'actes de corruption ou de volonté de corrompre ne ressort cependant de la procédure.').
- 4 Award of 19 Dec. 1991, (1992) 71 *Mealey's International Arbitration Report* 31, as quoted in M. Scherer, 'Circumstantial Evidence in Corruption Cases Before International Arbitral Tribunals' (2002) 5:2 *International Arbitration Law Review* 29 at 30.
- 5 See e.g. the final award in ICC case 13384 hereinafter.
- 6 *Republic of Philippines v. Westinghouse Elec. Corp.*, Civ. No. 88-5150, U.S. District Court for the District of New Jersey, 782 F. Supp. 972; 1992 U.S. Dist. LEXIS 1186, 4 February 1992.
- 7 *Westacre Investments Inc v. Jugoinport-SDRP Holding Co Ltd*, QBCM1 1998/0485/3, 12 May 1999, [1999] EWCA Civ 1401; [2000] QB 288.

As a result and for the reasons explained below, some parties will prefer not to raise allegations of corruption in arbitral proceedings rather than run the risk of having them dismissed, as here.

### C. Nature of corruption

Often, it is difficult, if not impossible, to prove that a contract has been made to mask bribery for the following reasons:

First, persons who resort to unlawful schemes such as bribery will take care not to leave any written evidence of their acts. Hence, agreements based on bribery are rarely recorded in writing and, even if they are, they are shaped in the form of a legitimate transaction. Consequently, it will be difficult for a party that alleges the unlawfulness of a contract involving bribery to produce documentary evidence proving its allegation.

Second, a party alleging corruption cannot rely on evidence from witnesses either. The fear of being pursued in criminal proceedings will deter anyone involved in a bribery scheme from giving testimony on the subject and will even cause the person to use all means to avoid appearing in the arbitration<sup>8</sup> and to plead that they cannot be obliged to give self-incriminating evidence.

Third, arbitrators lack the investigative apparatus that is at the disposal of state courts and the police. State authorities can forcibly recover documents and seize other evidence, conduct searches, interrogate witnesses (who may be held criminally liable for perjury if they give any false testimony) and have ways of finding and retrieving evidence deliberately concealed by a party, such as requesting the evidence from third parties (e.g. banks, government agencies) and ordering witnesses to be summoned to testify under oath. Arbitrators, on the other hand, have no real power to compel a party to produce evidence. At most, they may draw an adverse inference from a party's refusal to cooperate or sanction the party through a decision on costs, but they cannot physically force the party to produce the documents in question. Moreover, third parties such as banks have no obligation to comply with a request for documents from an arbitral tribunal since they are not bound by the relevant arbitration agreement and have a duty to keep the data they possess confidential. Where arbitrators are entitled to ask state courts to assist in collecting evidence, they rarely do so, notably because of the complexity of the procedures involved and the resulting delay.

It is hardly surprising, then, that in most known arbitration cases in which corruption has been taken into account, this was because it had either been admitted by one of the parties<sup>9</sup> or had been established outside the arbitral proceedings,<sup>10</sup> but rarely due to the arbitral tribunal's own investigations. The inevitable consequence, as stated above, is that arbitration continues to provide a safe harbour for disputes arising from contracts that cover bribes. To change this situation, it is necessary to revisit traditional approaches to proving corruption in international arbitration.

### 3. Should arbitrators raise corruption issues *sua sponte*?

Before discussing how to prove corruption, it first needs to be asked whether arbitral tribunals can and should open the issue of corruption on their own initiative, if it is not raised by any of the parties. There may be times when the parties deliberately avoid raising the issue. To justify refusing to pay an agreed fee to an agent, a principal may argue that the contract is invalid (for a reason other than its illegality) or that the agent had failed to discharge his obligations. One of the reasons why parties may try at all costs to circumvent the issue of corruption is that an award from a respected arbitral institution will lend credibility to the underlying transaction and help protect it against any risk of appearing suspicious. Arbitrators need to be vigilant in order to see through such a stratagem. As stated in a recent unpublished ICC award:

The Tribunal shares the view that if a suspicion of corruption has materialised, it would be under a duty to carry, even *sua sponte*, enquiries and investigations regarding the irregularities.

There are several reasons why an arbitral tribunal should not hesitate to investigate corruption on its own initiative.

First, arbitrators have a duty not just to resolve a dispute, but to issue an award that is valid at least at the place of arbitration. An award that overlooks corruption in effect sanctions it. Insofar as this is contrary to both national and international public policy, a state court will be obliged to set aside or refuse to enforce the award, as illustrated by the following case brought before the Swiss Federal Tribunal. In 1992, Frontier AG and Brunner Sociedad Civil de administracao Limitada brought a US\$ 37 million claim against Thales, seeking commission due on the sale of warships to Taiwan. Five years later, an

<sup>8</sup> See e.g. hereinafter the final award in ICC case 13384 at para. 76, where it is reported that the respondent refrained from asking its executive director to appear before the arbitral tribunal.

<sup>9</sup> In *World Duty Free Co Ltd v. The Republic of Kenya* (ICSID case ARB/00/7), bribery was revealed by the claimant's chief executive officer and shareholder of World Duty Free, who testified that he had made a personal donation to the President of Kenya in order to win an investment contract.

<sup>10</sup> In the *Thales* case (see below), corruption was proven in criminal proceedings. In *Siemens A.G. v. Argentine Republic* (ICSID case ARB/02/08, award of 6 February 2007), the fact that a contract had been won through a bribe was admitted by a Siemens employee outside the arbitration.

ICC arbitral tribunal awarded the two agents roughly US\$ 28 million. Thales challenged the award, but was told that it was 'not inconsistent with public order'. The enforcement proceedings were stayed pending the outcome of proceedings in France in which many of the participants in the deal were being examined. A French judge ruled that one of the witnesses had submitted false evidence to the tribunal by stating that there was no bribery involved in the deal. The Swiss court thereupon set aside the award as it was based on untrue testimony.<sup>11</sup>

Second, an arbitrator's function has not only a private aspect (that of resolving a dispute), but also a public aspect (that of rendering a decision that has the same force as a judgment issued by a state court). For this reason, arbitrators cannot sanction activity that goes against public policy. Although some arbitrators do not accept that they perform a public function, this becomes obvious in the following example. Imagine that an arbitral tribunal has to settle a private dispute between members of a drug cartel over the failure to pay for a delivery of heroine. It goes without saying that even if neither party claims that the contract was invalid, the arbitrators have no choice but to refuse to enforce the agreement since it violates international public policy. It is nowadays generally acknowledged that corruption is just as incompatible with international public policy and basic morals as is drug trafficking.

Third, if arbitrators sanction bribery they are in effect aiding and abetting a crime by facilitating the payment of bribes. This will be the case if an award orders a company to pay a fee to an agent in disregard of the fact that the underlying transaction is of a dubious or suspicious nature.

For these reasons, arbitrators have a duty to investigate suspicions of corruption on their own initiative even if not raised by the parties. In his study of arbitral case law relating to corruption, Antonio Crivellaro gives three illustrations of situations in which this has occurred:

In three cases, the agreement was *ex officio* declared illegal and invalid, either because its purpose was illicit according to the law chosen by the parties to govern their agreement [ICC case 3913] or because it contravened international public policy [ICC case 3916] or because an award enforcing the contract would be contrary to the public policy of the country in which the award would be enforced [ICC case 4219].<sup>12</sup>

The arbitral tribunal took a similarly proactive approach in ICC case 8891.<sup>13</sup>

However, such an approach begs a certain number of questions: When should the arbitral tribunal start to look into suspected corruption on its own initiative? What circumstances signal the possibility of corruption calling for the arbitral tribunal's attention? How should the arbitral tribunal handle the burden and the standard of proof in such cases? To answer these questions, it will be necessary first to look at how corruption schemes work and then to consider how arbitrators can tackle the matter.

#### 4. A classic corruption scheme

Corruption is as old as humanity itself. Ancient Rome was notorious for its reliance on corrupt practices which permeated the entire society. Little could be achieved without resorting to illegal payments or string-pulling. Likewise, there are numerous countries today where the exercise of illegal influence is accepted as part and parcel of commerce.

The following is a hypothetical example of a typical arrangement that relies on corruption to achieve the desired result.

An international construction company known as Multinational Co. has shown an interest in a project worth an estimated US\$ 100 million. However, corruption is endemic in the country where the project is located, making it impossible to win a contract without paying a bribe. Multinational Co. reaches an agreement with the minister of construction responsible for awarding contracts relating to the project. Under the agreement the minister is to receive as a bribe 10% of the anticipated contract value. In the unlikely event that the parties record their understanding in writing, the agreement would resemble the following:

<sup>11</sup> Federal Tribunal, 6 Oct. 2009, 4A.596/2008.

<sup>12</sup> A. Crivellaro, *supra* note 1 at 114.

<sup>13</sup> [2000] *Journal du droit international* 1076 at 1083.

**Bribery Contract**

1. The Minister of Construction shall cause his employees to award to Multinational Co. a contract for the construction of a bridge construction valued at no less than US\$ 110,000,000 (the 'Main Contract').
2. Multinational Co. shall pay a bribe to the Minister in an amount equal to 10% of the value of the Main Contract in return for the contract being awarded to it.
3. The bribe shall be paid as follows:
  - a sum equal to 5% of the value of the Main Contract shall be paid immediately upon the Main Contract being awarded to Multinational Co.; and
  - the remaining sum equal to 5% of the value of the Main Contract shall be paid pro rata as and when payments are received by Multinational Co. under the Main Contract.
4. No bribe shall be paid if the Main Contract is not awarded to Multinational Co. No expenses will be reimbursed in this event.

Signatures .....

Ignoring, for the purpose of our example, that such a contract is illegal, the terms and conditions essential to the contract are as follows:<sup>14</sup>

1. The bribe-taker provides the service of awarding the main contract to the bribe-giver.
2. The bribe-giver passes the agreed fee to the bribe-taker if (and only if) the main contract is awarded to the former.
3. The fee is expressed as a percentage of the value of the main contract.
4. The fee is paid only after the main contract has been awarded to the bribe-giver and is linked to payments stipulated in the main contract.
5. If the main contract is not awarded to the bribe-giver, no reimbursement is due (including expenses).

It is, of course, extremely unlikely that Multinational Co. and the minister would ever enter into a written agreement as set out above. If discovered, the document would serve as perfect evidence in any criminal proceedings that might be brought against the parties, not to mention the fact that Multinational Co. would never be able to make a payment under such a contract as it would be picked up by internal compliance controls or by the banks involved in the payments.

Consequently, the two parties would need to make certain changes to give their unlawful arrangement a semblance of legitimacy.

First, the minister will need to be replaced, as Multinational Co. would be infringing both public service and anti-bribery laws if it were to pay a state official.

Second, the purpose of the transaction (bribery) will need to be replaced by something that is lawful but does not provide for any tangible deliverables, as none will be forthcoming. Agency, consultancy or system integration services would be ideal replacements, for example.

The other material terms and conditions will remain unchanged, as the parties would be uncomfortable without them. Thus, the minister needs to have the means of compelling Multinational Co. to pay the promised bribe once the main contract has been signed, and Multinational Co. should not have to make any payment to the minister if it is not awarded the main contract or does not receive the payments provided for in the main contract.

Accordingly, a deal that embodies the material terms and conditions of the bribery contract but under a lawful cover will have the following features:

1. The purpose of the contract will be intangible (e.g. agency, consultancy or advisory services);
2. The agency fees will represent a percentage of the value of the awarded main contract, and their amount will be unreasonably high in comparison to the work to be done by the agent;
3. The agency fees will be payable only after the main contract has been awarded or the payments due under the main contract have been made;
4. If the main contract is not awarded, no fees will be due and any costs incurred will not be reimbursed.<sup>15</sup>

**14** cf. J.-B. Zufferey-Werro, *Le contrat contraire aux bonnes mœurs* (Fribourg: Editions universitaires, 1998) at 282, quoted by the tribunal in a 2003 unpublished ICC award ('Le contrat de pot-de-vin désigne l'accord portant sur l'octroi d'un avantage matériel destiné à inciter son bénéficiaire (le corrompu), à procurer un avantage matériel au donateur (le corrupteur) dans le cadre des relations entre un tiers et le corrupteur; en principe, il s'agit d'une relation d'employé à employeur.' English translation by the author: 'The contract for payment of a bribe can be defined as an agreement on the granting of a material advantage intended to encourage its recipient (the bribed person) to get a material advantage from the payer (the bribing person) within the framework of the relationship between a third party and the bribing person; in theory, it is a relationship between an employee and an employer.');

**15** cf. the *Westman* case, (1995) XX Y.B. Comm. Arb. 198 at 199 ("Westman shall not be entitled to any indemnity of any kind" if Alstom "does not receive an order for the project during the [contract's] period of validity").

**16** In the *Westacre* case, according to the affidavit of M.M. filed in the English enforcement proceedings, one of two witnesses stated that the consultant (*Westacre*) was controlled and owned by the son-in-law of the then Secretary General of the Council of Ministers of Kuwait.

**17** In ICC case 12990 hereinafter the tribunal examined the following typical indicators of corruption: lack of evidence of service performed; brevity of negotiations; unusual payment arrangements; disproportionately high remuneration; corruption endemic in the country concerned; secrecy; incrimination of persons involved. In ICC case 13914 hereinafter the tribunal noted the following: country ridden with corruption; high rate of commission fees;

inadequate documentation; lack of a qualified consultant; interest and involvement of the beneficiaries of bribes.

- 18** Identified as a high-risk factor in the ICC Guidelines on Agents, Intermediaries and Other Third Parties, page 3, see <http://iccwbo.org/advocacy-codes-and-rules/document-centre>: 'Any Third party that will be engaged to deal directly with a public official on behalf of the enterprise where that official has discretionary authority over some matter impacting or involving the enterprise, and, in particular, such Third parties that are located or doing business in a country with high levels of bribery'.
- 19** As a rule, shareholders in privately-owned companies usually exercise tight control over purchase prices and the bribery of officials in private companies is for that reason less common than in publicly or state-owned companies.
- 20** cf. ICC case 13914 hereinafter at para. 194, final subpara.
- 21** In an unpublished ICC case the consultancy service at issue was defined as 'advice and assistance which you [Claimant] are continuing to provide in the execution of the project, particularly with respect to extensions to it and associated projects'. The author is also aware of an *ad hoc* award in which the sole arbitrator stated that 'the Contract presents a dramatic variation from anything similar to a bona fide contract for the provision of technical services. It is totally lacking any individualizing feature ... The description "Technical-Technological Documentation" is totally devoid of specific content if not downright nonsensical.'

It should not be thought that the circumstances that characterize agreements to engage in bribery are limited to the above material terms and conditions. Such agreements are usually identifiable by certain other indications of unlawful activity.

One such indication is the identity of the agent. In the above example, finding the right intermediary may well prove difficult. The minister will need to avoid (i) persons with whom he has a professional or working relationship, as signing a contract with close colleagues would look very suspicious, and (ii) persons who might deceive him and simply pocket the money. A close relative of the minister,<sup>16</sup> a school friend or even a sports coach might be possible choices. However, if a close relative or school friend of the minister were chosen and this became known to the public, it would cause an outcry. A better choice of intermediary would be a company owned by nominal shareholders, so that the actual shareholders (who may be the minister's relatives or friends, or the minister himself) are not recorded in the company's books. For the same reason, the company would most likely have nominal directors.

The company acting as intermediary is unlikely to engage in any real business, as this would require its business activities to be conducted by people who are unlikely to be happy about their enterprise being used as a conduit for bribes. They would also be likely to keep control of any such business, leaving the minister without any real control. Hence, the company is likely to be a special purpose entity or vehicle, whose sole purpose would be to serve as a screen to conceal the unlawful transaction.

The income received by the company under the transaction would normally be taxable, which could considerably reduce its value for the agent. For this reason, it is tempting to establish the company in a tax-free territory. Moreover, such territories are likely to be fairly lax when it comes to controlling suspicious transfers of funds. However, the company is likely to keep its bank accounts elsewhere, preferring a country that has a stable banking system and tolerates anonymous accounts.

Although the agency contract or consultancy agreement made to hide a corrupt transaction may list numerous services to be provided under the agreement, there is generally no evidence of any such services actually having been provided, nor of any staff to handle them.

Therefore, a bribery contract is quite often (although not always) characterized by the following:<sup>17</sup>

1. The main contract is related to a country having a high corruption rating.<sup>18</sup>
2. The payer under the main contract is a state, a state-controlled entity, or a publicly listed company.<sup>19</sup>
3. The main contract relates to a sector prone to corruption, such as defence, healthcare or construction.
4. There is a related contract (agency contract) with an intermediary (agent) for agency, consultancy or facilitation services or joint activities.
5. The agent has been recommended by officers of a party to the main contract.<sup>20</sup>
6. There is no substantial time lag between the execution of the agency contract and the date when the main contract is awarded to the principal.
7. The subject matter of the agency contract is not tangible.<sup>21</sup>

8. The agent's fees are calculated as a percentage of the value of the main contract and their amount is unreasonably high in comparison to the work to be done by the agent.<sup>22</sup>

9. The agent's fees are to be paid into an account in a country other than that where the agent is incorporated.<sup>23</sup>

10. The agent's fees are payable only after the main contract has been awarded or the payments due under the main contract have been made.<sup>24</sup> If the main contract is not awarded, the fees are not payable and any costs incurred are not reimbursable.

11. The agent's actual owners and beneficiaries are unknown or are individuals with close links to the officers of a party to the main contract.<sup>25</sup>

12. The agent has no recorded prior activity.

13. The agent has no website.

14. The agent is registered in a tax-free territory.

15. The agent has only nominal directors (usually residents of tax-free territories or lawyers);

16. The agent does not have a real office or does not have an office at the place designated for the performance of its obligations under the agency contract.

17. The agent does not have sufficient personnel capable of performing the work presupposed by the value of its purported services.<sup>26</sup>

18. There are no substantial records (e.g. employees' time sheets of the employees, minutes of meetings, exchanges of correspondence) confirming performance under the agency contract.

Characteristics such as these may serve as warnings of possible corruption and are therefore often referred to as 'red flags'.

The ICC Guidelines on Agents, Intermediaries and Other Third Parties provide the following examples of red flags, some of which coincide with those listed above:

- A reference check reveals a Third party's flawed background or reputation, or the flawed background or reputation of an individual or enterprise represented by the Third party;

- The operation takes place in a country known for corrupt payments (e.g., the country received a low score on Transparency International's Corruption Perceptions Index);
- The Third party is suggested by a public official, particularly one with discretionary authority over the business at issue;
- The Third party objects to representations regarding compliance with anti-corruption laws or other applicable laws;
- The Third party has a close personal or family relationship, or business relationship, with a public official or relative of an official;
- The Third party does not reside or have a significant business presence in the country where the customer or project is located;
- Due diligence reveals that the Third party is a shell company or has some other non-transparent corporate structure (e.g. a trust without information about the economic beneficiary);
- The only qualification the Third party brings to the venture is influence over public officials, or the Third party claims that he can help secure a contract because he knows the right people;
- The need for the third party arises just before or after a contract is to be awarded;
- The Third party requires that his or her identity or, if the Third party is an enterprise, the identity of the enterprise's owners, principals or employees, not be disclosed;
- The Third party's commission or fee seems disproportionate in relation to the services to be rendered;
- The Third party requires payment of a commission, or a significant portion thereof, before or immediately upon the award of a contract;
- The Third party requests an increase in an agreed commission in order for the Third party to 'take care' of some people or cut some red tape; or
- The third party requests unusual contract terms or payment arrangements that raise local law issues, payments in cash, advance payments, payment in another country's currency, payment to an individual or entity that is not the contracting individual/entity, payment to a numbered bank account or a bank account not held by the contracting individual/entity, or payment into a country that is not the contracting individual/entity's country of registration or the country where the services are performed.

<sup>22</sup> See e.g. ICC case 13515 hereinafter. In some awards, tribunals have taken account not only of the percentage mentioned in the agreement but also the actual amounts paid as commission. For example, in another ICC case, while the commission paid to a minister was just 2.6%, this amounted to as much as GBP 825,000, which the tribunal found unreasonably high in comparison with value of the services to be rendered.

<sup>23</sup> cf. ICC case 13515 hereinafter.

<sup>24</sup> Identified as a high-risk factor in the ICC Guidelines on Agents, Intermediaries and Other Third Parties, page 3: 'Any Third party engaged to interact with public officials that is compensated on the basis of their success in securing a contract, permit or increased business'.

<sup>25</sup> Identified as a high-risk factor in the ICC Guidelines on Agents, Intermediaries and Other Third Parties, page 3: 'Any Third party that may be, or may have been, a public official or an enterprise in which a public official holds an economic interest (e.g. as an owner, shareholder, employee, or director); Any Third party who is or may be a relative or close associate of a present or former official, or a Third party that has a relative of a present or former official as an owner, shareholder, employee, director; and Any Third party that is owned or controlled by or closely linked to a government agency'.

<sup>26</sup> e.g. ICC case 13914 hereinafter, para. 197, fourth subpara.

The red flags identified by the US government<sup>27</sup> include the following characteristics: unusual payment patterns or financial arrangements; a history of corruption in the country; unusually high commissions; lack of transparency in expenses and accounting records; an apparent lack of qualifications or resources on the part of the joint venture partner or representative to perform the services offered.

## 5. Responding to red flags

Red flags such as those listed above can serve as a useful tool in arbitration to check whether there is a risk of corruption. Most of the information listed will be readily available in the case file. Arbitrators necessarily have information on the parties to the main contract and on the country and the industrial sector in which it was made, and they will doubtless know where the agent is registered and has its bank account. Other information at their disposal includes the nature of work to be done under the agency contract, the amount of the fees payable to the agent and the conditions under which payments are to be made. On the basis of even a brief examination of the case with these red flags in mind, arbitrators will easily be able to determine whether there are strong indications of corruption. If there are, then the next question will be what to do next?

Let it be said at the outset that arbitrators should be discouraged from following the examples of state courts, which, when faced with allegations of corruption, often suspend the proceedings and forward the relevant evidence to the police or the prosecutor's office for additional investigation. It would be inappropriate to do likewise in international arbitration for the following reasons:

1. The purpose of arbitration is not to identify and punish persons engaged in a criminal activity, but to settle a private dispute. Arbitrators have enough tools at their disposal to resolve a private dispute without applying to law enforcement agencies.
2. Criminal proceedings may last for years, or even indefinitely (e.g. where the suspects are on a wanted list). If arbitration proceedings were to be suspended pending the outcome of a criminal case, the dispute could remain unresolved for a very long time. Also, it would offer an easy means of avoiding liability for breach of contract: an unscrupulous party would simply need to present some evidence of corruption for the arbitration to be delayed indefinitely until the criminal case is resolved.

3. In countries where corruption charges are made against high-ranking public officials, it is highly unlikely that the law enforcement authorities would vigorously pursue a criminal case against those officials, at least while they are in power.

Therefore, when faced with a dispute in which corruption is or may be at issue, arbitral tribunals should resolve the dispute by their own means, without ignoring the corruption issues or referring them to law enforcement agencies and waiting for the result.

As the traditional approach whereby each party must prove its own allegations is of little value when it comes to proving bribery, an arbitral tribunal may rely on the following options when deciding whether suspected corruption has indeed taken place:

- (i) Procedural presumption of corruption on the basis of circumstantial evidence (red flags);
- (ii) Shifting the burden of proof;
- (iii) Making an adverse inference.

It is generally acknowledged that arbitral tribunals have discretion to establish appropriate rules and standards of proof, which may therefore include making procedural presumptions and allocating the burden of proof. There is therefore nothing formally preventing them from departing from the traditional approach to the standard and burden of proof in cases involving allegations of corruption.

### (i) Procedural presumption of corruption on the basis of circumstantial evidence

If one accepts as a starting point that the material terms and conditions of bribery as set out above in section 4 are found in virtually all forms of contracts covering bribes, then the arbitral tribunal's task is to identify whether, in a particular agency or consultancy contract, these terms and conditions are present. If other red flags are present too, the tribunal could make a procedural presumption that the contract is a cover-up for a bribe, until and unless the party relying on the agency contract proves that it is a legitimate transaction.<sup>28</sup>

<sup>27</sup> See *A Resource Guide to the FCPA U.S. Foreign Corrupt Practices Act* (November 2012), <http://www.justice.gov/criminal/fraud/fcpa/guide.pdf>.

<sup>28</sup> In ICC case 13914 hereinafter the arbitral tribunal inferred from red flags that a consultancy agreement covered a bribe and shifted the burden of proof to the consultant to demonstrate that the contract had a legitimate purpose.

Evidence proving the legitimate nature of the contract may, for example, include:

1. Information showing the existence of personnel qualified to perform the work defined in the agency or consultancy agreement;
2. Records of the involvement of such personnel in the performance of the work (e.g. employee time sheets, payslips);
3. Reports stating what work was performed, when and how;
4. Data on other similar projects implemented by the agent or the consultant;
5. Information on the extent to which the agent's fees are consistent with market rates;
6. Confirmation by certified auditors that the fees paid to the agent have been spent on lawful purposes.

A company engaged in legitimate consulting or agency business will normally not have any difficulty providing such evidence, so should be able to rebut the presumption easily.

Of course, the agent or consultant may argue that some of the information mentioned above is confidential and therefore cannot be disclosed. One solution under such circumstances may be to call upon an independent expert with a solid reputation to examine the documents and report his or her findings to the parties and the arbitrators.

If documents proving the legitimate nature of the contract cannot be provided or are insufficient, the procedural presumption will remain uncontested and the arbitral tribunal will conclude that the contract in question is illegal.<sup>29</sup>

## (ii) Shifting the burden of proof

Shifting the burden of proof is similar to making a procedural presumption.

In cases where a party claims that the agency contract in question is a cover-up for a bribe, the arbitral tribunal may shift the burden of proof to the party that claims the transaction to be legal.

To meet the initial burden of proof, the party alleging corruption will simply need to demonstrate to the tribunal that there are a sufficient number of red flags present in the case.

The burden of proof will then be transferred to the other party, which will be expected to demonstrate that the contract is legitimate. If the

evidence it presents in support of legitimacy is insufficient, the tribunal may conclude that the agency contract is, in fact, a cover-up for bribery.<sup>30</sup>

## (iii) Making an adverse inference

Some arbitration practitioners may find the techniques proposed above (i.e. making procedural presumptions and shifting the burden of proof) too radical, as they are in stark contrast to the approach traditionally used in international arbitration.

However, there is another less radical, but nonetheless efficient, tool for dealing with corruption, which is to make an adverse inference if the party fails to produce the information listed above. The tribunal will simply need to order the party to produce documents confirming the legitimate nature of the transaction in question. If no such documents are produced, it may make an adverse inference that the transaction is illicit.<sup>31</sup>

## 6. Conclusions

The author realizes that the above suggestions for tackling corruption in arbitration challenge traditional views on the burden and standards of proof and even flout the generally accepted presumption of good faith in international trade, as reflected in Article 1.7 of the UNIDROIT Principles of International Commercial Contract. However, traditional methods have proved inadequate in combatting corruption. An alternative and more effective procedure for preventing the enforcement of the contracts involving corruption needs to be found. To this end and on the basis of the foregoing discussion, the author proposes three checklists for use in the process of determining whether the contract underlying a dispute referred to arbitration is tainted by corruption:

Checklist 1: Circumstances triggering further investigation by the arbitral tribunal *sua sponte*

Checklist 2: Non-exhaustive list of circumstantial evidence of contracts involving corruption

Checklist 3: Non-exhaustive list of information disproving that the contract is a cover-up for bribery

These checklists follow as appendices to this article.

<sup>29</sup> In ICC case 8891 ([2000] *Journal du droit international* 1076), on the basis of its examination of legal writing and court decisions, the arbitral tribunal found that 'there were four indicia on the basis of which an arbitral tribunal may, in general terms, base its assumption of illegality: a) the inability of the agent to provide evidentiary proof of his activities, b) the duration of the agent's intervention, c) the manner and method of remunerating the agent, and d) the amount of money agreed to be payable to the agent as compared to the advantages obtained by the principal' (A. Crivellaro, *supra* note 1 at 141). The tribunal found that the consultancy contract had been entered into with the intent of conducting bribery and, as such, was contrary to international public policy and therefore void. See also the final award in ICC case 12990 hereinafter and the final award in ICC case 6497, (1997) XXIV Y.B. Comm. Arb. 71.

<sup>30</sup> cf. ICC case 12990 hereinafter; ICC case 6497, (1999) XXIV Y.B. Comm. Arb. 71.

<sup>31</sup> In ICC case 13914 hereinafter the tribunal interpreted the claimant's refusal to produce the requested documents as a red flag.

### Checklist 1: Circumstances triggering further investigation by the arbitral tribunal *sua sponte*

- The main contract is related to a country rated high for corruption.
- The principal in the main contract is a state, an entity under state control or a publicly listed company.
- The main contract relates to a sector prone to corruption, e.g. defence, public health, construction.
- There is a contract with an intermediary, e.g. for agency, consultancy or facilitation services, joint activity (agency contract)
- The subject matter of the agency contract is not tangible.
- The agent's fees are established as a percentage of the value of the main contract to be awarded and the amounts are unreasonably high in comparison to the work to be done by the agent.
- The agent's fees are payable only after the main contract has been awarded or after the payments under the main contract have been made.
- If the main contract is not awarded, the fees are not payable and any costs incurred are not reimbursable.

### Checklist 2: Non-exhaustive list of circumstantial evidence of contracts involving corruption

- The agent was recommended by officers of a party to the main contract.
- There is no substantial time gap between the execution of the agency contract and the date when the main contract was awarded to the principal.
- The agent does not have an office at the place designated for the performance of obligations under the agency contract.
- The agent does not maintain a real office.
- The agent does not have sufficient personnel capable of carrying out work corresponding to the stated value of the service to be provided.
- There are no substantial records confirming performance under the agency contract, e.g. time sheets of employees, minutes of meetings, reports about work performed, exchanges of correspondence.
- The real beneficiaries of the agent are unknown or its shareholders (beneficiaries) are people capable of influencing the execution or performance of the main contract.
- The nature of such influence is unclear.
- The agent is registered in a tax-free territory.
- The agent has only nominal directors (usually residents of tax-free territories or lawyers).
- The agent's fees are payable into an account in a country other than where the agent is incorporated.
- The agent has no prior history of activity.
- The agent has no website.

### Checklist 3: Non-exhaustive list of information disproving that the contract is a cover-up for bribery

- ❑ Existence of personnel qualified to do the work described in the agency contract.
- ❑ Records showing that such personnel is already engaged in the performance of work, e.g. employee time sheets, payslips.
- ❑ Documents describing the work performed, when and by whom.
- ❑ Information about previous projects implemented by the agent.
- ❑ Information on the extent to which the agent's fees are consistent with market rates.
- ❑ External opinion of auditors commissioned to check cash flows confirming that the fees paid to the agent were spent lawfully.