Corruption and International Arbitration

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The effect of allegations of corruption of international arbitration proceedings, in particular in relation to the jurisdiction of the tribunal and the enforcement of awards

Most developed systems consider corruption1/ to be *contra bonos mores* and illegal, and prescribe that agreements tainted by corruption are unenforceable.2/

Such principles are arguably part of international public policy (or order public international), which is that body of rules shared by civilized nations that reflect fundamental economic, legal, moral, political, religious, and social values.3/

This paper addresses the effect of allegations of corruption on international attribution proceedings, in particular in relation to the jurisdiction of the tribunal and the enforcement of awards.4/

1. Hypothetical case study

Let us consider a hypothetical case study. Of course, this scenario is fictitious as are the names of the companies and any persons referred to.

City Power Limited, an aggressive international power company, bids for the construction of a power station in Corruptia, a country of dubious morals. City Power understands that in order to have any chance of obtaining the construction contract, worth $100 million, it must persuade the President of Corruptia, Dr. Backhander (which is understood to be very close to the President) whereby Mr. Persuader agrees to assist City Power with its bids. Mr. Persuader is to be aid $5 million for his services. The agreement contains an arbitration clause.

City Power is awarded the contract and Mr. Persuader asks City Power for payment of his fees. When City Power resists, Mr. Persuader starts arbitration against City Power. City Power argues that the payment of Mr. Persuader was intended to be used to bride the President, and that therefore the contract is illegal and unenforceable. Mr. Persuader responds that no brides were paid or ever intended to be paid, and his fees are to cover the costs of legitimate lobbying. Let us call this the “Persuader arbitration”.

Two years after the contract was awarded to City Power, and near the end of the construction period, there is a change of Government in Corruptia, and President Backhander is replaced by President Clean. The new regime cancels the power station contract, on grounds that it was obtained by corruption. City Power denies this allegation (contrary to what it is arguing in the other arbitration) and brings arbitration proceedings against the State of Corruptia, for damages and loss of profit running to millions of dollars. Let us call this the “City Power Arbitration”. In response, the State of Corruptia starts litigation proceedings in Corruptia against City Power seeking a declaration that the construction contract is void, and an injunction enjoining City Power from continuing with the arbitration. Let us call this the “Corruptia litigation”.

2. Jurisdiction of the tribunal

The first question for any tribunal being asked to determine issues of corruption is whether it has jurisdiction. If the contact is illegal, then it would be *void ab initio* and it follows that the arbitration clause should be ineffective.

Recognizing that "*corruption is an international evil"* and *"countrary to good morals and to an international public policy common to the community of nations",* Judge Lagergren famously stated in an arbitration award in 1963 that:5/

"It cannot be contested that there exists a general principle of law recognized by civilized nations that contracts which seriously violate bonos mores or international public policy are invalid or at least unenforceable and that they cannot be sanctioned by courts or arbitrators".

Judge Lagergren went on to add:6/

"*Parties who ally themselves in an enterprise of the present nature must realize that they have forfeited any right to ask for assistance of the machinery of justice (national courts or arbitral tribunals) in settling their disputes.*

Judge Lagergren concluded that an arbitral tribunal does not have jurisdiction where there is a *prima facie* case of corruption.

This is no longer the generally accepted view/7. It is now considered appropriate, in most cases for an arbitral tribunal to assume jurisdiction and determine whether or not there has been corruption that would render the contract illegal.

This modern approach is based on certain fundamental principles underlying international commercial arbitration:

1) First, if the parties have agreed to have any disputes determined by arbitration, that agreement should be respected/8.
2) Secondly, the principles of competence-competence. Under most arbitral rules and national laws the arbitral tribunal has the power to determine its own jurisdiction/9, i.e. it is for the tribunal to determine whether or not a contract is illegal.
3) Finally, the principles of sever ability of the arbitration clauses, i.e. the illegality only goes to the substance of the main contract and not to the arbitration clause.

Accordingly, the tribunal is entitled to hear the submissions of the parties and receive evidence to determine for itself the question of illegality. This has been accepted by many States courts, e.g. in England/10, Switzerland, 11/ and the US/12.

There may be cases where it is not appropriate and the English court has recently suggested that an arbitral tribunal should decline jurisdiction if the nature of illegality impeaches the arbitration clause itself/13. Thus, as an exception to the sever ability principles, if the corruption impeaches the attribution clause, as well as the main contract, then the attribution agreement is also illegal and void/14.

In our two hypothetical Persuaders and City Power arbitrations, it is very likely that the respective tribunals would assume jurisdiction and proceed to hear evidence on whether or not contracts are tainted by legality.

The City Power tribunal might be affected, however, by the Corruptia Litigation. For the reasons stated above, it generally accepted that all disputes arising out of a contact with an arbitration clause, including allegation of corruption, should be determined by arbitration.

This was not the approach recently taken by the Pakistan Supreme Court in *Hubco –v- WAPDA/15.* The Pakistan court concluded that the allegation of corruption made by WAPDA against Hubco must be determined by the court and not the arbitral tribunal and granted an injunction enjoining Hubco from proceeding with an arbitration against WAPDA.

It is hoped, however, that the courts of Corruptia would stay or dismiss the litigation proceedings brought by the State of Corruptia, deferring the substance of the dispute to the tribunal in the City Power arbitration.

3. Determining the substance of the dispute

Assuming the arbitral tribunal takes jurisdiction, the tribunal must then determine whether or not the relevant agreements are tainted by corruption, and are, as a result, unenforceable.

Some tribunals have found that the contract was illegal/16. Other tribunals have allowed a claim for "commission" where the agreement was entered into prior to the enactment of prohibitory legislation/17. Of course, there have also been tribunals, which have found the agreements to be perfectly legal.

In any case, the allegation of corruption must be proved on the balance of probabilities. The tribunal cannot base its decision on a more suspicion of corruption/18.

There is, however, some support for the arguments that whilst it is for alleging party to raise and prove corruption, the tribunal should not allow itself to be used by the parties to sanction conduct which is illegal, and should address issues of corruption *ex officio* or of its own motion if it has suspicions that the parties are colluding in hiding the truth/19.

4. Enforcement of the award

An award may be challenged and\or enforcement refused if the award and\or its enforcement is contrary to public policy (see Articles 34 and 36 of the NUCITRAL Model Law/20, and Article V.2(b) of the New York Convention/21). An award that gives effect to corruption is generally considered to be contrary to public policy/22.

The public policy exception to enforcement/23 is an acknowledgement of the right of the State and its courts to exercise ultimate control over the arbitral process. There is tension, however, between: on the one hand, not wishing to lend the State's authority to enforcement of awards which contravene domestic laws and values; and, on the other hand, the desire to respect the finality of awards.

Corruption may arise at the enforcement stage of the award as a public policy issue in one of two ways. First, an award may be challenged if the making of the award itself was induced or

affected by corruption. Secondly, an award may be challenged on the basis that the tribunal did not give due consideration to the allegations of corruption raised during the arbitration proceedings.

(a) Challenge to the making of an award

Let us imagine that the City Power tribunal renders an award in favor of City Power, but President Clean soon discovers that the members of the tribunal have started enjoying lavish lifestyles beyond that usually expected of the humble international arbitrators. An investigation agency discovers that the arbitrators have had monies paid into their wife's accounts from a Liechtenstein trust believed to be connected to City Power.

There is undoubtedly international consensus that enforcement of an award should be refused i its making was induced or affected by corruption/24.

For example, Australia/25, New Zealand/26, India/27, and Zimbabwe/28 have enacted modified versions of the UNCITRAL Model Law, which provide that, "*for the avoidance of doubt"* and "*without limiting the generality"* of Articles 34 and 36 (for the Model Law), an award is contrary to public policy if: "*the making of the award was induced or affected by fraud or corruption".*

The ICSID Convention includes as one of the grounds for annulment of an award: *"that there was corruption on the part of a member of the Tribunal"* (Art. 52(c)).

There are differences of opinion as to the whether the corruption must be shown to have affected the outcome. We should submit that as with fraud/29, corruption involving the tribunal should make the award unenforceable without having to prove its effect but corruption by the successful party must have influenced the outcome before the enforcement is refused.

Allegations that the tribunal was corrupt were raised during the enforcement of the award in *AAOT Foreign Economic Association (VO) Technostroyexport ("Techno") –v- International Development and Trade Services Inc ("IDTS")/30* in the US courts. A dispute between the Techno and IDTS under a sales contract was referred to a tribunal consisted by the Chamber of Commerce in Moscow. Techno sought to enforce an award in its favor in the US courts. IDTS opposed the enforcement claiming that it was contrary to public policy because the tribunal has been bribed (having themselves earlier enquired as to the whether the tribunal could be bought) IDTS was aware of the possibility that the tribunal was corrupt by had remained silent until an adverse award was rendered. For this reason, the US Court of Appeal held that even if the allegations were made out, IDTS has waived its right to object to the award on this basis. IDTS should had at least informed opposing counsel of it suspicions. If Techno had insisted on proceeding with the arbitration, then IDTS could have reversed its objections and been free to raise them in the enforcement proceedings.

(b) Challenge to the substance of an award

As noted above, the courts of most developed legal systems will not enforce an arbitral award that upholds corruption. But there is considerable debate as to whether and to what extent the enforcement court should review a finding of the arbitral tribunal that corruption was not proved and the contract was legal. There is further debate as to whether the enforcement court should enforce a contract which is legal under its governing law but may be illegal under the law of the place of enforcement.

These issues can best be illustrated by looking at three recent English cases.

(i) Westacre/31

In that case, allegations of corruption arose in the context of a consultancy agreement for the procurement of contracts for the sale of military equipment in Kuwait. It was alleged that *Westacre* had bribed various Kuwaitis to exercise their influence in favour of entering sales contracts in violation of Kuwaiti law and public policy. The agreement was governed by Swiss law (but performed in Kuwait) and provided for arbitration in Switzerland. The tribunal rejected the allegation of corruption, confirming that it was straightforward commercial contract. The tribunal found that lobbying by private enterprises to obtain public contracts not as such an illegal activity, nor were contracts to carry out such activities illegal under Swiss law/32.

The award was first challenged in the Swiss Federal Court. One of the parties sought to bring new allegations of corruption (some allegations of corruption already having been considered and rejected by the tribunal). The Swiss Federal Court rejected the claim on the basis that allegations of corruption had already been dealt with and rejected by the arbitral tribunal. As there is no right of appeal from the decision of an arbitral tribunal in Switzerland, the award was enforceable.

The award was subsequently challenged in the English courts, these new allegations of corruption again being raised. The English courts emphasized that it was award, not the underlying contract, that was being enforced. The award was valid in accordance with the law of the seat of the arbitration, i.e. Swiss law, which has been chosen by the parties. It was rendered by attributors who, having jurisdiction, applied the law governing the contact, which was also Swiss law/33. Colman J (at first instance) emphasized that the conclusion was not be read as in any sense indicating that the English Commercial Court was prepared to turn a blind eye to corruption on international trade, but rather as an expression of its confidence that if the issue of illegality by reason of corruption was referred to high caliber ICC arbitrators and duly determined by them, it would be entirely inappropriate in the context of the New York Convention that the enforcement court should be invited to retry that very issue in the context of a public policy submission/34.

Accordingly, both the first instances court and the Court of Appeal held that the public policy of sustaining international arbitration awards outweighed the public policy in discouraging international commercial corruption where the corruption had been considered and determined by the tribunal. There was nothing on the face of the award to indicate the alleged corruption, nor that the contract was indisputably illegal. Moreover, the new allegation raised did not raised did not arise out of fresh evidence but were based on facts and material which could have been brought before the arbitral tribunal/35.

(ii) Soleimany v. Soleimany/36

It is only in the case as *Soleimany* where the allegation of illegality in apparent on the face of the award that the court will look behind the award and consider the allegations of corruption or other forms of illegality at the enforcement stage. In that case, the court was concerned with an award made by the Beth Din (the Court of the Chief Rabbi in London) under Jewish law, which enforced an agreement between a father and son for the smuggling of carpets out of Iran, in breach of Iranian revenue laws and expert controls. The tribunal recognized the illegality of the

enterprise but held it to be of no relevance, under Jewish law, to the rights of the parties to the sale proceeds. The English court, however, refused to enforce the award because it was plain on the face of the award that the contract was illegal and countrary to English public policy.

(iii) OTV v. Hilmarton/37

In *Omnium De Traitment ae de Valorisation S.A. v. Hilmarton Limited,* Hilmarton was engaged to approach public servants and the government officials with a view to obtaining a drainage project in Algeria for OTV. The consultancy agreement was governed by Swiss law and provided for arbitration in Switzerland. Such activity was in breach of Algerian law, which prohibited the intervention of middlemen in connection with any public contract within the ambit of foreign trade. Hilmarton brought a claim for unpaid consultancy fees. The tribunal, sitting in Geneva and applying Swiss law, made an award in favor of Hilmarton. The tribunal found that absent any evidence of bribery, the agreement was not unlawful under Swiss law/38. OTV sought to resist enforcement of the award in England. Timothy Walker J emphasized that he was adjudicating upon the award not the underlying contract. He acknowledge that an English arbitral tribunal applying English law may have reached a different result/39, but unlike the *Soleimany* case, which involved "*quite simply a smuggling contract"/40,* there was no element of corruption or illicit practice on the arbitrator's unchallengable findings of fact that the contract was legal under Swiss law, this being the governing law of the contract.

(iv) Summary of English position

To state the situation at its barest simplicity, the contract in *Soleimany* was clearly for smuggling an illegal act internationally condemned. In contrast, the contracts in *Westacre* and *Hilmarton* were for lobbying rather than outright corruption. Whether there should be such a distinction between contracts which involve any form of bribery or corruption in another matter (being addressed elsewhere at this conference).

Accordingly, it is only in cases where the alleged act of illegality is serious enough to be universally condemned, such as actual corruption, that the English courts will go behind the award and review the underlying contract.

(v) Public policy in European courts

The situation in various European courts appears to be difficult. For example, the Paris Court of Appeal appears to be more willing to carry out a full scale review of the award, as indicated by *European Gas Turbines SA –v- Westman International Ltd/41,* where the court opined that a review of an international award by an annulment court under the public policy exception (Article 1502.5 of the Code of Civil Procedure – *ordre public international)* concerns all legal and factual elements justifying (or not) the application of the international public policy rule, including the evaluation of the validity of the contract according to this rule.

5. Conclusion

In most cases, arbitral tribunals faced with allegations that a contract is tainted by corruption will assume jurisdiction and go on determine the substantive issues. The international condemnation of corruption is given effect in most legal systems and transactions tainted by bribery or corruption is considered illegal and unenforceable. An award which gives effect to corrupt transactions, will not enforced by most national courts, as being contrary to public policy. But

some national are reluctant to review the finding of the arbitral tribunal. Less outright forms of corrupt activity, such as the purchase of personal influence, continue to cause factual, legal and policy difficulties.

It is hoped that City Power's arrangements with Mr. Persuader were revealed for what they truly were – as corruption in its worst from or simply expensive public relations – and justice was done.

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Notes:

1 it is beyond the scope of this paper to attempt to define what does not constitute, but see Article 1 of the 1997 OECD *Convention on Combating the Bribery of Foreign Officials International Transactions,* signed on 17 December 1997, and which came into effect on 15 February 1999. some jurisdictions make a distinction between on the one hand the paying of brides, which are held to be illegal, and on the other hand commissions or agreements to exert personal influence, which are considered to be legal.

2 As Gary Born stated in his book, *International Commercial Arbitration* (Kluwer, 2001). "*… it is hornbook law in developed legal system that an illegal agreements is generally not enforceable" p208.* See for example, in the Paris Court of Appeal, *European Gas Turbines SA –v- Westman International Ltd, 30 Sept. 1993, (1994) Rev. Arb. 359,* and reported in (1995) XX Yearbook 198 and in England, Chitty on Contracts (28th end. Sweet & Maxwell, 1999), chapter 19; and *Lembda Trading Co Ltd v African Middle East Petroleum Co Ltd* [1998] I All ER 513, [1998] QB 448 per Walter LJ.

3 See Report on "Public policy as a ground for refusing enforcement for foreign arbitral awards" (2000), published by International Commercial Arbitration Committee of the International Law Association.

4 See also Koheri and Leboulanger, "L'arbitrage face a la corruption et aux traffics d'influence", (1984) *Rev. Arb.3;* Mayer, "Le contrat illicit ", (1984) *Rev. Arb. 205;* Oppetit, "Le paradoxe de la corruption a l'epreuve du droit du commerce international", (1987) 1 *JDI* 5; Mayer, "La regle morale dans l'arbitrage international", *Etudes Pierre Bellet* (Litec, 1991); Heuze, "La morale, l'arbitre et le juge", (1993) *Rev. Arb.* 179; Derains, "La lutte contre la corruption – Le point de vue de l'arbitre international", *Contribution au Congres* AIJA, Montreux 1996; Knoepfler, "Corruption et arbitrage international", *Droit International Prive et Arbitrage* 357; Rosell and Prager, "Illicit Commissions and International Arbitration: The Question of Proof", (1999) 15 *Arbitration International* 329.

5 Published in (1994) 10 *Arbitration International* 277, at 293

6 Ibid., p. 294.

7 See A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration,* London, Sweet & Maxwell, 1999, pp. 152 – 153; Kosheri and Leboulanger, supra n. 4; and Oppettit, supra n. 4.

8 *Harbour Assurance* Co (UK) – v – *Kansas International Assurance* Co. [1993] QB 701 at 710 per Ralph Gibson LJ, where he recognized the most important policy consideration is to give effect to the wishes of the parties unless there are compelling reasons of principle why it is not possible to do so. Though not a corruption case, it did concern an illegal contract.

9 See, for example, Article 21 UNCITRAL Arbitration Rules; Articles 6.2 and 6.4, ICC Rules; Article 23, LCIA Rules; and Article 41, ICSID.

10 *Harbour Assurance,* supra n. 8 at 710 per Ralph Gibson LJ. Though not a corruption case, it did concern an illegal contract.

11 Decision of the Swiss Federal Tribunal in *National Power Corporation (Philippines)* v Westinghouse (USA), 2 September 1992.

12 See, for example, *Prima Paint Corp. –*v- *Flood & Conklin Manufacturing Co.,* 388 U.S. 395 (1967) at 403 – 404 per Fortas J; *and Republic of Philippines v Westinghouse Electric Corp.* 714 F.Supp, 1362 (DNJ 1989); and G. Born, supra n.2, p55-74 and p197-201.

13 *Westacre Investments Inc. v. Jugoimport – SDPR. Holding Co. Ltd, The Times,* 26 November 1998, where the English Court of Appeal held that a clause in a gaming agreement which contained an arbitration clause could not survive independently because the transaction breached the Gaming Act 1985 and the arbitration clause was part and parcel of the void agreement. See also Mustill & Boyd, *Commercial Arbitration,* 2001 Companion Volume to the Second Edition, Butterworths, London 2001, p317.

15 Published in (2000) 16 *Arbitration International* 431.

16 See, for example, ICC case 3916 (1983) (unpublished) referred to in Kosheri, supra n.4; and ICC case 8891 (unpublished) referred to in Rossel and Prager, supra n.4, in which the tribunal itself raised the issue of illicit commissions and invited submissions, are noted in its award that the illicit character of contracts for the payments of brides was well established in arbitral jurisprudence and that arbitrators may properly base their decision in such matters on general principles of law and transnational public order.

17 See, for example, *Northrop Corp. –v- Triad* 593 F. Supp. 928 (1984)

18 *Westacre,* supra n.13 at 868 per Waller LJ reported what the tribunal stated, "*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 witness during the phase to established the facts of the case is entirely insufficient to form such conviction of the arbitral tribunal".*

19 See J. Rosell and H. Prager, supra n.4

20 United Nations Commission of International Trade Law ("UNCITRAL") Model Law on International Commercial Arbitration, as adopted by UNCITRAL on 21 June 1985, and recommended by the General Assembly of the United Nations to Members States on 11 December 1985 (Resolution No.40\72)

21 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signed in New York on 10 June 1985 (the "New York Convention"); *United Nations Treaty Series* (1959), vol.300, p.38, no.4739. The New York Convention has been ratified, accede of succeeded to by over 120 countries, although not all of those practical effect to the Convention. See also cases applying and interpreting the New York Convention reported in the International Council for Commercial Arbitration *Yearbook Commercial Arbitration (the "Yearbook")* (Kluwer, general editor A. van den Berg).

22 See supra n.2 and n.4

23 The principles relating to resisting enforcement of awards are similar to those apply to challenge of award.

24 See the example the Report of the UNCITRAL Commission, UN Doc. A\40\17, paras. 297 and 303.

25 International Arbitration Act 1974, s. 19(a). See Pryles, "Australia", *Handbook,* Suppl. 13, Sept. 1992, p.27; Jacobs, *International Commercial Arbitration in Australia* (The Law Book Company Ltd. 1992), para. 43.620; and Miller, "Public Policy in International Commercial Arbitration in Australia", (1993) 9 *Arbitration International* 167.

26 Arbitration Act 1996, article 36. See Kennedy-Grant, "New Zealand", Handbook, Suppl. 25, Jan. 1998, p.27; and also *NZ Law Commission Report No. 20* (1991), paras.403-404.

27 Arbitration and Conciliation Act 1996, article 48(2).

28 Zimbabwe Arbitration At 1996, section 36(3). See "Zimbabwe", *Handbook,* Suppl. 24, Oct. 1997, Annex I; and McMillan; "Zimbabwe Arbitration Act 1996", (2000) 15 *Mealey's Int. Arb. Rep 42.*

29 For an example of an award obtained by fraud in Germany, see BGH NIW 1990, 2199. The English court acknowledges that an award obtained by perjury is not enforceable in certain very limited circumstances: see *Westacre,* supra n.13. To enforce an award based on the testimony of a witness who had given a conflicting statement on a prior occasion has occasion has been held in United States no to contravene public policy: *Waterside Ocean Navigation Co. Inc. –v- International Navigation Ltd,* 737 F.2d 150 (2d Circ., 1984).

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30. 139 F.3d 980 (1998) US Court pf Appeal, 2nd Circ.

31 139 F.3d 980 (1998) US Court of Appeal, 2nd Circ.

32 *Westacre,* supra n.13.

33. Supra n.13, Colman J's description of the tribunal, at 578.

34. Supra n.13, at 600 per Colman J.

35. The Court of Appeal took a similar approach in *Soinco SACI –v- Novokuznetsk Aluminium Plant* [1998] 2 Lloyd's Rep. 337.

36. Supra n.13, at 887 per Mansell LJ.

37. [1998] 3 WLR 811.

38. *Omnium De Traitement et de Valorisation S.A. v. Hilmarton Limited* [1999] 2 Lloyds Rep 222 See S. Wade, "Westacre v. Soleimany: What policy? Which public?" [1999] *Int.* ALR 97 for a commentary of the *Hilmarton* case.

39. The case involved two awards: the first award was challenged, first in the Court of Justice in Geneva and then in the Swiss Supreme Court and was reversed. Following the several of the award, the original arbitrator resigned and the newly appointed arbitrator considered himself bound by the decision of the Swiss Supreme Court, on which he based his award. During these various proceedings, there were also proceedings in relation to both awards in the French courts, which were finally resolved by the French Supreme Court, see 12 *Mealey's Int'l Arb. Rep* July 1997, at I-l.

40. Supra n.37 at 224. See also Wade, supra n.37 p101; *Soinco,* supra n.34, where Waller LJ took a similar approach, taking note of Sir David Hirst and Mantell LJ in *Westacre.*

41. Supra n.37 at 225.

42. Decision dated 30 Sept. 1993, (1994) *Rev. Arb.* 359 and reported in (1995) XX *Yearbook* 198.