"IS THE CORRUPTION DEFENCE A BIG RED FLAG?": AN ANALYSIS OF THE POTENTIAL ABUSE OF THE CORRUPTION DEFENCE VIS-À-VIS RED FLAGS

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Abstract

Arbitral tribunals have often held that the claims of an investor will be defeated if it is found that the investment was procured through corruption. As a consequence, commentators have believed that the use of corruption as a defence to investor claims by States that have participated equally in the corruption gives the States a clear advantage. One wonders, however, whether the States can potentially abuse this advantage by implicating less culpable investors, purely for their own political or tactical advantages. This essay seeks to explore this question and understand whether the use of a low threshold of proof, such as the use of circumstantial evidence or red flags, by a tribunal can aggravate the potential abuse.

I. Introduction

It is trite that corruption in any form is "*universally illegal*"[1] as it allows parties to unfairly benefit at the expense of other parties and the economy of a State.[2] To combat the effect of illegally-procured investments, States have often argued that this very corruption is a defence against investor claims ["**the corruption defence**"].[3] A positive finding of corruption would usually have serious consequences for the investor, either rendering the investment null on account of the void investment contract or leaving the investor with no practical remedy due to the tribunal's lack of jurisdiction.[4] The corruption defence, as used in the context of arbitration, stems from the 1963 award rendered by Judge Gunnar Lagergren in ICC Case No. 1110, where he declined jurisdiction on the ground of violation of international public policy, *inter alia*, because the contract in question was centred around the bribery of Argentinian government officials.[5]

Despite these well-intentioned beginnings of the corruption defence, it has recently been used by host States for their own unilateral benefit, in cases where investments have been procured by the mutual corruption of the host State government officials and the investor.[6] At the same time, for equal participation in the corrupt activity, the State (or government officials involved) may bear no consequences for accepting a bribe from an investor and will have the benefit of an enforceable contract, while the investor may stand to have its claim dismissed before a tribunal, when neither

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1 R. Doak Bishop, *Toward a More Flexible Approach to the International Legal Consequences of Corruption*, 25(1) *ICSID REV. FOREIGN INV. L.J.* 63, 63 (2010).

2 *Id.* at 63.

3 World Duty Free Co. Ltd. v. Republic of Kenya, ICSID Case No. ARB/00/7, Award, ¶¶ 105–08 (Oct. 4, 2006), 17 ICSID Rep. 209 (2016); Metal-Tech Ltd. v. Republic of Uzb., ICSID Case No. ARB/10/3, Award, ¶ 110 (Oct. 4, 2013) [*hereinafter* "Metal-Tech"]; TSA Spectrum de Argentina S.A. v. Arg. Republic, ICSID Case No. ARB/05/5, Award, ¶¶ 164–68 (Dec. 19, 2008).

4 ALOYSIUS P. LLAMZON, CORRUPTION IN INTERNATIONAL INVESTMENT ARBITRATION 221 (2014).

5 J. Gillis Wetter, *Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case No. 1110*, 10(3) ARB. INT'L 277, 282–94 (1994).

6 Mathew Reeder, *Estop That! Defeating a Corrupt State's Corruption Defense to ICSID BIT Arbitration*, 27(3) AM. REV. INT'L ARB. 311, 316 (2016).

party should be allowed to unjustly benefit directly or indirectly from the corruption.[7] In furtherance of this, it has been surmised by some commentators that some States may potentially find this situation so attractive, that they may use the corruption defence for their own tactical and political agenda.[8] In other words, there is potential for States (acting through their government officials) to abuse the corruption defence to gain political or tactical advantage, such as the downfall of their political rivals. For instance, consider the political uprising witnessed in Egypt in 2011, which resulted in the termination of the rule of long-time President, Hosni Mubarak's government.[9] During the political coup, an Israel-based gas company brought arbitral proceedings against the Egyptian Natural Gas Holding Company and the Egyptian General Petroleum Corporation for breach of a gas concession contract.[10] The Respondents, operating under the nascent Mohammad Morsi-led government, alleged that the contract was void since it had been procured through corruption under the overthrown Mubarak government.[11] More specifically, they alleged that the Claimant had bribed the then Minister of Petroleum, Sameh Fahmy, to obtain the contract.[12] While there is no doubt that Egypt's government had long been riddled with claims of corruption,[13] the timing and manner of the Respondents' reliance on the corruption defence is rather suspicious. This suspicion arises *first*, because the corruption defence was used by the Respondents against Fahmy consistently throughout the arbitral proceedings even though he was acquitted of all bribery charges by the Egyptian Court of Cassation,[14] and *second*, it was used to accuse Fahmy, an appointee of Morsi's political rival, Hosni Mubarak, in the midst of the political coup.

In recounting these events, this essay does not opine on the alleged corruption of Fahmy and whether there was any abuse of the corruption defence. Additionally, the essay does not, in any manner, suggest that any form of corruption be condoned. What the essay does observe, however, is the curiously suspicious timing of events, which adds value to the apprehension of abuse of the corruption defence for political agendas that has recently been the subject of serious discussion.[15] In fact, commentators have gone so far as to question if the potential abuse of the corruption defence could be exacerbated by the use of a low threshold of proof of corruption, comprising purely '*red flags*' or indicators of corruption based on circumstantial evidence ["**the red flag**

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7 *Id.* at 316.

8 Nikhil Gore & Amanda Tuninetti, *Gazprombank v Belarus: the value of requiring direct evidence to support illegality allegations,* GLOBAL ARBITRATION REVIEW (July 13, 2020), *available at* https://globalarbitrationreview.com/article/1228561/gazprombank-v-belarus-the-value-of-requiring-direct-evidence-to-support-illegality-allegations [*hereinafter* "Gore & Tuninetti"]; LLAMZON, *supra* note 4, at 237.

9 Clayton Swisher, *Egypt's Lost Power*, AL JAZEERA, June 9, 2014, *available at* https://interactive.aljazeera.com/aje/2014/egyptlostpower/index.html.

10 East Mediterranean Gas S.A.E. v. Egyptian Nat'l Gas Holding Co., Egyptian General Petrol. Corp., Israel Elec. Corp. Ltd., ICC Case No. 18215/GZ/MHM, Award, ¶ 20 (Dec. 4, 2015) [*hereinafter* "East Mediterranean Gas"].

11 *Id.* ¶ 180.

12 *Id.* ¶¶ 484–91.

13 Swisher, *supra* note 9.

14 Omar Fahmy, Yara Bayoumy & Stephen Powell, *Egypt court acquits ex-oil minister of corruption charges*, THOMSON REUTERS, Feb. 21, 2015, *available at* https://in.reuters.com/article/uk-egypt-court/egypt-court-acquits-ex-oil-minister-of-corruption-charges-idUKKBN0LP0GF20150221.

15 Gore & Tuninetti, *supra* note 8; John Branson & Raúl Manon, *Why tribunals should not ignore "red flags" of corruption,* GLOBAL ARBITRATION REVIEW (Aug. 12, 2020), *available at* https://globalarbitrationreview.com/article/1229354/why-tribunals-should-not-ignore-%E2%80%9Cred-flags%E2%80%9D-of-corruption [*hereinafter* "Branson & Manon"].

threshold"], thus allowing States to take liberties with the arbitral process by raising facile claims of corruption.[16]

This essay seeks to examine the likelihood of abuse of the corruption defence. For this purpose, Part II of this essay shall analyse the general consequences of the corruption defence and examine certain cases to understand the motivations behind actions of States. Part III of the essay shall examine the significance of the red flag threshold, specifically to observe if the threshold amplifies the likelihood of abuse of the corruption defence. Finally, the essay aims to understand what threshold of proof is best suited to international arbitration, to avoid possible exploitation of the corruption defence.

II. The corruption defence and evidence of its misuse

A. The consequences of using the corruption defence

The tribunal in *World Duty Free Company Ltd.* v. *Republic of Kenya* was the first tribunal constituted under the International Centre for Settlement of Investment Disputes ["**ICSID**"] to adjudicate on a matter where the State relied on the corruption defence. The facts posed what was, at the time, a unique situation – the invocation of '*corruption*' as a defence by a State to the investor's contract-based arbitration claim, after the investor admitted to paying bribes, which had allegedly been solicited by the President of the State.[17] Despite the unequivocal proof of corruption stemming from both the investor and the Kenyan President, the Tribunal ultimately dismissed the investor's claims on the ground that these actions of the Kenyan President could not be imputed to the Kenyan State.[18] The Tribunal's acknowledgment that corruption operates as a complete defence[19] has had a significant impact on investment arbitration.[20] The paradigm set for the corruption defence appears to be that even though in most cases, States are as culpable as the investor for corruption, they may escape liability leaving the investor to bear the brunt of the consequences.[21]

Following in these footsteps, many host States have attempted to unilaterally rely on the corruption defence to dismiss investor claims, despite the "*inherently bilateral nature*" of corruption.[22] It has been argued that this paradigm has given host States a somewhat superior position[23] and given the thrust of this benefit, the rise in the number of host States using the corruption defence[24] is unsurprising.

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16 Gore & Tuninetti, *supra* note 8.

17 World Duty Free, ICSID Case No. ARB/00/7, Award, ¶ 180 (Oct. 4, 2006), 17 ICSID Rep. 209 (2016).

18 *Id.* ¶¶ 169, 185.

19 *See* World Duty Free, ICSID Case No. ARB/00/7, Award, ¶ 188 (Oct. 4, 2006), 17 ICSID Rep. 209 (2016) ("The Claimant is not legally entitled to maintain any of its pleaded claims in these proceedings as a matter of *ordre public international* and public policy under the contract's applicable laws"); R. Zachary Torres-Fowler, *Undermining ICSID: How the Global Antibribery Regime Impairs Investor-State Arbitration*, 52 VA. J. INT'L L. 995, 1010 (2012) [*hereinafter* "Torres-Fowler"].

20 LLAMZON, *supra* note 4, at 199.

21 Torres-Fowler, *supra* note 19, at 1014–17; Jason Webb Yackee, *Investment Treaties and Investor Corruption: An Emerging Defense for Host States*, 52 VA. J. INT'L L. 723, 733 (2012) [*hereinafter* "Yackee"]; *see also* Michael A. Losco, *Streamlining the Corruption Defense: A Proposed Framework For FCPA-ICSID Interaction*, 63(5) DUKE L.J. 1201, 1233 (2014) [*hereinafter* "Losco"].

22 LLAMZON, *supra* note 4, at 199.

23 Margareta Habazin, *Investor Corruption as a Defense Strategy of Host States in International Investment Arbitration: Investors' Corrupt Acts Give an Unfair Advantage to Host States in Investment Arbitration*, 18 CARDOZO J. CONFLICT RESOL. 805, 807 (2017).

24 LLAMZON, *supra* note 4, at 198–99; *see also* Tamar Meshel, *The Use and Misuse of the Corruption Defence in International Investment Arbitration*, 30(3) J. INT'L ARB. 267, 272–74 (2013) [*hereinafter* "Meshel"].

B. Evidence of misuse of the corruption defence through suspicious behaviour

Gore and Tuninetti observe that the '*superior position*' granted to States from the corruption defence could potentially leave gaping opportunities for them to raise frivolous claims of corruption for political or tactical reasons.[25] They compound their concern by arguing that a low threshold of proof of corruption, such as the red flag threshold, will simply aid States in such endeavours.[26]

Others, such as Branson and Manon, however, insist that the increasing use of the corruption defence by host States cannot be imputed to pure tactics.[27] Rather, they argue that the use of the defence is more likely a result of a zero-tolerance policy toward corruption.[28] Therefore, they suggest that the red flag threshold is sufficient to prove a case of corruption when there is absence of direct evidence and consequently, there is no necessity to rely solely on the 'clear and convincing' standard of proof of corruption.[29] No doubt, the merit to upholding the red flag threshold of proof is undeniable due to the comparative ease with which this threshold can be met.[30] However, Branson and Manon's suggestion is primarily premised on the belief that increasing use of the corruption defence cannot be attributed to pretextual or tactical reasons. This premise, *first*, ignores the fact that the current apprehension is centred around the very real potential or possibility for misuse of the corruption defence rather than a confirmed and definite use of the corruption defence by States purely for tactical reasons. *Second*, while their premise is not without merit in regard to certain cases where States may have adopted a zero-tolerance policy towards corruption, it unjustifiably envelops every single host State (along with its government officials) into a paradigm of virtuosity in foreign investment, devoid of corrupt practices. In fact, Doak Bishop notes at least one case of corruption where the government of a host State and its President actively took no steps to curb the solicitation of bribes by public officials, despite having sufficient time and being adequately notified to put an end to the practice.[31] Therefore, irrespective of their suggestion to abide by the '*clear and convincing*' standard, Gore and Tuninetti's apprehension regarding agenda appears to be a valid one.

Admittedly, it is difficult to find direct evidence to aid this postulation. Torres-Fowler asserts, however, that this should be no surprise given the power wielded by the host States over investors in return for their promise not to alert law enforcement bodies of the investors' alleged corruption.[32] In any case, the following pieces of indirect contemporary evidence coupled with the ubiquitous character of corruption make it impossible to disregard the argument's merit.

i. Politically-strategic action taken by States

The first bit of evidence comes from cases where it appears that the host States (or their public officials acting in official capacity) may have claimed the corruption defence to achieve their political goals. The aforementioned gas-concession scenario in Egypt serves as a prime example.[33] As earlier mentioned, Egypt's State entities responded to the contract-based arbitration claim of

25 Gore & Tuninetti, *supra* note 8.
26 *Id.*
27 Branson & Manon, *supra* note 15.
28 *Id.*
29 *Id.*
30 *See infra* notes 71–77 and accompanying text.
31 Bishop, *supra* note 1, at 65.
32 Torres-Fowler, *supra* note 19, at 1018.
33 *See supra* notes 9–14 and accompanying text.

East Mediterranean Gas by relying on the corruption defence, claiming that EMG had bribed the then Minister of Petroleum, Sameh Fahmy to alter the tender process to give it an advantage.[34] The Tribunal, however, observed that Fahmy was being implicated despite having been acquitted of corruption charges by the Egyptian Court of Cassation and therefore, the State entities' claim had failed to satisfy even the most minimal threshold of proof of corruption.[35] The Egyptian government's reliance on the corruption defence implicating Fahmy, who was acquitted, would curiously give it a distinct political advantage in consideration of the fact that it just so happened to be taking over from the previous Mubarak-led government that Fahmy had represented at the very same time.

Similarly, following a raid ordered by the Belarusian National Bank on the offices of Belgazprombank (a bank owned mainly by the Russian financial institutions Gazprom and Gazprombank Commercial Bank), Belarusian authorities arrested Belgazprombank's senior executives and appointed new key personnel. Belarus claimed that the crackdown resulted from an investigation into tax evasion[36] with the Belarusian President, Alexander Lukashenko, accusing the former head of Belgazprombank, Viktor Babariko, of corruption.[37] Gazprombank responded by threatening to bring international action against Belarus, possibly under the Treaty on the Eurasian Economic Union.[38] Notwithstanding Gazprombank's previous trysts with corruption charges in Venezuela[39] and Switzerland,[40] Belarus's actions in this case appear suspiciously political when one notes the following facts: *first*, it alleged corruption against Babariko in June, right before the upcoming Belarusian presidential election in August 2020, where Babariko was the top rival of President Lukashenko;[41] *second*, Babariko, a contender for the presidential election, was suddenly arrested for alleged corruption exactly two months prior to the scheduled date for the election;[42] and *third*, Belarus' actions are set against the politically tense environment of deteriorating relations with the Russian government,[43] which is the primary shareholder of Gazprom.[44]

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34 East Mediterranean Gas, ICC Case No. 18215/GZ/MHM, Award, ¶¶ 571–82 (Dec. 4, 2015).

35 *Id.* ¶ 582.

36 Andrei Makhovsky, *Belarus unit of Gazprombank raided as Lukashenko cracks down on election opponents*, THOMSON REUTERS, June 11, 2020, *available at* https://www.reuters.com/article/us-belarus-election-idUSKBN23I1UG.

37 Andrei Makhovsky, *Belarus president accuses election rival of corruption after raid*, THOMSON REUTERS, June 12, 2020, *available at* https://in.reuters.com/article/belarus-election/belarus-president-accuses-election-rival-of-corruption-after-raid-idINKBN23J2AZ.

38 *Joint statement by Gazprombank and Gazprom regarding current situation with Belgazprombank,* GAZPROM (June 12, 2020), https://www.gazprom.com/press/news/2020/june/article507063.

39 Alexandra Ulmer, *France's Perenco, Russia's Gazprombank named in Venezuela graft case – source,* THOMSON REUTERS, Nov. 2, 2018, *available at* https://in.reuters.com/article/venezuela-pdvsa-companies-exclusive/exclusive-frances-perenco-russias-gazprombank-named-in-venezuela-graft-case-source-idINKCN1N663M.

40 Press Release, Swiss Financial Market Supervisory, FINMA concludes Panama Papers proceedings against Gazprombank Switzerland (Feb. 1, 2018), *available at* https://www.finma.ch/en/news/2018/02/20180201-mm-gazprombank-schweiz.

41 Makhovsky, *supra* note 37.

42 Linas Jegelevicius, *Victor Babariko, main rival of Alexander Lukashenko, barred from Belarus presidential election*, EURONEWS, July 30, 2020, *available at* https://www.euronews.com/2020/07/14/victor-babariko-main-rival-of-alexander-lukashenko-barred-from-belarus-presidential-electi; Gore & Tuninetti, *supra* note 8.

43 Brian Whitmore*, Is Russia's Pressure on Belarus Putting It in Play for the West?*, WORLD POL. REV. (Feb. 24, 2020), *available at* https://www.worldpoliticsreview.com/articles/28556/deteriorating-belarus-russia-relations-could-put-minsk-in-play-for-the-west.

44 GAZPROM'S SHARES, *available at* https://www.gazprom.com/investors/stock/ (last visited Jan. 25, 2021).

ii. Claiming "corruption" as an afterthought to defeat a claim or avoid an award

The second reason for suspecting the potential misuse of the corruption defence is the behaviour of certain States which, rather suspiciously, claim corruption after a prolonged period without any reasonable cause. Such delayed claims of defence appear to be an afterthought to defeat the arbitration itself or escape the consequences of an award. For example, in *Unión Fenosa Desarrollo y Acción Exterior, S.A.* v. *Arab Republic of Egypt* ["**Unión Fenosa**"], the Tribunal observed that the Claimant and the Egyptian General Petroleum Corporation had executed a Natural Gas Sale and Purchase Agreement ["**SPA**"] on August 1, 2000.[45] However, when the Claimant instituted ICSID proceedings against Egypt in 2015, Egypt turned to the corruption defence, claiming that the SPA had been procured through the Claimant's corruption. The Tribunal observed, among other things, that Egypt's belated objection had come 15 long years after the SPA had been signed and appeared to serve the tactical purpose of seeking to defeat or delay the investor's claim.[46] When faced with its delayed use of the corruption defence, Egypt did not deny having had prior knowledge of the alleged corruption, rather it simply asserted that there is no time bar to raise corruption claims in international arbitration.[47] This appears starkly different from a case where a State raises delayed claims of corruption due to the genuine lack of knowledge (or suspicion) regarding the corruption, despite having taken reasonable care.[48]

The events following the award passed by the tribunal in *Ron Fuchs* v. *Republic of Georgia*[49] offer yet another example. The ICSID tribunal, which was instituted upon the termination of an oil concession by Georgia, awarded the investor compensation of approximately USD 98 million on March 3, 2010.[50] Following the award, Ron Fuchs was arrested for bribery on October 14, 2010 and sentenced to seven years in prison in Georgia.[51] Georgia also filed an application for revision of the award on January 21, 2011, based on the fact that the alleged bribery of Mr. Fuchs was newly discovered during the investigation which was immediately followed by Mr. Fuchs' arrest.[52] This, however, appears incongruous with Fuchs' account that prior to his arrest, he had been pressed by Georgian officials to agree to a reduced value of award compensation, following which he had specifically been invited to Georgia by the Prime Minister, Nika Gilauri, on the pretext of arranging payment of the award.[53] Fuchs additionally claimed that Georgian officials had made his release from prison conditional on the forfeiture of the USD 98 million award against Georgia.[54]

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45 Unión Fenosa Gas, S.A. v. Arab Republic of Egypt, ICSID Case No. ARB/14/4, Award, ¶ 3.8 (Aug. 31, 2018) [*hereinafter* "Unión Fenosa"].

46 *Id.* ¶¶ 7.53, 7.111–112.

47 *Id.* ¶ 7.22.

48 *See* Fed. Republic of Nigeria v. Process & Indus. Dev. Ltd. [2020] EWHC (Comm) 2379 [239] (Eng.).

49 Ron Fuchs v. Republic of Geor., ICSID Case No. ARB/07/15, Award (Mar. 3, 2010).

50 *Id.* ¶ 693.

51 Luke Eric Peterson, *Georgian Authorities Arrest Foreign Investor on the Eve of ICSID Hearing and Charge Him with Corruption; Israeli Businessman and Greek Partner Release Text of $90 Million Arbitration Verdict Against Georgia*, INVESTMENT ARBITRATION REPORTER (Oct. 15 2010), *available at* https://www.iareporter.com/articles/georgian-authorities-arrest-foreign-investor-on-eve-of-icsid-hearing-and-charge-him-with-corruption-israeli-businessman-and-greek-partner-release-text-of-90-million-arbitration-verdict-against-georg.

52 Ron Fuchs v. Republic of Geor., ICSID Case No. ARB/07/15, Decision of the ad hoc Committee to suspend the Annulment Proceeding, ¶¶ 2–4 (Mar. 21, 2011).

53 Gornitzky & Co., *Israeli Hostage Rony Fuchs Will Appeal Conviction by Georgia to European Court of Human Rights, says Jailed Man's Lawyer, Archil Kbilashvili*, PR NEWSWIRE (Apr. 1, 2011), *available at* https://www.prnewswire.com/news-releases/israeli-hostage-rony-fuchs-will-appeal-conviction-by-georgia-to-european-court-of-human-rights-says-jailed-mans-lawyer-archil-kbilashvili-119061069.html.

54 *Id.*

Georgian authorities have since denied these allegations and claimed that the bribery charges have nothing to do with the ICSID ruling.[55] However, it is suspicious that after serving one year of his prison sentence, Fuchs was pardoned by the Georgian President and a sudden announcement was made that the parties had agreed to settle the dispute for USD 37 million, a significantly smaller sum compared to the award compensation.[56] The application for revision was also discontinued on December 21, 2011.[57] Even though this particular case does not concern the corruption defence, it is still pertinent to observe that after the award was declared in Fuchs's favour, Georgia attempted to obtain a settlement from Fuchs. Shortly thereafter, Georgia alleged corruption, arrested Fuchs and then requested a revision of the award. Further down the line, Georgia obtained a settlement and then discontinued the application for revision. Evidently, there is the likelihood that the claim of corruption was merely an afterthought, designed to obtain a tactical advantage of settlement for the State.

iii. Use of corruption allegations as leverage

The following sub-part observes those cases where investors have admitted to indulging in acts of corruption, while congruently assessing the behaviour of host States after such confessions have been made. These particular examples do not suggest or allude that States have made tactical accusations of corruption. In fact, it is clear that the investors have consented to the corruption, under no duress from the State. The focus, rather, is on the apprehension that host States may not necessarily be above using confessions of corruption to their advantage.

First is the case of *Siemens A.G.* v. *Argentine Republic*, where Siemens entered into a contract with Argentina to create official national identity cards for its public.[58] Four years later, Siemens instituted ICSID proceedings against Argentina, alleging unlawful expropriation of its investment due to a change in the regulatory framework.[59] However, shortly after winning an award of almost USD 218 million in 2007,[60] Siemens was investigated by German and American authorities for large-scale corruption. Subsequently, its key personnel confessed to procuring the contract by bribing Argentinian officials to American regulatory authorities.[61] Argentina responded by filing a request with the ICSID for a revision of the award.[62] It is important to note *first*, that there was no certainty regarding Argentina's success in the revision proceeding and *second*, that the Argentinian public officials were equally involved in the act of corruption as they had accepted the bribes. Despite this, Siemens chose to discontinue the arbitration proceedings, losing its USD 218 million

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55 Molly Corso, *Georgia: Israeli Bribery Case Puts Spotlight on Court System,* EURASIANET, Feb. 11, 2011, *available at* https://eurasianet.org/georgia-israeli-bribery-case-puts-spotlight-on-court-system.

56 Margarita Antidze, *Georgia pardons two Israelis jailed for bribery*, THOMSON REUTERS, Dec. 3, 2011, *available at* https://www.reuters.com/article/georgia-israel-businessmen-idAFL5E7N22IE20111202.

57 Natalia Charalampidou, *Range of Disputes under the Energy Charter Treaty*, 7 TRANSNAT'L DISP. MGMT. (2018), *available at* www.transnational-dispute-management.com/article.asp?key=2622.

58 Siemens A.G. v. Arg. Republic, ICSID Case No. ARB/02/8, Award, ¶¶ 81–97 (Feb. 6, 2007), 14 ICSID Rep. 518 (2009).

59 *Id.* ¶¶ 96–115.

60 *Id.* ¶ 403.

61 Press Release, U.S. Department of Justice, Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay $450 Million in Combined Criminal Fines (Dec. 15, 2008), *available at* https://www.justice.gov/archive/opa/pr/2008/December/08-crm-1105.html.

62 Luke Eric Peterson, *Argentina And Siemens Ask Annulment Panel To Suspend Proceedings, So Original Arbitrators Can Look At Bribes Evidence*, INVESTMENT ARBITRATION REPORTER (July 28, 2008), *available at* https://www.iareporter.com/articles/argentina-and-siemens-ask-annulment-panel-to-suspend-proceedings-so-original-arbitrators-can-look-at-bribes-evidence.

award.[63] It is believed that Siemens's decision to "walk away" from the massive award was motivated by Argentina's keenness to use the allegations of corruption to its advantage and the resultant impact of ongoing litigation on its reputation.[64]

In *Azpetrol International Holdings B.V.* v. *Republic of Azerbaijan*, the Claimant's director, Michael Booster, admitted to bribing Azeri officials to protect certain unnamed individuals in Azerbaijan while being cross-examined.[65] After his testimony, Booster retracted his admission claiming it had been untrue, however, the details of the confession had already been transferred to law enforcement officials in Azerbaijan, the Netherlands, and Britain.[66] The State allegedly used this confession to leverage its position, effectively ensuring that the Claimant would avoid bringing any more claims against it, for the fear that the State would reveal the details of the corruption.[67]

Torres-Fowler argues that if host States are allowed to benefit so publicly from confirmed cases of corruption where public officials partake in the bribery, there is a valid concern that future investors could be denied the protection of their investments even when they are in less culpable positions (having participated in the corruption under duress).[68]

While the evidence may not necessarily establish abuse in a concrete manner, the suspicious behaviour of States is sufficient to give legitimacy to the apprehension of misuse of the corruption defence by States for tactical or political purposes.

III. The increasing use of red flags to adduce corruption in arbitration

A. The transition from a higher threshold to a lower threshold of proof of corruption

Generally, tribunals hearing arguments on corruption in international arbitration would utilise standards of proof such as the clear and convincing evidence standard (which requires direct evidence of impropriety)[69] and a more nuanced approach to the balance of probabilities standard (where an allegation of impropriety must be proved on the basis of the entire body of direct and indirect evidence before it).[70]

Llamzon's seminal work on corruption, however, highlights the slow but steady expansion of evidentiary standards from these standards to include more flexible ones such as the red flag threshold.[71] Llamzon opines that tribunals were initially hesitant to move away from the higher standard of proof to establish corruption due to their acknowledgment of its serious consequences, some of which would include the invalidation of the contract, the unenforceability of the contract

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63 Luke Eric Peterson, *Siemens Waives Rights Under Arbitral Award Against Argentina, Follows Company's Belated Corruption Confessions*, INVESTMENT ARBITRATION REPORTER (Sep. 2, 2009), *available at* https://www.iareporter.com/articles/siemens-waives-rights-under-arbitral-award-against-argentina-follows-companys-belated-corruption-confessions.

64 Torres-Fowler, *supra* note 19, at 1028; Yackee, *supra* note 21, at 725.

65 Azpetrol Int'l Holdings B.V., Azpetrol Group B.V. and Azpetrol Oil Servs. Group B.V. v. Republic of Azer., ICSID Case No. ARB/06/15, Award, ¶ 6 (Sep. 8, 2009).

66 *Id.* ¶ 7.

67 Torres-Fowler, *supra* note 19, at 1023.

68 *Id.* at 1028; *see also* Losco, *supra* note 21, at 1233.

69 EDF (Servs.) Ltd. v. Rom., ICSID Case No. ARB/05/13, Award, ¶ 221 (Oct. 8, 2009) [*hereinafter* "EDF"]; Waguih Elie George Siag & Clorinda Vecchi v. Arab Republic of Egypt, ICSID Case No. ARB/05/15, Award, ¶¶ 325–26 (June 1, 2009) [*hereinafter* "George Siag"].

70 The Rompetrol Group N.V. v. Rom., ICSID Case No. ARB/06/3, Award, ¶ 183 (May 6, 2013).

71 LLAMZON, *supra* note 4, at 234–37.

or a finding of lack of jurisdiction.[72] Ironically, some tribunals encouraged this high burden of proof despite being cognisant of the practical difficulty in adducing direct evidence of corruption, as there tends to be little or almost no physical evidence of corruption.[73] This incongruous paradigm set by tribunals was adeptly summarised by the noted practitioner, Constantine Partasides QC as: "*Dear investor, you will inevitably find the allegation almost impossible to prove, but we are nonetheless going to raise the evidential hurdle to make it even harder*".[74]

This difficulty in procuring direct clear and convincing evidence of corruption led to a change in approach, with the Tribunal in *Metal-Tech Ltd.* v. *Republic of Uzbekistan* ["**Metal-Tech**"], being the first to allow corruption to be established through circumstantial evidence, which could establish corruption with reasonable certainty.[75] This expansion of evidentiary standards has proved to be a refreshing response to the innate difficulty in proving corruption.[76] In fact, according to Gaillard, "*[t]his practice should be applauded as an appropriate contribution of arbitrators' inherent fact-finding powers to the global fight against corruption*".[77]

B. The current red flag threshold

The *Metal-Tech* tribunal observed multiple red flags in the testimony of the Claimant's Chairman, which established corruption with reasonable certainty.[78] The fact that the Claimant hired the brother of the then-Prime Minister of Uzbekistan as a consultant, the consultants' lack of qualification to advise on the molybdenum industry, the disproportionately large fee paid to the consultants despite the tangible lack of services provided, and the absence of documentation regarding the consultancy contract and financial records of the transactions collectively pointed to corruption.[79] The Tribunal also drew adverse inferences from the Claimant's failure to provide additional documentary or testimonial evidence regarding the legitimacy of the consultancy agreement and services provided, when questioned.[80]

Similarly, the ICSID tribunal in *Spentex Netherlands, B.V.* v. *Republic of Uzbekistan*[81] ["**Spentex**"] found a USD 130 million claim to be inadmissible based purely on circumstantial evidence of corruption, such as the inordinately large sum of money paid to a consultancy firm, controversial payments made to accounts situated in known tax havens such as the British Virgin Islands, the consultancy firm's lack of qualification in that particular sector of business, the investor's failure to disclose the consultancy contracts, other documents regarding the consultancy services, and bank records of the transaction.[82] Additionally, on obtaining the contracts from the Respondent,

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72 *Id.*; *see also* Saba Fakes v. Republic of Turk., ICSID Case No. ARB/07/20, Award, ¶¶ 131–35 (July 14, 2010); George Siag, ICSID Case No. ARB/05/15, Award, ¶¶ 325–26 (June 1, 2009).

73 EDF, ICSID Case No. ARB/05/13, Award, ¶ 221 (Oct. 8, 2009); Lao Holdings N.V. v. Lao People's Dem. Republic, ICSID Case No. ARB(AF)/12/6, Award, ¶¶ 109–10 (Aug. 6, 2009); *see also* LLAMZON, *supra* note 4, at 236.

74 Constantine Partasides, *Proving Corruption in International Arbitration: A Balanced Standard for the Real World*, 25(1) ICSID REV. FOREIGN INV. L.J. 47, 56 (2010).

75 Metal-Tech, ICSID Case No. ARB/10/3, Award, ¶ 243 (Oct. 4, 2013).

76 Emmanuel Gaillard, *The Emergence of Transnational Responses to Corruption in International Arbitration*, 35(1) ARB. INT'L 1, 9–10 (2019).

77 *Id.*

78 Metal-Tech, ICSID Case No. ARB/10/3, Award, ¶¶ 240–43 (Oct. 4, 2013).

79 *Id.* ¶¶ 337–51.

80 *Id.* ¶ 245.

81 Spentex Netherlands, B.V. v. Republic of Uzb., ICSID Case No. ARB/13/26, Award (Dec. 27, 2016).

82 Vladislav Djanic, *In Newly Unearthed Uzbekistan Ruling, Exorbitant Fees Promised to Consultants on Eve of Tender Process are Viewed by Tribunal as Evidence of Corruption, Leading to Dismissal of All Claims Under Dutch BIT*, INVESTMENT ARBITRATION

the Tribunal also noted that the consultancy contracts contained no details about the services provided and only vague descriptions of the contract such as "*ensuring good support for the bid*".[83] Despite the lack of direct evidence, the Tribunal decided that if the dots marking individual pieces of circumstantial evidence were connected, corruption could be construed.[84] Evidently, the *Metal-Tech* and *Spentex* tribunals have centred the red flag threshold around five broad themes:

i. Relationships between the State officials and the investor or consultant (if any);

ii. Insufficient qualifications and absence of legitimate legal existence of the consultant;

iii. Unusually generous compensation paid to the consultant;

iv. Absence of legitimate documentation regarding the consultancy contract, duties, and services performed by the consultant; and

v. Absence of tangible work performed by the consultant.

These central themes have been reiterated recently in a toolkit entitled "*Corruption and Money Laundering in International Arbitration: Toolkit for Arbitrators*", which details various instances characterised within the aforementioned themes.[85] The toolkit adds another important central theme which is the poor reputation of the parties to the contract. In other words, that the State, investor or consultant may have a history of corruption and improper payment practices.[86] Therefore, the current red flag threshold is comprised of six central themes to identify corruption.

C. The practical problems with the current red flag threshold vis-à-vis the corruption defence

In spite of the aforementioned theoretical advantage over a high standard of proof, it appears that the current red flag threshold is not without practical limitations.

The first issue is that the present red flag threshold does not cover a broad enough spectrum of practical circumstances and situations. As observed above, it is apprehended by Gore and Tuninetti that States relying on the corruption defence have the resources to plant innuendo in the press at short notice and manufacture alleged red flags in many industries.[87] Considering Gore and Tuninetti's argument that it would not be difficult for governments to "*come up with*" red flags to dismiss investor claims, the limited range of circumstantial evidence currently in use could enable States to portray a case of corruption where there is none.[88] For instance, a State government that is currently in place could highlight a connection between the party (or the consultant) and a public

REPORTER (June 22, 2017), *available at* https://www.iareporter.com/articles/in-newly-unearthed-uzbekistan-ruling-exorbitant-fees-promised-to-consultants-on-eve-of-tender-process-are-viewed-by-tribunal-as-evidence-of-corruption-leading-to-dismissal-of-all-claims-under-dutch.

83 *Id.*

84 *Id.*

85 Mark Pieth & Kathrin Betz, *Corruption and Money-Laundering in International Arbitration: A Toolkit for Arbitrators,* BASEL INSTITUTE ON GOVERNANCE (Apr. 19, 2019), *available at* https://baselgovernance.org/sites/default/files/2019-05/a_toolkit_for_arbitrators_29_05_2019.pdf.

86 *Id.*

87 Gore & Tuninetti, *supra* note 8.

88 *Id.*

official to portray the effect of influence or could possibly initiate unnecessary investigations or proceedings against the party or the consultant to show corruption.

Second, no tribunal or institution has adequately addressed how to handle a situation where the circumstantial evidence presented consists purely of a series of mere coincidences or which has a perfectly reasonable justification. For example, there may be a case where an investor hires a consultant who just so happens to be well-connected with the State government officials or where the consultant is accused of corruption for being well-paid (above industry standards) for his services, but has no personal stake in or control over the project. The Tribunal in *Unión Fenosa*, which decided to adopt the red flag threshold to check for corruption, noted the presence of several classic red flags which were offset by "*neutral black flags*".[89] While the Tribunal failed to expressly explain what constituted a neutral black flag, it appears from contextual understanding that such black flags are comprised of innocent explanations, genuine coincidences and justifications which counteract the effect of a series of red flags. This opinion, however, was criticised as paying mere "*lip service*"[90] to the red flag threshold which shows that the idea of a tribunal adopting a more holistic approach to the red flag threshold may not be widely accepted. Nevertheless, its value cannot be discredited.

The final issue with the current red flag threshold is that it lacks safeguards to prevent the ease with which it may be exploited by a party. Unfortunately, no arbitral tribunal or institution has distinctly identified a counter-mechanism (consisting of circumstances or incidences) to check if the red flag threshold is being misused by a State (or a public official) relying on the corruption defence. In the event of abuse, there is the likelihood that influential public officials could not only obtain the dismissal of the investor's claim, but additionally also stand to gain personal or political advantages. This apprehension finds its basis in the aforementioned examples, which display what appears to be the suspiciously-timed use of the corruption defence by States.[91]

It is unequivocal that this present assessment of the *lower* red flag threshold vis-à-vis the corruption defence does not aim to curb or trivialise genuine claims of corruption. Rather, it seeks to ascertain and repair the practical loopholes existing in a theoretically ideal threshold, to implement effective change.

IV. The way forward

Undoubtedly, an unchecked low threshold to prove corruption would increase the risk of States misusing the corruption defence. Gore and Tuninetti suggest that this may be combatted by using the threshold of clear and convincing evidence of impropriety in lieu of circumstantial red flags, since direct evidence cannot be easily generated on "*tactical timelines*".[92] Their suggestion, however, ignores the previously discussed difficulty involved in obtaining actual evidence of corruption.[93] According to Partasides, all that is required is cogent evidence of corruption.[94] Consequently, applying an impractically severe threshold of proof risks the non-detection of genuine cases of

89 Unión Fenosa, ICSID Case No. ARB/14/4, Award, ¶ 7.114 (Aug. 31, 2018).
90 Lucinda A. Low, *Dealing with Allegations of Corruption in International Arbitration*, 113 AM. J. INT'L. L. 341, 344 (2019).
91 *See supra* notes 33–56 and accompanying text.
92 Gore & Tuninetti, *supra* note 8.
93 Partasides, *supra* note 74, at 57.
94 *Id.* at 57–59.

corruption. Therefore, Branson and Manon's suggested use of the red flag threshold[95] may be adopted with the caveat that such a threshold may easily be abused for political and tactical advantages. Accordingly, this essay recommends that a strengthened version of the red flag threshold would cogently demonstrate corruption.

A. Including more themes within the red flag threshold

To tackle issue of the limited range of themes in the red flag threshold, this essay suggests the inclusion of as many scenarios as possible which may allude to corruption. To ensure that the red flags are not "*manufactured*" or planted, a tribunal could adopt a slightly revised threshold which would include more themes sub-divided into indicia or indicators. These additional themes could include indicia that require a solid basis in fact, which cannot be generated by governments, both past and incumbent (and their officials) for their political or private convenience. A tribunal would ideally assess the current red flag indicia in tandem with the following indicative (and non-exhaustive) list:

i. Suspicious behaviour of the State while awarding contracts

- If the State specifically recommended or insisted upon working with a particular investor or hiring a specific consultant;
- Absence of transparent records regarding the tender process or other mechanism for States to choose investors or consultants;
- Absence of transparency as to the public officials who shall be involved in the tender process (or any other chosen process), especially if there is a conflict of interest between the officials and applicants;
- Records of the State having awarded multiple contracts to the same investor or consultant;
- Complaints from other bidders/applicants regarding the lack of transparency in the bidding process or in awarding the contract. For example, a complaint that the losing bidder has won the contract without any explanations or reasoning given by the State.

ii. Suspicious activity of the investor/consultant

- The investor or the consultant has close ties to other public officials who have a history of corruption;
- The consultant has a personal stake or equity in the investment;
- Complaints that shadow bidding has occurred, where the investor wins the tender by giving an appearance of competition by arranging for colluders to manipulate the tender system;
- Any suggestion from the consultant that otherwise illegal conduct is acceptable in the present case because it is the norm in a different country;

[95] Branson & Manon, *supra* note 15.

- Suspicious statements made by the consultant. For example, needing payments to "*take care of things*" or "*finalize the deal*".

iii. *Expanding red flags on reputation and history of the parties*

- A public official involved in facilitating the investment deal currently has other allegations of corruption levelled against him or has been convicted for corruption charges in the past;

- The investor or the hired consultant have previously been convicted of corruption in the past, in the host State or elsewhere;

- The consultant suspiciously has either no track-record in that particular field or on the other hand, has a poor reputation in that field.

Raising the red flag threshold to include some of these factors would automatically increase the plausibility of proving corruption before a tribunal. In fact, evidence of a wide range of indicia would also reduce the likelihood of a corrupt party being able to offer paltry justifications or take advantage of the previously lower threshold. A tribunal or court would, therefore, be able to evaluate a case holistically, rather than risk a fallacious outcome based on a limited set of indicators.

B. Legitimising the 'neutral black flag' mechanism

As a corollary to the use of the corruption defence, Partasides opines that a party denying its corruption must be given an adequate evidentiary hearing.[96] The 'neutral black flags' reasoning where the tribunal could assess the innocent explanations offered by the accused party, adopted in *Unión Fenosa* proves particularly useful for a party to prove its innocence, specifically in those cases where there might be an abuse of the corruption defence.[97] The tribunal could, therefore, adjudge the absence of corruption by duly evaluating any neutral black flags or reasoned justifications raised by the party to vindicate the circumstantial evidence of corruption, in the absence of availability of direct evidence. The evidentiary weight of each black flag must be compared to its corresponding red flag to assess the likelihood of corruption.

It may be argued that if an actual corrupt investor is allowed to prevail by offering justifications, however inadequate they might be, for every red flag noticed by the tribunal, the red flag threshold is rendered powerless. However, given the efficacy of the strengthened red flag threshold, it stands to reason that a corrupt party's behaviour would be subject to an increased number of red flags, which would automatically be difficult for the corrupt party to justify adequately before a tribunal. It follows that if the tribunal finds that the weight of black flags outweighs that of the red flags, the party has adequately shown the absence of corruption.

C. Safeguards

Finally, it is suggested that the tribunal also consider circumstances or factors that point to the abuse of the red flag threshold by a State that has relied on the corruption defence. These may either be presented by the party proclaiming its innocence or taken up *sua sponte* by the tribunal. This provides a safeguard against States which may use the corruption defence for political or

96 Partasides, *supra* note 74, at 60.
97 Unión Fenosa, ICSID Case No. ARB/14/4, Award, ¶ 7.114 (Aug. 31, 2018).

tactical advantages in an arbitration. To set off the potential abuse, the tribunal could consider the following factors:

- Whether the corruption has been claimed by the State when elections to its government offices are scheduled to begin shortly thereafter?

- Whether any official (or a relative of an official) of the investor company happens to be a business or political rival of any public official of the State (or the relative of the public official) involved in the matter?

- Whether the State or a public official (or a relative of a public official) ostensibly has something to gain by implicating the investor as corrupt or by winning the arbitration, other than merely defeating the investor's claim?

- Whether the State has suddenly raised the corruption defence to defeat the investor's claim despite an unreasonable delay in making such a claim at any time prior[98] or after an unreasonable prolonged period of passivity to corruption suspicions and complaints?[99]

- Whether the State suddenly begins conducting investigations or prosecuting allegedly corrupt parties after the investor institutes arbitration proceedings, despite having known of such corruption for a significant period of time and having remained passive to it till the institution of the arbitration?

V. **Conclusion**

As a final comment, this essay acknowledges that many commentators have suggested the use of principles such as equitable estoppel and contributory fault to hold States accountable when using the corruption defence.[100] There is unequivocal merit to these suggestions, however, they are applicable to a case only after the corruption has been established in the conventional sense and if the corruption is found to have been perpetuated mutually by both parties.[101]

As this essay has been premised on the potential for abuse of the corruption defence, the assessment of behavioural patterns of States determines that there is significant likelihood of a State concocting a claim of corruption to defeat an investor's claim for its own political or tactical advantages in the future. To prevent the aggravation of this abuse by allowing States to show corruption through a limited range of indicia, this essay suggests the tribunal adopt a well-rounded, yet attainable threshold of proof to test for the presence of corruption. In conclusion, the author believes that an elevated form of the red flag threshold, complete with aforementioned checks and balances, will ideally curb any potential abuse of the corruption defence.

98 LLAMZON, *supra* note 4, at 272–74.
99 *Id.*
100 Losco, *supra* note 21, at 1219; Meshel, *supra* note 24, at 281.
101 Losco, *supra* note 21, at 1219–20; Meshel, *supra* note 24, at 281.