

2017 International Investment Law and Policy Speaker
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**Baker
McKenzie.**

Corruption issues in international investment arbitration

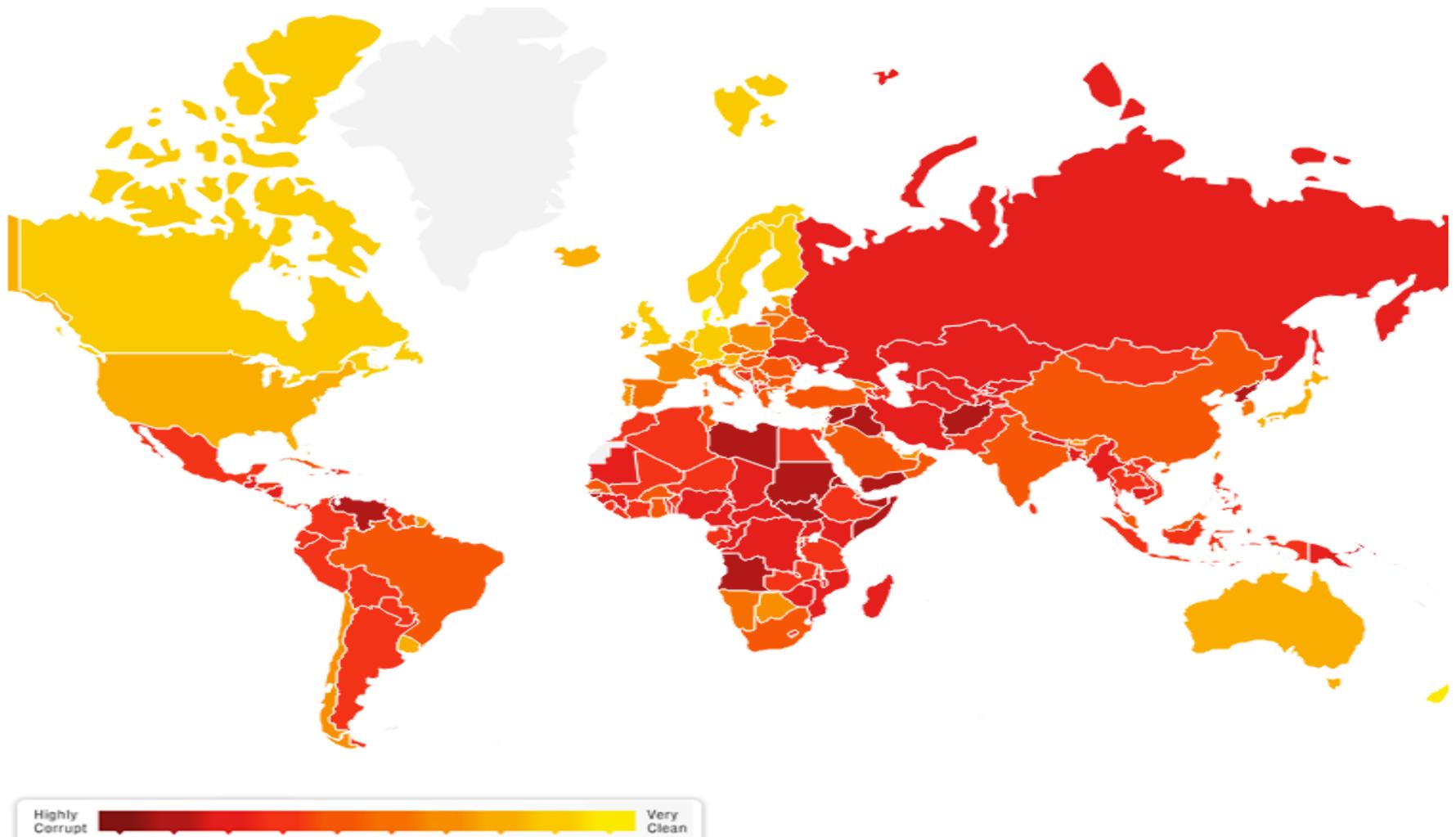
Vladimir Khvalei, partner, Baker McKenzie; Vice-President of ICC Court
of Arbitration, Chairtman of the Board of Russian Arbitration Association

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Transparency International

CORRUPTION PERCEPTIONS INDEX 2016



World Bank: Damages Caused by Corruption

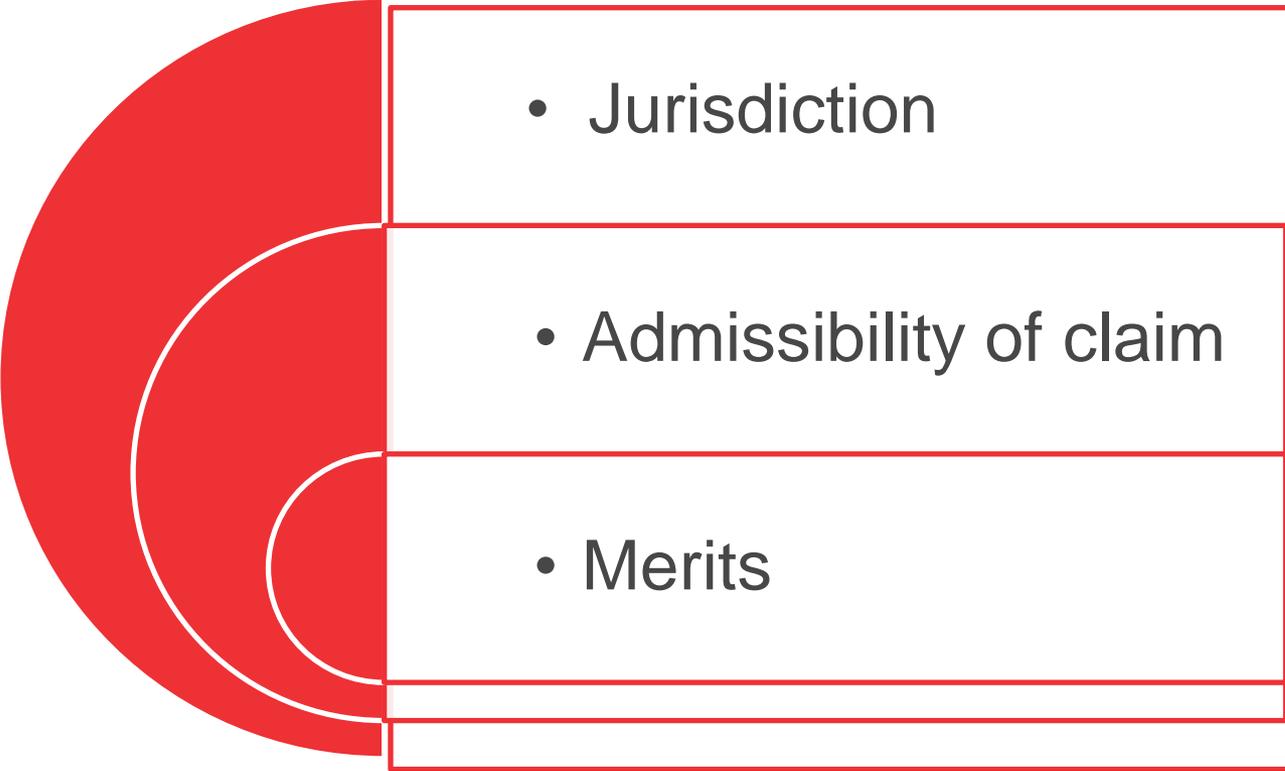
Businesses and individuals pay an estimated \$1.5 trillion in bribes each year. This is about 2% of global GDP—and 10 times the value of overseas development assistance. The harm that corruption causes to development is, in fact, a multiple of the estimated volume, given the negative impact of corruption on the poor and on economic growth.

<http://www.worldbank.org/en/topic/governance/brief/anti-corruption>

International legal instruments on the issue of corruption

- UN Convention Against Corruption
- OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions
- Council of Europe Criminal Law Convention on Corruption
- Council of Europe Civil Law Convention on Corruption
- Inter-American Convention Against Corruption
- Convention on the Fight Against Corruption Involving Officials of the European Communities or Officials of Member States of the European Union
- African Union Convention on Preventing and Combating Corruption

Examination of Corruption Allegations



- Jurisdiction

- Admissibility of claim

- Merits

State's open offer to arbitrate not available – a limit on state's consent

Illegality during the life of the investment

Arbitration agreement not affected based on separability, the tribunal examines allegations on the merits

Investment cases dismissed due to corruption: Facts and Figures

	World Duty Free v. Kenya (2006)	Metal Tech v. Uzbekistan (2013)
Amount of investments made	Lease payments + construction costs ~ USD 37 million	Value of the project: USD 19.3 million
Amount of the bribe	A personal donation of USD 2 million	~USD 4.4 million paid to consultants
Amount of compensation sought by the investor	Restitution of the investment or ~ USD 500 million	~USD 174 million
Tribunal's findings on corruption	The bribe-giving was established on evidence from the Claimant	The bribe-giving was established on evidence from the Claimant
Prosecution of the public officials involved	None	None

World Duty Free v. Kenya (ICSID Case No. ARB/00/7) (2006)

G.Guillaume (President); A.Rogers (C); V.V. VEEDER (R)

- Based on an investment contract governed by English law
- The claimant won the right to operate duty free complexes at Nairobi and Mombassa airports
- A personal donation of USD 2 million to Kenya's President
- Corruption was confirmed based on claimant's witness testimony:
 - *"I felt uncomfortable with the idea of handing over this "personal donation" which appeared to me to be a bribe. However, this was **the President**, and I was given to understand that it was lawful and that I didn't have a choice if I wanted the investment contract. I paid the money on behalf of House of Perfume, treating it as part of the consideration for the agreement **and documented it fully as can be seen from the documentary evidence I have referred to.**"*
- Kenya applied for dismissal of claims using the corruption defense
- The tribunal found it "*disturbing*" that the corrupt recipient of the Claimant's bribe was Kenya's most senior officer

World Duty Free v. Kenya Kenya (ICSID Case No. ARB/00/7) (2006), *Cont.*

- The tribunal noted that on the evidence
 - the bribe was apparently solicited by the Kenyan President and not wholly initiated by the Claimant
 - no attempt has been made by Kenya to prosecute the former President for corruption or to recover the bribe in civil proceedings
- The tribunal did not attribute to Kenya the knowledge of the offense as there is no “*warrant at English or Kenyan law for attributing knowledge to the state (as the otherwise innocent principal) of a state officer engaged as its agent in bribery*”
- The tribunal found that 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*’
- While dismissing the claims the tribunal noted on the issue of apparent unfairness toward the investor that “*the law protects not the litigating parties but the public; or in this case, the mass of tax-payers and other citizens making up one of the poorest countries in the world.*”

Metal-Tech v. Uzbekistan (ICSID Case No. ARB/10/3) (2013)

Kaufmann-Kohler, G. (President); Townsend, J.M. (C); von Wobeser, C. (R)

- Israel - Uzbekistan BIT (1994)
- Uzmental – a JV to build and operate a modern plant for the production of molybdenum products (owned jointly by the Claimant (50%) and 2 state entities)
- Claimant's contracts with JV (EPC contract (construction and upgrade of facilities) and Export contract (sale of molybdenum to Claimant for further reselling worldwide))
- By resolution of the Government the state cancelled the Claimant's exclusive right to export refined molybdenum oxide
- A raw material supply contract was terminated in court proceedings
- Criminal proceedings were initiated against management of the JV for alleged abuse of authority
- JV liquidated, assets transferred to the two state companies – participants of the JV

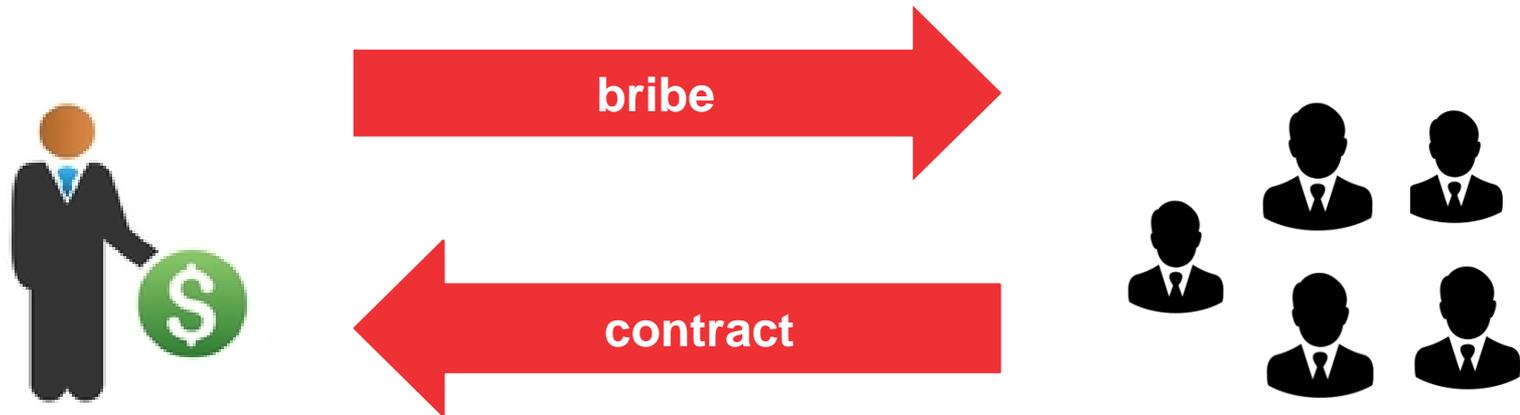
Metal-Tech v. Uzbekistan (ICSID Case No. ARB/10/3) (2013), *Cont.*

- An express legality requirement in the BIT: Investments represent ... "*any kind of assets, **implemented in accordance with the laws and regulations** of the Contracting Party in whose territory the investment is made*"
- Claimant's CEO testified at the hearing that more than USD 4 mln were disbursed not for "*assistance with operation of the JV in Uzbekistan, production, delivery of products*", but for lobbying activities:
 - high amounts paid to consultants
 - no services or proof of services
 - lack of qualification of consultants
 - lack of transparency of payment arrangements (through a Swiss company)

Metal-Tech v. Uzbekistan (ICSID Case No. ARB/10/3) (2013), *Cont.*

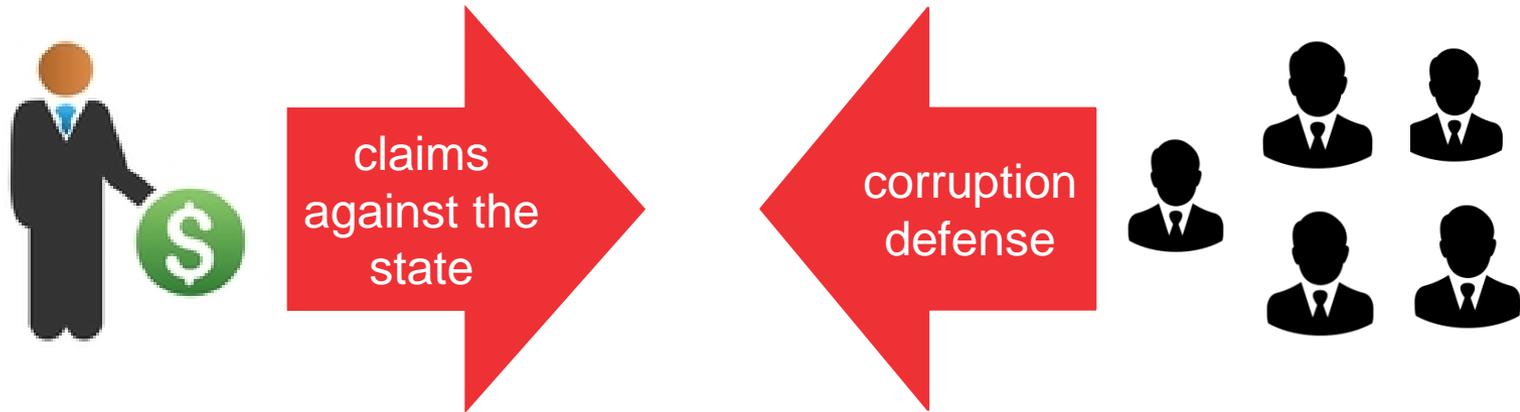
- The testimony led to the tribunal's demand for evidence production and disclosure based on its *ex-officio* powers
- Consultants had connections with the government, i.a.
 - the consultant was a government official whose duties included examining candidates to head various ministries and Government departments
 - the consultant is a brother of the Prime Minister of Uzbekistan
- The tribunal confirmed it could rely on circumstantial evidence to establish corruption
- Claims were dismissed for lack of jurisdiction
- No officials were prosecuted for their involvement in the project

Host States' Use of Corruption Defense



- Unlike fraud, corruption as a rule involves two parties
- Corruption as a crime against the state's interests
 - bribe-taking is prohibited under the laws of the state
 - corruption causes damages to the state
- Host State Participation in Corruption
 - Extortion of the bribe
 - Failure to prosecute corrupt officials

Host States' Use of Corruption Defense



- Dismissal of investor's claims leaves the state unpunished
- Concerns voiced by tribunals

“It remains nonetheless a *highly disturbing* feature in this case that the corrupt recipient of the Claimant's bribe was more than an officer of state but *its most senior officer*, the Kenyan President; and that it is *Kenya which is here advancing as a complete defence* to the Claimant's claims *the illegalities of its own former President.*” (World Duty Free v Kenia)

OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions

Article 3 Sanctions

3. Each Party shall take such measures as may be necessary to provide that **the bribe and the proceeds of the bribery** of a foreign public official, or property the value of which corresponds to that of such proceeds, are **subject to seizure and confiscation** or that monetary sanctions of comparable effect are applicable.

https://www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf

COE Criminal Law Convention on Corruption

Article 19 – Sanctions and measures

2 Each Party shall ensure that legal persons held liable in accordance with Article 18, paragraphs 1 and 2, shall be subject to effective, proportionate and dissuasive criminal or non-criminal sanctions, including monetary sanctions.

3 Each Party shall adopt such legislative and other measures as may be necessary **to enable it to confiscate or otherwise deprive the instrumentalities and proceeds of criminal offences** established in accordance with this Convention, or property the value of which corresponds to such proceeds.

National Anti-Corruption Laws: Penalties

Country	Monetary penalty for bribery of public officials
France	a fine of up to EUR 5 million (alternatively, 2 times the proceeds of the offense)
UK	an unlimited fine
USA	up to USD 2 million per each violation of anti-bribery provisions, up to USD 25 million for each violation of accounting provisions disgorgement of ill-gotten gains
Canada	an unlimited fine
The Netherlands	a fine of up to EUR 820,000 or fines of up to 10% of the annual turnover of the company
Sweden	a fine between SEK 5,000 and SEK 10 million
Australia	the maximum penalty is the greater of: <ul style="list-style-type: none">▪ AUD 18 million▪ 3 times the illicit profit▪ 10% of the company's annual turnover in the year preceding the violation

SEC: Disgorgement

- Civil penalty imposed for violation of i.a. FCPA accounting provisions
- Equitable remedy
- Illegally derived profits - a “reasonable approximation of profits causally connected to the violation”
- Costs associated with the revenue received from improper conduct could be used to reduce the disgorgement amount

Wena Hotels v. Egypt (ICSID Case No. ARB/98/4) (2000)

M. Leigh, Esq. (President); Prof. I. Fadlallah (C); Prof. Don. Wallace, Jr. (R)

- Egypt-UK BIT
- The investor claimed that the state's failure to prevent seizure of hotels and the withdrawal of license amounted to unlawful expropriation
- Egypt alleged that at the time of the agreements' conclusion Wena was retaining the services of the Egyptian entity's chairman (Mr. Kandil) under a consultancy agreement:
 - coincidence in the timing of the payments and the signing of the Luxor and Nile hotels
 - apparent over-payment of Mr. Kandil
- The tribunal found that Egypt failed to discharge its burden of proof and provide evidence refuting the evidence submitted by investor that "*the contract was a legitimate agreement to help pursue development opportunities*" in another area unrelated to the investment

Wena Hotels v. Egypt (ICSID Case No. ARB/98/4) (2000), *Cont.*

- Tribunal reasoned that, if proved, the allegations of corruption would result in dismissal of the claimant's claims
- However, the tribunal noted that the state's role in the corruption could serve as grounds for precluding the success of corruption defense:
 - the state was aware of the chairman's role as adviser to the investor
 - no proof of his conviction or prosecution

*“...given the fact that the Egyptian government was **made aware** of this agreement by Minister Sultan but **decided (for whatever reasons) not to prosecute** Mr. Kandil, the Tribunal **is reluctant to immunize** Egypt from liability in this arbitration because it now alleges that the agreement with Mr. Kandil was illegal under Egyptian law.”*

Spentex v. Uzbekistan (ICSID Case No. ARB/13/26) (2016)

A. Reinisch (President); S. Alexandrov (C); Brigitte Stern (R)

- Netherlands-Uzbekistan BIT
- No express legality requirement
- Corruption allegations involving large fee payments to 2 consultant firms two days before the tender
- Uzbekistan argued the payments were not made for legitimate services but covered up bribes paid to secure success in the tender process
- Uzbekistan refused to name the officials involved in corruption
- Red flags identified:
 - excessive amount of payments
 - lack of relevant experience
 - increase in the tender bid by USD 6 million after retaining the firms

Spentex v. Uzbekistan (ICSID Case No. ARB/13/26) (2016), *Cont.*

- Investor disputed the allegations:
 - corruption denied by the state's own witnesses
 - consultants provided legitimate services – on-the-ground and logistical support and investment banking and market data
- Investor argued no express legality provision contained in the BIT
- The tribunal ruled that the purpose of the investment system is to promote the rule of law, which precluded offering protection to investor that engaged in unlawful activities
- The tribunal ruled that the investment was obtained through corruption and found by majority the claims to be inadmissible
- The tribunal relied on
 - international public policy
 - an “unclean hands” doctrine

Metal-Tech v. Uzbekistan (ICSID Case No. ARB/10/3) (2013): Addressing State's Role in Corruption

- Tribunal reflected on the state's role in corruption:
 - Despite finding for the state, the tribunal decided that the parties are to share the costs of arbitration
 - The tribunal urged the respondent to make USD 8 million donation to a UN anti-corruption fund
 - Otherwise the tribunal threatened to make an adverse cost order in the case, holding the government liable for
 - the costs of the proceedings, and
 - reimbursing 75% of the claimant's over \$17 million in legal fees and expenses

State responsibility for corruption



- Balancing the parties' misconduct:
 - prevent the state from relying on corruption defense if the state fails to show commitment to fighting domestic corruption by prosecuting the corrupt public official (*Wena v. Egypt*)
 - limit the amount of damages due to investor
 - allocation of costs (*Metal-Tech v. Uzbekistan*)
 - other creative approaches (*Spentex award*)

