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The Authority of Arbitration in Determining the Liability of Multiple Actors in Foreign Investment Corruption

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ABSTRACT

The importance of investment and the necessity for its legality, alongside the occurrence of corruption due to the involvement of multiple actors in the investment process, render its examination - especially in arbitration - unavoidable. Corruption may manifest through foreign investors and pressures from their home states or affiliated intermediaries, taking the form of bribery and collusion with domestic officials of the host state or through threats against them. Furthermore, the emergence of corruption may stem from structural weaknesses or corruption-laden processes within the host state's system. At times, a combination of all the aforementioned factors, alongside the involvement of third parties, can create a corrupt and illegal investment process. Given the private nature of arbitration, the primary question arises: does an arbitral tribunal possess the jurisdiction and authority to examine and determine the liability of each of the aforementioned actors? Through an analytical and documentary investigation, this article establishes that, firstly, arbitral tribunals generally do not have the power to investigate criminal behavior and related inquiries; secondly, due to secrecy and threats against witnesses, collecting and maintaining the security of evidence within the sovereign territory of the host state is challenging; thirdly, ICSID tribunals often rely on the "balance of probabilities" and significantly on "red flags" and reports from anti-corruption organizations. Fourthly, the consideration of the initiating factor of corruption, the degree of influence of participating actors (the prevalence of corruption in the host state and the level of the host state's involvement in the occurrence of corruption), as well as the circumstances of "duress" and "hostage" situations and the nature of the bribe (transactional / variance), may lead, depending on the case, to the complete condemnation of the investor (and a finding that the investment is unjust) or a reduction of liability or immunity for the host state.

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Introduction

The proliferation of corruption negatively impacts international trade. Foreign investment contracts are often established by developing countries to extract underground resources for domestic expenditures and costs, frequently accompanied by various crimes. In some countries, governance structures are so weak that conducting trade and economic activities without bribery is nearly impossible. Certain cases from the ICSID[1] suggest that corruption has become so pervasive that it has transformed into a local culture.

Furthermore, if an arbitration tribunal seeks to address any of these factors, it will face numerous limitations. For instance, in situations where the host state has played an active role in facilitating corruption, it may seek to use the foreign investor as a hostage. Additionally, the host state, given its sovereign powers, can destroy or conceal evidence of corruption from the tribunal. Thus, examining the tribunal's capacity to confront this phenomenon is of significant importance.

Although the payment of bribes in securing a contract stems from various motivations, the extent of each factor has not yet been thoroughly analyzed. Therefore, the primary questions are: what is the role of various factors in the formation of corruption, and how do they impact the liability of the parties involved? What powers does the tribunal possess to combat the abuses of the parties? How will the tribunal address evidence of corruption, given its concealed nature? This paper posits that the tribunal must ascertain the occurrence of corruption based on circumstantial and inconclusive evidence. In this regard, it will first address the contexts in which corruption exists in foreign investment and the contributing factors. Subsequently, it will outline the limitations and powers that the arbitral tribunal faces in uncovering and, if necessary, combating corruption.

1. Contexts of Corruption in Foreign Investment

Corruption typically arises from multiple underlying factors, an understanding of which can assist arbitration tribunals in uncovering the truth. Some documented scenarios that may reveal

1 International Centre for Settlement of Investment Disputes

corruption include the following: First, consider a construction contract where costs escalate. In such cases, the employer may neglect to pay amounts needed by the contractor for project advancement. Faced with this loss, the contractor may also refrain from paying the "representation fee" to an intermediary who secured the contract through bribery. Second, in some instances, after a foreign investment contract is formed, the government or certain political officials may change. The previous officials played a critical role in establishing the investment contract with their preferred contractors. Consequently, the contractor may decide to cease bribing an intermediary involved in financing the contracts due to the loss of personal relationships and influence with those previous officials. This situation can lead to increased disputes between the parties in court or arbitration. For these reasons, arbitration tribunals may regard these instances as strong evidence of corruption.[1]

Most cases involving corruption are associated with infrastructure projects such as power plants, telecommunications systems, and dam construction. The next group includes arms procurement, and the construction of educational and military facilities, as well as projects exploiting natural resources. Contracts unrelated to the financing aspects of public projects are relatively rare. Geographically, while corruption occurs globally and spans oil and gas-producing countries to others, the majority of arbitration cases related to corruption in foreign investment arise from South Asia and the Middle East. Quantitatively, investors rarely engage in illegal activities directly. In most cases, they enter into contracts with intermediaries (agents or consultants) to act on their behalf. This arrangement offers several advantages to investors, including the fact that they do not need to disclose their identities to others. In such cases, the secretive relationships between the parties remain concealed. Furthermore, representatives or consultants are often based in the host country and frequently possess the nationality of that country. Therefore, they are culturally and geographically closer to the host country officials and have greater awareness of the local culture, including the customs and practices governing corrupt behaviors.[2] The closer intermediaries are to corrupt structural processes within various governments, the greater their potential for influence within political structures and decision-making in those countries.

Cases related to corruption in foreign investment indicate that in most instances, the involved parties (the investor and the host state) initially enter into investment contracts, such as joint ventures or Build-Operate-Transfer (BOT) contracts. During or after the investment occurs, disputes may arise concerning certain terms of the contract. Typically, the host state fails to fulfill its contractual obligations, compelling the investor to initiate arbitration against the host state. In many cases, political disputes within the host country lead to conflicts, as a newly ascendant government critically reviews the actions of the previous administration, claiming that the investment contract was improperly established. For example, it may be alleged that the prior government's consent was obtained through bribery, and thus, with the change of government, the new administration may refuse to honor its obligations under the contract.

1 M D Valle and P S de Carvalho, 'Corruption Allegations in Arbitration: Burden and Standard of Proof, Red Flags, and a Proposal for Systematization' (2022) 39(6) Journal of International Arbitration 817, 484.

2 H Raeschke-Kessler and D Gottwald, 'Corruption in Foreign Investment-Contracts and Dispute Settlement between Investors, States, and Agents' (2008) 9(1) The Journal of World Investment & Trade 1, 8.

Some researchers have claimed that out of 36 cases concerning allegations of corruption, 11 relate to claims initiated by the new government. The remaining cases are also facilitated by intermediaries (legal and financial advisors).[1]

As noted above, the contexts in which corruption exists can vary based on the specific circumstances of each case. Nevertheless, the constituent factors of corruption can be examined within a limited set of frameworks. These factors can be assessed based on which party initiated the corruption, including the role of the investor's home state, which is often overlooked.

2. Constituent Factors of Corruption

The division of culpability in corruption cases can be relative, depending on which party initiates the corrupt activities. An examination of cases related to corruption in foreign investment indicates that corruption does not solely originate from foreign investors; in some instances, although foreign investors play a significant role in the occurrence and proliferation of corruption, requests for bribes may also arise from the host state. Such requests aim to position the foreign investor in a situation where they are compelled to pay substantial amounts to political officials or intermediaries within the host state to continue their economic activities. Additionally, when the investor's home state wields considerable political and economic power, it can exert pressure on the host state to support its investors. While this behavior may initially appear as "support for the foreign investor," it also represents one of the roots of corruption stemming from improper relations and political pressures exerted by home states on host states. The following sections will explore various instances and differences in the conditions under which corruption occurs.

2.1. Initiation of Corruption by Foreign Investors

In this scenario, corrupt actions are initiated by the foreign investor. Here, the foreign investor bribes government officials to create an incentive for them to award contracts and facilitate opportunities for the investor. In this case, the payment of bribes is not made under duress or at the request of government officials; rather, it is a proactive measure taken by the foreign investor to advance their commercial interests and secure greater profits.

In the case of *Lao Holdings v. Lao People's Democratic Republic*,[2] an American entrepreneur filed a complaint against Laos based on a bilateral investment treaty between the Netherlands and Laos. In this case, the claimant had established an entity to attract investment in the casino industry in Laos in 2007. When the claimant encountered a dispute with one of their local partners, they accused that partner of conspiring with the host state to expel the entity from Laos. In response to this allegation, the host state accused the claimant of various offenses related to the investment. The respondent claimed that the claimant had paid $500,000 in bribes to a Lao government official to halt the casino's audit. In this context, the claimant had utilized a private consultant named "Ms. Sangkeo" to transfer the funds to senior officials in the Lao government. The tribunal concluded that "it is likely that Ms. Sangkeo acted as a conduit for bribing government officials to stop the audit of the casino; however, this conclusion was not proven to a higher standard known as 'clear and convincing evidence.'" Furthermore, the

1 Raeschke-Kessler and Gottwald (n 3) 9.

2 *Lao Holdings N.V. v Lao People's Democratic Republic* ICSID Case No ARB(AF)/12/6.

tribunal noted that the Lao government had not held any recipients of the bribes among its officials accountable or pursued legal action against them.[1]

2.2. Initiation of Corruption by the Host State

Similar to the previous case, in this scenario, the foreign investor is involved in the corruption related to the execution of the investment; however, the corruption does not originate from them. In this context, establishing fault is particularly challenging, as the investor may not be entirely culpable. It could even be argued that in this scenario, no fault can be attributed to the investor. In fact, the investor may be regarded as being in a "hostage" situation, as the host state threatens to destroy their investments and obstruct stable economic activities, demanding bribes from them. In some cases, if foreign investors refuse to comply with bribery demands, the host state may detain individuals involved in the investment operations. Essentially, the stronger the host state's influence, the less freedom of choice the investor has.

Moreover, the host state may initiate "criminal activities" in which the investor voluntarily participates; this means that although the illegal actions are initiated by the host state, the investor subsequently joins these activities. This complicates the attribution of corrupt behaviors to the foreign investor. Under these conditions, given that the investor is not compelled to participate in these actions, fault can be distributed more or less equally between the investor and the host state.

A prominent example of this scenario is the case of *EDF Services Ltd. v. Republic of Romania*.[2] In this case, the arbitration tribunal was tasked with answering the question: Does a governmental demand for a bribe violate its obligations under international investment treaties? The subject of this case involved a joint investment with state-owned enterprises in Romania. The claimant argued that following the election of a new government in Romania, government officials requested a bribe of $2.5 million. This request was made by two senior government officials (the Prime Minister and the then Minister of Foreign Affairs of Romania). The claimant asserted that by demanding a bribe, the respondent violated the obligation of fair and equitable treatment under the bilateral treaty. In contrast, the respondent denied all allegations and referred to a final ruling from the Romanian courts regarding the case previously initiated by the claimant. In that proceeding, the Romanian National Court had definitively rejected the claim of bribery.[3]

This case illustrates that the practice of arbitration tribunals typically requires a high standard of proof to establish corruption. In many instances, corruption initiated by the host state is not substantiated because such claims demand clear and convincing evidence. Although the investor claims to be in a hostage situation, they did not pay the requested bribe. Consequently, there is insufficient evidence to assess how the arbitration authority should impose liability on the parties fairly.[4]

If the investor asserts that they were threatened by an internal official of the host state, placing them in a "hostage" position, the following conditions must be proven to the arbitration tribunal: 1. The host state must make an unlawful threat against the investor that compels them

1 M D A Reisman, 'Apportioning Fault for Performance Corruption in Investment Arbitration' (2021) 37(1) Arbitration International 1, 8.
2 *EDF (Services) Ltd v Republic of Romania* (Procedural Order No 3) ICSID Case No ARB/05/13 (29 August 2008).
3 Adilbek Tussupov, *Corruption and Fraud in Investment Arbitration* (Springer International Publishing 2022) 102.
4 Reisman (n 6) 9.

to pay a bribe. 2. The investor must have no reasonable alternative other than to engage in such an act (paying a bribe). Among these two conditions, proving the first is practically impossible; as it assumes that government agencies are systematically involved in corruption. Furthermore, government officials are not compelled to demand bribes openly. Thus, it can be said that the host state does not necessarily need to directly threaten foreign investors. Regarding the second condition, the investor must demonstrate that they do not willingly wish to participate in systemic corruption. This condition is generally provable, as investors typically only resort to bribery when coerced. Therefore, establishing this condition is relatively easier for the arbitration tribunal compared to the first condition.

Ultimately, various factors such as the value of potential loss, the extent of threats against investors, and the amount of the requested bribe play a role in determining the extent of the threat. The value of potential loss primarily depends on the amount of capital invested in the host country. In other words, the greater the investment, the more pressing the threat from the host country. Furthermore, the context of bribery for obtaining permits differs from that of bribery for "facilitating the investment process." It should also be examined whether the investor could successfully hold the host state accountable in the courts of that country; however, given the existence of systemic corruption, domestic courts are likely considered lacking in independence.[1]

2.3. Initiation of Corruption through Collaboration between the Host State and the Investor's Home State

In certain infrastructure-related projects, the home state of the investor may play a role in fostering corruption by exerting political or economic pressure on the host country to award contracts to its citizens rather than others. Several European countries, along with Japan and South Korea, have long been scrutinized for lobbying host states to secure contracts for their nationals. Recently, the United States has joined this type of lobbying. In this scenario, home states attempt to leverage their influence in the global economic and political landscape to sway weaker countries, particularly in regions like the Middle East.

In these cases, the occurrence of corruption can lead not only to the signing of agreements that experts deem suboptimal in terms of volume and price, but also to situations where the host country may have no actual need for these contracts. Any contract, in addition to the primary payments, typically involves ancillary payments as well. For instance, the former head of Indonesia's electricity distribution company publicly stated that he was told to sign electricity contracts with German companies, even if the total electricity specified in the investment contract exceeded the predictable capacity relative to demand and distribution in the country.[2]

In this context, U.S. government pressure often has a political nature, and despite the Foreign Corrupt Practices Act (FCPA), the U.S. judiciary tends to overlook instances of corruption involving American companies, consistently seeking to assist them. In 1994, U.S. officials made several visits to Indonesia to negotiate deals for consortia led by American companies. The

1 Nobumichi Teramura, Luke Nottage, and Bruno Jetin, *Corruption and Illegality in Asian Investment Arbitration* (Springer Nature 2024) 195.
2 K Mills, 'Corruption and Other Illegality in the Formation and Performance of Contracts and in the Conduct of Arbitration Relating Thereto' (2006) 3 TDM 1, 4.

U.S. Secretary of Commerce, Ron Brown, traveled to Indonesia while several contracts in the private sector for electricity generation with American companies were being negotiated. Due to political pressure from the United States, the head of Indonesia's electricity authority was compelled to sign five contracts at a ceremony honoring Brown, accepting conditions imposed by foreign investors without regard to their fairness or the internal needs of the host country. This action was contrary to Indonesian law and ultimately contributed to rising inflation in the country.[1]

In this instance, foreign investment not only failed to contribute to growth and development in the host country but also led to outcomes contrary to its intended purpose. As such, the corrupting influence of investment must be considered in arbitration proceedings, particularly concerning the establishment of fault.

2.4. Corruption Arising from Actions of Individuals and Factors Unrelated to the Parties

In this scenario, there is strong evidence of investor corruption, but no causal relationship exists between the corrupt act and the subject of the current investment dispute. The alleged behaviors may pertain to investments separate from the disputed investment. In other words, while there may be a history of corruption between the parties, the bribery has no connection to the investment contract in question. For instance, an investor may have three mining projects in the host country, but bribery could have been paid concerning the execution of mining project "A," while the arbitration pertains to mining project "B." In this case, the primary motivation for the corruption may have been to gain an advantage regarding a different investment, thus lacking the necessary causal link to the disputed contract. Consequently, arbitration tribunals typically tend to reject claims of corruption in such cases.In the case of *Tethyan Copper Company Pty Ltd v. Islamic Republic of Pakistan*,[2] the claimant (an Australian mining company) filed a complaint under the Australia-Pakistan bilateral investment treaty after its mining lease application was rejected in 2011. Pakistan informed the tribunal that it had obtained "substantial and new evidence" of investor corruption. This claim included invitations extended to Pakistani government officials to Chile and Toronto, as well as bribery related to airport land leases in 2007, the extension of exploration licenses in 2007 and 2008, and the procurement of visas for the investor's employees. The tribunal dismissed the bribery allegations, citing insufficient evidence. However, regarding the trips to Chile and Toronto by government officials, the tribunal stated, "In this case, it is not sufficient to establish that inappropriate behavior is attributed to the claimant; rather, a causal relationship must be established with the investment made by the claimant, meaning that such inappropriate behavior must have aided in obtaining a right or benefit related to the claimant's investment." Based on the evidence in the case, the tribunal determined that while the claimant may have organized the trips to "establish a close relationship with government officials," given that the parties had signed another contract concerning the mine, and the previous contract between them had not been enforced, the necessary causal link

1 Mills (n 11) 5.

2 *Tethyan Copper Company Pty Ltd v Islamic Republic of Pakistan* ICSID Case No ARB/12/1.

between the inappropriate conduct and the investment in question was absent. Accordingly, the tribunal rejected the corruption claim.[1]

This case illustrates that while bribery and corruption may be present in the context of the investment relationship, the payment of bribes served solely to incentivize officials of the host state. This situation suggests that bribery could influence long-term relationships between the parties, potentially providing greater motivation to form new contracts.

Nonetheless, while the arbitration tribunal must identify the initiation of corruption and the role of each party in its occurrence and proliferation, these factors should be considered alongside aspects such as the nature of the bribery and its prevalence in the host state, especially in accordance with metrics from reputable global institutions regarding economic integrity.

3. Participation of the Host State and Investors in Fault

Article 39 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA, 2001) addresses situations where the harm caused results from a state's international wrongdoing, but the injured party has contributed to the harm through their own actions or omissions (intentional or negligent). According to this article, the arbitration tribunal must apportion compensation between the parties based on each party's role in the existence and proliferation of corruption. The tribunal can determine each party's share in compensation by considering three factors: 1. The nature of the corruption; 2. The prevalence of corruption in the host state; 3. The level of participation of the host state in the occurrence of corruption. These factors are elaborated upon below.

3.1. The Nature of Corruption

Bribery can be divided into two categories: "transactional bribery" and "variance bribery." Transactional bribes, often referred to as "facilitation payments," are payments made to government officials in a routine and non-personal manner to ensure or expedite their official duties. Transactional bribery equally affects both the investor and the host state in terms of fault distribution. This implies that fault can be shared equally between the parties. Such bribery is considered permissible under the U.S. FCPA, indicating that the social losses incurred from these offenses are viewed as less significant than in other cases. For example, payments may be made to expedite customs clearance, as government employees, due to low wages, may cause delays in administrative processes.[2]

In many West African and East Asian countries, this type of bribery is widespread. In many cases, facilitation payments are not regarded as "corruption" by either sellers or buyers because "facilitation is where you maintain your performance." On the other hand, "corruption is where you try to gain a competitive advantage." Some traders believe that without making facilitation payments, "you cannot survive as a business in Asia and Africa." Facilitation payments are also observed in customs operations: some traders have empirically noted that in African countries, payment amounts are pre-determined for all business actors. These payments depend on who

1 Reisman (n 6) 10.

2 S W Schill, 'Illegal Investments in Investment Treaty Arbitration' (2012) 11(2) The Law & Practice of International Courts and Tribunals 281, 297.

the receiver or sender is. A multinational company dealing with soap, detergents, and other consumer products may have to pay a facilitation fee of $100 for each container (in 2011). Additionally, in African countries, a container shipped by a major oil company from one of the cities may be required to pay $10,000 per container.[1]

In contrast to transactional bribes, "variance bribes" assign greater fault to the investor compared to the host state. This type of bribery is defined as a payment made to achieve a desired result by deviating from the proper execution of formal norms. Examples of this type of bribery include "suspending the enforcement of laws or regulations in favor of the investor by government officials," "the personal discretion of a government official that ultimately benefits the investor," or even "changing laws and regulations in favor of the investor." In cases of this type of bribery, if the benefits obtained are legal but not accessible to all investors, the harm caused by the bribery is more severe. For instance, if economic governance in the host state allows for exploration and exploitation permits to be issued annually only to a limited number of individuals, the investor may pay a bribe to the issuing authority to ensure receiving one of these permits. The consequences of bribery in this case are quite severe, as bribery effectively guarantees the investor a competitive advantage at the expense of losing that advantage relative to other investors. Therefore, greater fault should be attributed to the investor.[2]

The most serious form of bribery can be described as a means of obtaining illegal advantages. For example, an investor may receive a permit by paying a bribe, despite not meeting the necessary legal conditions to obtain it. In this context, "evading labor law or environmental regulations" or "avoiding oversight or prosecution by judicial authorities" can be cited. This type of bribery is more severe than the previous cases because the actual profit sought is illegal under domestic laws. Consequently, the tribunal must also attribute greater fault to the investor.[3]

Conversely, "soft corruption," also referred to as "influence peddling," is essentially a diminished form of "hard corruption." It involves offering or promising an unfair advantage to someone claiming they can influence government decision-making. Influence peddling typically occurs with the aid of intermediaries. However, unlike hard corruption, the intermediary does not necessarily engage in bribery of government officials but rather uses their influence to achieve illegal objectives. The ICSID practice indicates that in several cases, allegations of corruption have been accepted as a defense in cases involving hard corruption, while to date, no host state has been allowed to raise a defense solely based on influence peddling.[4]

3.2. The Prevalence of Corruption in the Host State

Investors may adhere to illegal yet commonplace business practices in the host country. While this does not absolve the investor of all wrongdoing, the normality of corruption during the implementation phase of investment is an important factor that the tribunal must consider when apportioning fault between the investor and the host state.

1 Aloysius P Llamzon, *Corruption in International Investment Arbitration* (Oxford University Press 2014) 66.

2 Reisman (n 6) 16.

3 P Busco, 'The Defense of Illegality in International Investment Arbitration: A Hybrid Model to Address Criminal Conduct by the Investor, at the Crossroads between the Culpability Standard of Criminal Law and the Separability Doctrine of International Commercial Arbitration' [2018] Austrian YB Intl Arb 389.

4 H Yin, 'The ICSID Tribunals in Deciding International Investment Corruption Cases: Possible Solutions' (2020) 6(2) China and WTO Review 351, 361.

For instance, suppose each year, 15 permits for exploration and exploitation of mines are issued by the host state. An investor submits their application for one of the 15 available quotas. In this situation, the desired benefits are legal, but acquiring this position comes with significant limitations that can be alleviated through bribery. The investor is aware that other interested parties are also attempting to obtain permits and are bribing the relevant government officials. While this bribery may fundamentally be classified as variance bribery, attributing fault to the investor should be reasonably adjusted to reflect the reality that, in this context, paying a bribe is a common and anticipated business practice in the host country.

Therefore, the prevalence of this type of corruption must be considered alongside its nature. In other words, while the motivations of the parties involved in the bribery should be taken into account, this analysis must be conducted in conjunction with other factors such as the type and nature of the bribery.[1]

4. Options for the Tribunal in Addressing Corruption

Corruption inherently possesses a hidden nature. Additionally, tribunals face multiple limitations when dealing with corruption; however, there are circumstances under which tribunals can mitigate these constraints.

4.1. Consideration on the Balance of Probabilities by the Tribunal

There are two general approaches in legal systems for proving any claim. Some legal systems consider the " balance of probabilities" in evaluating evidence. Under this approach, it suffices for the truth of a claim to be more probable than its falsehood. This approach is used in common law legal systems for proving civil/commercial claims. Historically, this mechanism has been adopted by arbitrators operating in jurisdictions influenced by this legal system. In this case, if the likelihood of a piece of evidence aligning with reality is greater than that of other evidence, the claim can be easily proven. This approach reflects a lower standard of proof, which is typically applied in cases where there is less concern and significance surrounding the issues to be proven.

The second approach involves "requiring clear and convincing evidence" in evaluating evidence. Given that this method entails a higher standard for proving a claim, it is used in common law legal systems when proving criminal claims. In this method, arbitrators are required to establish facts "beyond a reasonable doubt." This means they cannot make decisions solely based on the probability that a claim is true over its falsehood. Consequently, in cases where society places greater importance and sensitivity on a claim, the second standard is utilized as the evidentiary standard.[2]

This distinction is particularly significant in proving allegations of corruption, given the associated criminal regulations. Nevertheless, some ICSID cases have shown that the use of the *balance of probabilities* has been supported in recent arbitration awards concerning investor-state corruption claims. In the case of *Unión Fenosa Gas, S.A. v. Arab Republic of Egypt*,[3]

1 Reisman (n 6) 16.

2 R Dalir, E Delshad, and I Amini, 'Evaluation of Evidence and Standards of Proof in International Commercial Arbitration' (2023) 19(1) Comparative Law Quarterly 245, 254 [In Persian].

3 *Unión Fenosa Gas, S.A. v Arab Republic of Egypt* ICSID Case No ARB/14/4.

the tribunal decided to apply the "balance of probabilities" standard. The tribunal argued that although the corruption allegations related to factors that inherently possess criminal aspects, since this proceeding is not criminal in nature, there was no reason for the tribunal to impose a higher standard for proof, and the balance of probabilities standard sufficed.[1]

However, a significant number of International Chamber of Commerce (ICC) cases have indicated that a finding of corruption in arbitration should be based on a very high degree of probability. According to a report released by the ICC regarding arbitration proceedings, minimal evidentiary standards were utilized in only one case. According to this practice, proving corruption is often overlooked; the evidentiary criteria restrict the scope of proof to such an extent that it can be argued that, given the hidden nature of corruption, proving it becomes exceedingly difficult, if not impossible.

Consequently, three arguments have been made in favor of this higher standard. First, proponents argue that a higher standard of proof dissuades parties from making baseless allegations in arbitration proceedings. Second, it is essential to avoid baseless claims in any circumstance, rather than suggesting that if one party can prove corruption based on a more acceptable criterion, this should be disregarded. Finally, it is claimed that discovering corruption in contracts is inherently unlikely because there is an assumption that these contracts are valid. This assumption is supported by the assertion that senior officials generally do not violate enforceable laws in national jurisdictions. Yet, corruption occurs in every country and has become a systemic and widespread problem in many parts of the world. Furthermore, the presumption of the legality of legal contracts should not be a reason to increase the standard of proof; rather, it should be considered an element for evaluating corruption claims by the tribunal.[2]

4.2. Consideration of Red Flags by the Tribunal

Given the aforementioned points, many experts in investment law believe that when the tribunal addresses allegations of corruption, it should utilize what are known as "red flags" as evidentiary support. Red flags are indicators that, while independently insufficient to prove the existence of corruption, can collectively raise strong suspicions about the presence and prevalence of corruption in a contract.

Some prominent indicators for identifying contracts that may have been obtained through corruption include:

1. **Engagement with Countries with High Levels of Corruption Records**: Contracts executed with countries known for their involvement in corruption, as evidenced by their poor rankings in the Corruption Perceptions Index (CPI) published by Transparency International. This index ranks countries based on corruption levels using data from multiple independent surveys.
2. **Refusal to Accept Anti-Corruption Commitments**: A party or contractor's unwillingness to agree to commitments aimed at combating corruption.
3. **High Payments to Intermediaries**: Unusually large sums paid to third parties.

1 S S Ong, 'Dismantling the Safe Harbor: Solving the Evidentiary Problems in Corruption Allegations in Investor-State Arbitration' (2019) 20(1) Asian Intl Arb J 23.

2 Valle and de Carvalho (n 2) 483.

4. **Lack of Transparency in Accounting Records**: Obscured financial records that make it difficult to trace transactions.
5. **Unusual Payment Mechanisms**: Payment methods that deviate from standard practices.

The World Bank also provides potential indicators, such as:

- Contracts often signed for amounts below typical thresholds.
- Bids presented in an irregular manner, not adhering to established patterns.
- No exchange of proposals between the parties for obtaining a contract.
- The presence of suspicious bidders, such as shell companies or those acting as fronts for others during the bidding process.
- Repeated awarding of contracts to the same companies.
- Unjustified changes in the scope and value of contracts after they have been signed.
- Services rendered being less than expected or of inferior quality compared to contractual obligations.[1]

The use of red flags is based on several fundamental considerations. Firstly, proving corruption is particularly challenging due to its inherently secretive nature. Secondly, criminal acts are operationally complex. For instance, in the context of banks conducting suspicious transactions, addressing and uncovering corruption can be difficult due to the extensive nature of business operations. While there is a relative consensus regarding conventional international business practices, it is crucial to recognize that each country's cultural aspects directly impact its business practices and norms. This highlights the need for arbitrators to be well-informed not only about the characteristics of common crimes in international business but also about the local customs where the contract is executed.

Moreover, the sources that compile red flags should be critically examined. Arbitrators might be concerned that findings related to corruption could have severe consequences for those involved. In jurisdictions where the rule of law is not fully upheld, uncovering corruption may be misused to target individuals as political victims in criminal proceedings. Similarly, arbitrators should not hastily seek out evidence of corruption. In this regard, considering the aforementioned criteria as "red flags" is of great importance.[2]

As previously stated, there are significant disagreements regarding the evidentiary standards surrounding corruption allegations. Some authors propose a solution that involves a two-pronged criterion: First, after corruption allegations are raised against one party, the tribunal should determine whether sufficient evidence of corruption has been presented. If the tribunal is satisfied with the number and strength of the red flags initially provided by the claimant, it should explicitly place the burden of proof on the opposing party, requiring them to provide counter-evidence, such as documents and testimonies, to refute the allegations. If the opposing party fails to demonstrate the absence of corruption, the tribunal may adjust the evidentiary standards, allowing the accused party to defend themselves using the balance of probabilities standard.[3]

1 Valle and de Carvalho (n 2) 850.
2 A Menaker, *International Arbitration and the Rule of Law* (Kluwer Law International 2017) 247.
3 Valle and de Carvalho (n 2) 845.

4.3. Issuance of Interim Orders to Prevent Criminal Proceedings

Host states sometimes initiate criminal prosecutions with the intent to intimidate witnesses and threaten them, which can hinder their ability to safely express concerns about corruption in investment contracts. In such cases, the host state often attempts to influence evidence that could potentially be used against it in arbitration proceedings, utilizing its judicial and security powers.

Consequently, foreign investors need protection against such actions by host states. While tribunals are granted the authority to issue interim orders in many situations, requests to prevent host states from pursuing criminal proceedings within their jurisdiction are considered complex. On one hand, each sovereign state possesses the inherent power to enforce its criminal laws and prosecute individuals who violate those laws. On the other hand, it is the tribunal's duty to safeguard the integrity of the arbitration process. Parallel criminal proceedings may jeopardize this integrity and obstruct the effective pursuit of the claimant's claims against the host state.[1]

Thus, the issuance of interim orders to prevent domestic prosecutions requires the tribunal to balance these conflicting interests. This challenge underscores the delicate nature of ensuring that the arbitration process remains unimpeded while recognizing the sovereign rights of states to enforce their laws.

5. Limitations of the Tribunal in Addressing Corruption

Given that arbitration proceedings are inherently private, they face multiple limitations, including:

5.1. Limitations in Evidence Collection and Witness Protection

One significant issue in evidence collection involves the security of witnesses called to testify about corruption. Potential witnesses may refuse to testify, claiming that doing so puts them at risk. This claim may be valid. While national courts possess broad powers to uncover and neutralize threats and ensure witness security, arbitration tribunals have very limited capacities in this regard. However, international courts often take measures to guarantee necessary protections, especially for whistleblowers, including strict limitations on disclosing the identities of witnesses.

Another challenge arises when witnesses, under local law, have the right to refuse to testify. For example, in Switzerland, parties to a dispute and third parties can refuse to testify under certain conditions, such as when testifying could harm close relatives. In such cases, the tribunal cannot compel a reluctant witness to testify through a summons, nor can it treat a witness's absence as evidence against one of the parties. In Switzerland, arbitrators or courts inform witnesses of their rights to refuse to testify in such circumstances.[2]

5.2. Parallel Proceedings by the Host State as a Threat to Witnesses

Many arbitration tribunals recognize that criminal investigations or parallel proceedings can impact a witness's willingness to testify against the host state, threatening the integrity of the arbitration process. In the case of *Quiborax v. Bolivia*,[3] the host country brought criminal charges against several individuals involved in the claimant's investment operations in Bolivia. For instance, a

1 L Uilenbroek, 'The Power of Investment Tribunals to Enjoin Domestic Criminal Proceedings' (2020) 36(3) Arbitration International 323, 339.
2 Menaker (n 26) 258.
3 *Quiborax S.A., Non-Metallic Minerals S.A. and Allan Fosk Kaplún v Plurinational State of Bolivia* ICSID Case No ARB/06/2.

witness named David Muscuso was arrested by local authorities for alleged document forgery, leading him to refuse to testify in favor of the claimant. Based on these events, the tribunal found that Bolivia had exerted undue pressure on potential witnesses, likely reducing their willingness to testify. Consequently, the tribunal accepted the claimant's assertion regarding the criminal charges against the witness and concluded that access to witnesses would only be facilitated if the criminal proceedings in the host state were halted until the arbitration concluded. Similarly, in the case of *Lao Holdings v. Lao People's Democratic Republic*,[1] the tribunal agreed to issue an interim order to stop the criminal proceedings, as the simultaneous criminal investigations could serve as a strong deterrent for witnesses to provide evidence against the host state's position.[2]

5.3. Resource Limitations and Lack of Authority over Criminal Matters

Generally, arbitration tribunals lack the authority to investigate criminal conduct. Investigating corruption may require extensive powers and resources, including the ability to compel companies to produce records and documents, to mandate witness testimony, and to have sufficient human resources and expertise. For instance, in the United States, the Attorney General and the Department of Justice can collaborate with a grand jury to gather evidence and prosecute individuals for various crimes. They work together to compel witnesses to testify and to investigate documents, data, and other relevant materials. If witnesses do not comply with subpoenas to appear in court, the court can compel them.

In ICSID proceedings, procedural rules allow the tribunal to "request the parties to submit documents, witnesses, and expert opinions." However, if the parties do not comply with such requests, the tribunal lacks the authority to compel them to act or to impose civil or criminal penalties. Under this rule, the tribunal can only focus its attention on a party's failure to provide documents and evidence and notify the parties accordingly. If the parties do not comply with these notifications, it may affect the tribunal's ruling on costs and damages. However, the tribunal cannot investigate or make definitive findings on whether elements of corruption have occurred.[3]

Overall, the tribunal lacks the resources and expertise that a state possesses to investigate corruption. For example, the budget of the U.S. Department of Justice for fiscal year 2017 was over $29 billion, and as of 2015, it employed 114,408 staff members. The Department of Justice utilizes various specialized offices, including the Drug Enforcement Administration and the Federal Bureau of Investigation. In contrast, ICSID is funded by the World Bank, with total assets of approximately $52.4 million in 2016. The Administrative Council, the governing body of ICSID, is chaired by the President of the World Bank and comprises representatives elected from member states. The Administrative Council appoints the Secretary-General and Deputy Secretary-General, who jointly head the secretariat. The secretariat maintains a list of completed arbitrations, manages funds to cover arbitration costs, approves rules and regulations for arbitration, and drafts model arbitration clauses for investment agreements. All of these tasks are managed by a staff of about 70 employees. Consequently, compared to the U.S. Department

1 *Lao Holdings N.V. v Lao People's Democratic Republic* (n 5).

2 D Galagan, 'Provisional Measures in International Arbitration as a Response to Parallel Criminal Proceedings' (LLM thesis, University of Victoria 2019) 157.

3 Menaker (n 26) 10.

of Justice, ICSID lacks the financial, human, and specialized resources necessary for extensive investigations into corruption.

6. The Impact of Tribunal Limitations on Erroneous Conclusions in Arbitration

In the case of *Siemens A.G. v. Argentine Republic*,[1] a contract was established between the claimant (the German electronics company) and the Argentine government to replace existing identification documents with new national ID cards, with an estimated project value of nearly $1 billion. Following a financial crisis in the country, Argentina enacted an "Emergency Law" during the 2001-2002 financial turmoil, which the tribunal found might constitute a case of creeping expropriation (indirect expropriation). Consequently, the tribunal ordered Argentina to pay $217 million to Siemens.

Shortly after the ruling, German prosecutors discovered that Siemens had engaged in systematic bribery around the world. It was later revealed that between 1997 and 2007, Siemens paid over $105 million in bribes to Argentine officials to secure the contract. Aware of the corruption scandal faced by Siemens, the Argentine government requested a "review" from the ICSID tribunal under Article 51 of the ICSID Convention.[2]

Seven months after this request, Siemens reached an agreement with American and German authorities to pay a fine of $1.6 billion. Five months later, Siemens halted its arbitration proceedings against Argentina, waiving its right to enforce the $217 million award it had obtained. Some commentators believe this decision was made to prevent damage to the company's reputation due to the financial scandals. Nonetheless, this waiver of rights is normatively problematic.

This case illustrates that if the ICSID tribunal had been aware of Siemens' corruption from the outset, it likely would have accepted the defense of corruption in favor of Argentina. Conversely, had there been no investigation by German prosecutors, Siemens could have exploited the dispute resolution provisions of a treaty that, in reality, offered no protection for its corrupt actions. This scenario highlights the tribunal's reliance on anti-corruption organizations and state prosecutors when adjudicating corruption claims.[3]

Conclusion

Developing countries need underground resources for their economic growth. Consequently, they often seek to attract foreign investment to meet this need. In these countries, due to weak governance structures, foreign investment is frequently accompanied by bribery. The tribunal faces limited powers in addressing this issue, as it lacks the prosecutorial and police authority to handle criminal matters. Additionally, in many instances, witnesses have the right to refuse to testify under local laws, especially if their testimony regarding corruption could expose them to personal danger. This limitation was evident in the *Siemens* case, where the tribunal could not ascertain the existence of corruption until German prosecutors uncovered evidence.

1 *Siemens A.G. v Argentine Republic* (Award) ICSID Case No ARB/02/8 (6 February 2007).
2 R Torres-Fowler, 'Undermining ICSID: How the Global Antibribery Regime Impairs Investor State Arbitration' (2012) 52 Va J Intl L 1027.
3 Yin (n 19) 367.

The hidden nature of corroborative evidence presents another challenge for the tribunal in dealing with corruption. However, if there are indications of corruption, such as when a contracting party is from a country known for their active involvement in corruption cases, the tribunal may recognize corruption through these signs. Nonetheless, the tribunal must establish the point of origin for the corruption. Just as a foreign investor might bribe domestic officials to obtain permits, domestic authorities could also threaten investors with asset expropriation unless a bribe is paid. Moreover, home countries of investors, including the United States, often exert pressure on host states to secure investment contracts.

In cases where economic governance in the host state limits the issuance of mining permits to a select few annually, the investor may bear greater culpability for undermining competitive advantages of other investors. Additionally, bribery may be so entrenched in the host country's culture that it is perceived as a gift. If an investor pays money to expedite customs permits, they may feel compelled to do so.

In instances where corruption arises from the host state and the foreign investor is held hostage, the blame falls entirely on the host state. However, if bribery occurs solely to incentivize officials without directly impacting the investment contract's acquisition, the ICSID tribunal may not find evidence of corruption, as the necessary causal relationship would be absent. Ultimately, the tribunal must consider the nature of the bribery— whether it was paid to gain a competitive advantage or to disrupt the host country's laws. This assessment also requires attention to the host state's domestic laws, as in some jurisdictions, such as the United States, certain facilitation payments may be deemed acceptable under statutes like the Foreign Corrupt Practices Act.

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