IRSTI 10.21.51

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Corruption in international investment arbitration

Absrtact. Corruption appears to be destructive to investment arbitration and the international development as a whole. In some states to engage in corruption is a typical method of conducting business in investment or trade. There are two forms of bribery regarding international investment. One of them is that when an investor corrupts public official to get a suitable investment agreement, another is where the investor is blackmailed to pay money by a person who has authority. The paper aims to evaluate whether international investment arbitration as a source of dispute settlement might be used to combat bribery in foreign investment. Also, the paper focuses on a controversial issue when host states may use corruption as a defence in investment tribunals. As an example, a case the World Duty Company Ltd v Republic of Kenya has been given to explain the defence by the host state. One may expect that this case is able to change approach taken by previous arbitrators.

Key words: Corruption, investment arbitration, investor, host state, tribunal, English law, anti-corruption policy

DOI: https://doi.org/10.32523/2616-6844-2019-126-1-48-56

Introduction. Corruption considered as being contrary to both, domestic laws of the countries and international public policy[1]. Nevertheless, it has become a widespread phenomenon which taints ordinary course of business in foreign investment and trade [2]. There is no precise definition of corruption. For example, Transparency International[3] defines it as "an abuse of entrusted power for the private gain" OECD Anti-Bribery Convention[4] definition of corruption focuses on "bribery of a foreign public official". Chapter 3 of the UN Convention against Corruption[5] provides a list of illegal acts which should be prohibited and prosecuted in domestic jurisdictions of the signatories of the Convention.

According to Zahari[6] corruption regarding investment arbitration can be understood as "an abuse of duty owned". The definition refers to the underlying notion of a relationship between investor and public official who is repository of public trust, and the illegal payment made to that agent in exchange for a favorable decision. In turn, Llamzon[1, 20 p.] defines corruption in a broader way, as "knowing application or refusal to apply laws in a manner that benefits private demands at the expense of public need". The definition contains two forms of corruption. One of them is bribery which includes an element of voluntariness where the investor induces a public official to accept bribes to secure his investments and another is extortion where the person in charge of administrative functions demands payments from the investor. In both scenarios, there is a consensus between the parties agreed to commit an illegal act for the mutual benefit. Therefore, emphasis and blame should be placed on both sides [1, 23 p.].

Corruption has a damaging effect on the international development and growth. According to the World Bank [7], more than 1 trillion dollars or 3 % of the World economy are paid in bribes each year. It is estimated that up to 10% globally and up to 25 % in developing countries of the cost of procurement contracts are corrupt [7]. Furthermore, to relocate the business from a country with low level of corruption to a state with a high and medium level of corruption is equivalent to 20% additional tax on business [7]. Logically, to compensate the cost of the bribery investors either input the of bribe into the price or provide the poor quality product [8].

However, there are some arguments in defense of corruption because in some parts of the world it is a natural way of conducting business and it is unavoidable at certain stages of development [9]. Among possible "benefits" is suggested economic development, because in some countries where corruption is "endemic and pervasive" it can serve as a source of capital formation and alternative to political violence[10]. The matter that corruption in international investment was treated tolerantly until recent times is supported by the fact that until 1990 tax laws of Germany and France allowed bribery payment as tax-deductible business expenses [11]. However, such views does not withstand criticism. Fundamentally, corruption affects the competitiveness of the entire global economy through inefficient redistribution of aid and ineffective investments, basically undermining work of developmental public policy institutions [12].

Discussion. It is argued [13, 88 p] that since international investment arbitration is a primary source of resolution of disputes between investor and state, it can also be effectively used to combat corruption in international investment and trade. The main argument is that investment arbitration is based on a robust legislation of foreign investment protection, and conducted independently from the host state judicial system [14, 208 p]. In addition, tribunals can have a relative discretion to apply a broad range of laws including domestic anti-corruption legislation as principles of international public policy [15]. Furthermore, the work of tribunals is transparent because the award is available for public access and the enforcement is supported by the worldwide recognized mechanism which is difficult challenge [16].

Although suggested arguments have strong merit, there are limitations which doubt the ability of investment arbitration to combat corruption in investment and trade.

The main criticism refers to the fact that host states can use corruption as a jurisdictional and substantive defence to frustrate the arbitration proceedings [17]. It is strongly criticized that corrupt authorities of the host state can be remained unpunished and benefit from its wrong whereas investor can be deprived its rights and property [18]. Clearly, this contradicts the purpose of investment arbitration, which is to provide the balance between protection of investor's interests and state's right to act within its legitimate needs [19, 21 p]. Consequently, the whole thrust in investment arbitration as a system of dispute resolution might be undermined.

Another problem to combat corruption in investment arbitration is the difficulty in proving allegations and the absence of a unified approach to the standard of proof in particular. According to Llamzon [1, 225 p.] practice demonstrates that arbitrators try to avoid issues related to corruption. He reasons [1, 210 p.] that because standards of proof are high, arbitrators are reluctant to deal with issues of corruption.

The main forum to which investor –state disputes can refer was established in 1965 through the conclusion of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention)[20]. Although the Convention was adopted by more than 150 states the mere signing and ratification of the Convention does not represent state's consent to arbitration under it. Consent can be given through the various mechanisms. For example, the conclusion of a contract between investor and state about particular investment (investment agreement); state's national legislation related to protection of foreign investment (statute consent); or conclusion of bilateral or multilateral investment treaties between countries, the salient example of which is the Energy Charter Treaty. Within all forms of consent rights and

obligations of the state and investor are clearly set with reference to any disputes to arbitration under ICSID or any other forum or UNCITRAL ad hoc arbitration [21]. Therefore, a state's consent to investment arbitration is a "standing offer" to potential investor claimants. The investor accepts the offer by launching a claim.

However, to perfect arbitration agreement the investor must have already held assets which qualify as an investment under a particular treaty with the host state [6]. Further, if the underlying investments is acquired through unlawful means, the investor can be denied protection under the particular agreement [22].

One of the distinguishing characteristics of international commercial arbitration from international investment arbitration is the use of the concept of "separability" which allows consideration of an arbitration clause as a separate agreement in cases where illegality taints the underlying contract [21, para. 5.100]. In contrast, in international investment arbitration, if investment obtained through illegality it directly affects the investor's ability to exercise its rights under investment agreement [21].

It is suggested [22] that the doctrines of "separability" and "competence-competence" are fully applicable to international investment arbitration. The doctrine of "separability" preserves the recourse to international arbitration so the party to the proceedings could not frustrate it by pleading corruption[22]. In addition, it secures impartiality of investment arbitration by not letting the party rely on "one-sided defence"[18]. Arguably, this results in the efficient use of investment arbitration to combat corruption[18]. Consequently, investment tribunals must rule on its jurisdiction and consider claims at the merits stage unless corruption taints the underlying arbitration agreement itself [22].

To sum, whether such reasoning contains a rational and determine the ways international investment arbitration can be used more efficiently to combat corruption it is now necessary to analyse procedural circumstances where illegality arises and how tribunals approach them.

There are certain occasions where the issue of corruption can be raised in investment arbitration [23, 323 p]. For example, the host state can use it as a jurisdictional and substantive defense objecting enforcement of the investment agreement in the case of contract-based arbitration. In addition, the host state can use corruption as a jurisdictional defence in investment treaty arbitration. Another scenario is when the host state uses corruption as a defence claiming a violation of substantive standards contained in provisions of investment protection treaty. From the investor's perspective corruption allegations can be used to claim damages in circumstances when the refusal to extortions from state resulted in deprival of investments. Finally, the issue of standards are burdens of proof is important to prove corruption in the course of arbitration proceedings.

Defence by the host state.

Development of legislation and increasing unilateral intolerance to corruption in conjunction with greater efficiency in the work of anti-corruption agencies gives basis to expect that the respondent states in investment arbitrations will be raising corruption allegations as a defense more frequently [15].

The precedential case which influenced tribunals approach towards corruption charges and where corruption was outcome-determinative for the award is the World Duty Free Company Ltd. v Republic of Kenya (WDF) [24]. The case contains specific characteristics which distinguish it from investment treaty arbitration. For example, there was no applicable BIT and jurisdiction of the ICSID tribunal based on an arbitration clause in the concession agreement[24, para 4]. In addition, the choice of law provision is determined by English and Kenyan law as applicable to the contract, not international law as such. Therefore, it is plausible to argue that despite being investor state arbitration, the issue of corruption was not substantiality different from analogous in commercial arbitration cases [23, 39 p].

The claimant alleged that the pressure from the state authorities resulted in the expropriation of his investment under the concession agreement concluded with the Republic of Kenya for the construction and maintenance of duty-free complexes in two airports [24, para 63-70]. The most striking feature of the case was that CEO of the claimant directly admitted to the tribunal that he "was required to make personal donation" of US 2 $ million to the President of Kenya to procure the contract [24, para 66].

The respondent state pleaded corruption allegations as defense claiming that it would be contrary to international public policy and applicable to Kenyan and English law to enforce the contract procured through bribery [24, paras. 105-106]. The claimant tried to argue that the mens rea was absent, and he perceived requirement to pay as a cultural custom [24, para 110]. However, the tribunal determined that payment constituted bribery and was not separable from the agreement [24, paras. 170-174].

The ICSID tribunal ruled that corruption was established "beyond doubt" and applied anti-corruption laws against the investor party dismissing all his claims and declaring that the underlying contract is unenforceable and contrary to applicable law and transnational public policy.

Tribunal confirmed and applied this reasoning [24, para 157] and determined that since the main aim of the payment was to obtain concession agreement, it is against international public policy to enforce the contract procured through corruption [24, para 174].

It is also notable that the tribunal decided to disregard involvement of the respondent state [15]. Since payment was accepted by the President of Kenya who was officially in charge of awarding concession agreement, it is reasonable to expect his actions were imputable to the state under public international law and the ILS's Draft Articles on State Responsibility [25, art 7]. However, the tribunal determined that bribe would not be imputable to the state because it was "covert" and the party to the proceedings was not the President of Kenya, but the Republic of Kenya [24 para. 169].

Such reasoning clearly contravenes international principles of state responsibility [18]. In addition, because the English law governed the agreement the tribunal declined the claimant's request[24 para.176] to balance the parties' respective misconduct and applied "strict" rule of absolute contract nullity procured by illegality [24 para.177]. It is also noted that even if tribunal was allowed to engage in balancing operations it would not do so because the claimant voluntarily decided to participate in illegal conduct [24 para.178].

There is a controversial argument that were it proved that the state and investor were both involved in corruption a balancing operation is a fairer approach than leaving the state's conduct unpunished [26]. Refusal to balance the parties' misconduct would arguably lead to the fact that tribunals would favour the state, and they become reliant on corruption allegations as a defense, consequently undermining the effectiveness of international arbitration in combating corruption [18]. In fact, the tribunal in WDF noted that the claimant might feel it is unfair to allow Kenya to plead corruption as a defense and avoid the consequences of illegal conduct of their former head of state[24 para.180], but reasoning of the tribunal was that "English public policy protects not the parties to the proceedings but ordinary citizens. It is reasonable to suggest that parties to the proceedings but ordinary citizens" [24 para.181]. It is reasonable to suggest that since the applicable law to the agreement was English law, not international law as such, investment tribunals should be cautious in refusing to balance parties' misconduct, applying reasoning from WDF award.

The approach taken by the tribunal is vulnerable to criticism. It is argued that the award did not consider the degree to which the investment could have contributed to the development goals of the host state thereby disregarding interests of ordinary people and potential benefits to the economy that the claimant's investment could have made[14]. Consequently, if anti-corruption policy adopts a zero tolerance approach, this may potentially undermine trust in international foreign investment, which would be bring more harm to developing countries [14].

Finally, there is an opinion that allowing the one-sided defence to Kenya was not useful for the accomplishment of anti-corruption objectives because remedies granted by the tribunal failed to sanction corrupt behavior of the parties[18]. All parties to the proceedings escaped sanctioning. Therefore, the tribunal failed to protect the public from corruption [18]. There are reasonable arguments in the line of a criticism of award in the WDF. However, they seem not to consider that the investment tribunal is the instrument of civil remedies, and the fact that the investor loses its right to protection under the agreement is a serious punishment which has an economic impact on the commercial party. It is also a clear message that corruption would not be tolerated in international trade and investment. Therefore the decision can be perceived as a serious deterrent for investors to engage in corruption relations.

Arguments about "developmental goals" ignore the fact that potential engagement of the tribunal in balancing operation and punishment of the Republic of Kenya would have been disastrous for the economy of the country. The US $500 million[24, para. 78] claims by the WDF were more than the entire budget of the country at that time[27]. Even half of this sum would have come as an unbearable burden for the ordinary citizens of the public and would have bankrupted the whole state. Clearly, interests of the ordinary people were not disregarded by the tribunal in the WDF.

The WDF impact on international investment could not be overrated. Until the decision in WDF corruption allegations were raised as a defence by host states in six cases and in neither of them were outcome determinative [1]. Consequently it is plausible to suggest that WDF is a unique, precedential case which is expected to change approach taken by the arbitrators previously, i.e. to disregard corruption in investment arbitration.

Considering the increasing number of international investment arbitrations it is reasonable to expect that corruption allegations continue to be raised as a defence in public international law.

Conclusion. To conclude, international investment arbitration can be a useful mechanism to combat corruption in international investment and trade. The reasons for such determination are following: Firstly, the independence from the host state's judicial system allows the tribunal to stay impartial and uninfluenced by the host state authorities in considering corruption allegations and delivering the award. Secondly, unless it is directly determined in investment agreement tribunals are not limited to domestic laws and have relative freedom to apply principles of international public policy.

Corruption in investment arbitration may rise in two circumstances: when pleaded as a jurisdictional and substantive defence by the host state and when investor alleges extortions from the host state resulted in a violation of fair and equitable treatment provision of the treaty.

Use of international investment arbitration is not a primary solution to combat corruption, because tribunals apply principles of international public policy in the reasoning of the award it may form the general system of conduct in international investment and trade where corruption cannot be tolerated under any circumstances.

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Қазақстан Республикасы жанындағы мемлекеттік басқару академиясы, Астана, Қазақстан

Халықаралық инвестициялық арбитраждағы сыбайлас жемқорлық

Аңдатпа. Инвестициялық арбитраж үшін сыбайлас жемқорлықпен күрес ең өзекті мәселелердің бірі болып табылады. Кей мемлекеттерде сыбайлас жемқорлық сауда мен инвестицияда кәсіпкерлікті жүргізудің бір әдісі ретінде көрініс табуы мүмкін. Теория бойынша халықаралық инвестицияға қатысты сыбайлас жемқорлықтың екі нысаны бар. Бірінші нысан бойынша, инвестор өзіне қолайлы келісімшартқа қол жеткізу үшін лауазымды тұлғаға пара берсе, ал екіншісінде қолында билігі бар лауазымды тұлға инвестордан белгілі бір төлем сұрау арқылы бопсалайды. Ғылыми мақаланың мақсаты дауларды реттеудің қайнар көзі ретінде халықаралық инвестициялық арбитражды шетел инвестициясындағы сыбайлас жемқорлыққа қарсы күресте тиімділігін бағалау. Сондай-ақ, мақалада қабылдаушы мемлекеттің сыбайлас жемқорлықты инвестициялық соттарда(трибуналдарда) қорғаныс құралы ретінде қолдануы сияқты күрделі мәселелер қарастырылады. Осы мәселені түсіндіру мақсатында автор Халықаралық Дюти компаниясы мен Кения Республикасы арасында орын алған дау бойынша кейсті зерттейді. Бұл кейс бұрынғы арбитраждардың басшылыққа алған инвистиялық істерге қатысты ұстанымдарын өзгертуге ықпал жасады.

Түйін сөздер: Сыбайлас жемқорлық, инвестициялық арбитраж, инвестор, қабылдаушы мемлекет, трибунал, Ағылшын құқығы, сыбайлас жемқорлыққа қарсы саясат

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Коррупция в международном инвестиционном праве

Абстракт. Коррупция представляется губительной для инвестиционного арбитража и международного развития в целом. В некоторых странах участие в коррупции является типичным методом ведения бизнеса в сфере инвестиций или торговли. Есть две формы взяточничества в отношении международных инвестиций. Одна из них заключается в том, что, когда инвестор подкупает должностное лицо, чтобы получить подходящий инвестиционный договора. Другой случай, когда инвестор шантажируется, чтобы заплатить деньги лицу, имеющему полномочия. Цель данной статьи оценить эффективность международного инвестиционного арбитража как источник разрешения споров для борьбы с подкупом иностранных инвестиций. Кроме того, основное внимание в статье уделяется спорным вопросам, когда принимающие государства могут использовать коррупцию в качестве защиты в инвестиционных трибуналах. В качестве примера приведен кэйс, связанный со спором между World Duty Company и Республикой Кения. Подчеркивается, что этот кэйс может изменить подход предыдущих арбитров.

Ключевые слова: Коррупция, инвестиционный арбитраж, инвестор, принимающее государство, трибунал, Английское право, антикоррупционная политика

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