



Dealing with Corruption Issues in Arbitration: The Use (and Risks of Abuse) of ‘Red Flag’ Analysis in Arbitration

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What is Corruption?

- Most corruption allegations are really about bribery
 - Giving, offering or promising
 - Something of value
 - To a public official
 - Directly or indirectly
 - To secure an undue advantage or other business benefit
- See OECD and other ABC Treaties

Corruption Issues in Arbitration—Typologies

- Contracts for corruption
 - i.e., contracts with a *cause illicite*—whose purpose is bribery
 - Generally third-party (intermediary) contracts
 - **Versus**
- Contracts or investments procured by corruption
- Other scenarios: corruption as an FET violation (affirmative) in investor-state disputes; corruption in contract or investment performance

What Are “Red Flags”

- Risk Indicators with respect to intermediary relationships
 - Agents, consultants, partners, others
- Any fact or circumstance that suggests a heightened risk of an improper payment (generally to a public official) by a third party on behalf of a principal for a business benefit

Red Flags—US DOJ List

– 2012 *FCPA Resource Guide*:

- Excessive commissions to third party agents or consultants;
- Unreasonably large discounts to third-party distributors;
- Third-party “consulting agreements” that include only vaguely described services;
- The third party consultant is in a different line of business than that for which it has been engaged;
- The third party is related to or closely associated with the foreign official;
- The third party became part of the transaction at the request or insistence of the foreign official;
- The third party is merely a shell company incorporated in an offshore jurisdiction; and
- The third party requests payment to offshore bank accounts.

Red Flags—ICC Guidelines

- A reference check reveals the Third party's flawed background or reputation, or the flawed background or reputation of an individual or enterprise represented by the third party;
- The operation takes place in a country known for corrupt payments (e.g., the country received a low score on Transparency International's Corruption Perceptions Index);
- The Third party is suggested by a public official, particularly one with discretionary authority over the business at issue;
- The Third party objects to representations regarding compliance with anti-corruption laws or other applicable laws;
- The Third party has a close personal or family relationship, or business relationship, with a public official or relative of the official;
- The Third party does not reside or have a significant business presence in the country where the customer or project is located;
- Due diligence reveals that the Third party is a shell company or has some other non-transparent corporate structure (e.g., a trust without information about the economic beneficiary);

Red Flags—ICC Guidelines (cont'd)

- . The only qualification the Third party brings to the venture is influence over public officials, or the Third party claims that he can help secure a contract because he knows the right people;
- The need for the Third party arises just before or after the contract is to be awarded;
- The Third party requires that his or her identity or, if the Third party is an enterprise, the identity of the enterprise's owners, principals, or employees, not be disclosed;
- The Third party's commission or fee seems disproportionate in relation to the services to be rendered;
- The Third party requires payment of a commission, or a significant portion thereof, before or immediately upon, the award of a contract;
- The Third party requests an increase in an agreed commission in order for the third party to "take care of" some people or cut some red tape; or
- The Third party requests unusual contract terms or payment arrangements that raise local issues, payments in cash, advance payment, payment in another country's currency, payment to an individual/entity that is not the contracting party; payment to a numbered bank account or bank account not held by the contracting individual/entity, or payment to a country that is not the contracting individual/entity's country of registration or the country where the services are performed.

Red Flags—Typologies

- General
 - Country, industry
 - **Versus**
- Specific
 - Counterparty-based
 - Transaction-focused
 - Formation
 - Implementation

Conclusion

- Connecting the dots...
 - Aggregation of red flags or the search for explanations and evidence?
- Consequences of finding corruption
 - Causation issues for contracts procured by corruption
 - Corruption in the performance vs. the making of an investment

Questions?

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