Arbitration and Money Laundering: What Are The Obligations Placed On Counsel And Arbitrators And What Risks Do They Face?

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In June 2017, the Fourth European Anti-Money Laundering Directive (the "**Fourth EU Directive**" (EU) 2015/849) was transposed into German law. The regime was further tightened, its scope was extended and new features, such as the transparency register, were introduced. With the fifth European Anti-Money Laundering Directive already on the horizon, more changes are to come. These recent developments serve as a reminder that arbitration is often perceived as being vulnerable to white collar crime such as corruption, fraud and money-laundering. Why is that so?

At first glance, arbitration and money laundering seem to be worlds apart. It lies in the nature of money laundering that its magnitude is difficult to grasp. Due to the high number of unreported cases official statistics cannot provide an exact picture, yet the United Nations Office on Drugs and Crime (UNODC) estimate that every year two to five percent of the global GDP is laundered. This amounts to approximately US$ 840 billion to US$ 2.2 trillion a year. Given these numbers, it would be naïve to suggest that arbitration is unaffected.

The confidentiality of arbitration, which finds is basis in the parties' agreement, can provide an ideal environment to conceal and disguise the origin of money. An arbitral award – issued in terms that enshrine a settlement between the parties – might be seen as the perfect means to legitimize money flows.

There are three main scenarios in which a potential money laundering concern may emerge in an arbitration. In the first instance, a party to the arbitration may raise questions regarding money laundering itself, potentially as a defence in the proceedings. Second, the arbitral tribunal may become suspicious regarding the legitimacy of the dispute or the purported transaction underlying that dispute. This may in turn raise questions about whether the whole purpose of the arbitration proceedings is to launder money. Third, and this could coincide with the second scenario where the entire arbitration is fabricated, the arbitration may be financed by illegal activities, e.g. the security for costs is paid by laundered money. In all three scenarios the arbitral tribunal could itself become – at least to some extent – an unwilling participant in the money laundering process.

So how should counsel and arbitrators respond to issues of money laundering? What are their obligations and what are the risks, if any, of failing to comply with them?

From the counsel's perspective

As counsel, the Fourth EU Directive might have direct influence on the decisions taken. The Directive demands *"notaries and other independent legal professionals"* to file a report *"where the obliged entity knows, suspects or has reasonable grounds to suspect that funds, regardless of the amount involved, are the proceeds of criminal activity"*. The extent of this obligation and whether it will affect counsel will depend on how the Directive has been implemented in the respective Member State. For example, the German Anti-Money Laundering Act, which transposes the Directive into German law, specifically mentions lawyers as *"independent legal professionals"*. Depending on the assignment and work counsel is tasked with, at least under German law, counsel may potentially even be under a duty to report cases of suspected money laundering to the authorities. Arbitration proceedings as such do fall within the remit of application of the German anti-money laundering regime. If, however, the arbitration relates to a transaction that falls within the scope of the German AML laws, this should be examined more closely. Counsel, nonetheless, should always be alive to issue of money laundering and should be careful to comply with their firms' internal AML measures which will transpose the obligations imposed under the Fourth EU Directive into their jurisdiction.

The Fourth EU Directive on Money Laundering from an arbitrator's perspective

The position is more complicated when an arbitrator, rather than counsel, has suspicions of money laundering or money laundering concerns are raised before him or her. There was a debate as to whether any of the four EU Anti-Money Laundering Directives is applicable to arbitrators. It appears that at least from a German perspective this has now been settled. Under German law, Arbitrators are not subject to the EU Anti-Money Laundering Directive. While one might potentially take the position that lawyers acting as arbitrators (and if one where to stretch this even further) every arbitrator (including those who are no lawyers) as such have to be regarded as *"other independent legal professionals"*, arbitrator are not *"assisting in the planning or carrying out of transactions"*. Moreover, applying the Directive to arbitrators, but only to lawyers acting as arbitrators, cannot be the intention. If it was the case that lawyers acting as arbitrators were subject to the Directive, it would mean they had special duties to fulfill, which their fellow arbitrators would not be subject to. However, one has to be cautious: the interpretation in Germany may not be replicated across the EU and the situation may therefore vary in between EU Member States. Given the importance of anti-money laundering legislation globally, it is critical that arbitrators are aware of applicable AML-laws that may bite on them.

Where AML legislation does bite, failure to act in accordance with that legislation may expose the tribunal to fines or criminal investigation. Even where, as in Germany, an arbitrator is not obliged to report its suspicions under national law, the question how to deal with money laundering in arbitration remains.

In any scenario described before, the tribunal will not find a clear cut answer in the pertinent conventions, laws and arbitral rules. Rather, the arbitral tribunal will have to manoeuvre on unstable ground through the principles of party autonomy and *non ultra petita* on the one hand and the tribunal's duty to render an enforceable award which may not be challenged and/or not be recognised based on a violation of public policy on the other.

If an arbitral tribunal becomes suspicious about money laundering on its own, the tribunal has to deal with this issue. Turning a blind eye on the suspicion may potentially not only endanger the enforceability of the arbitral award but it may – in the extreme – expose the tribunal to a criminal investigation. In many jurisdictions, including Germany, the tribunal will not be obliged to notify the authorities of its suspicion; and still there remains the risk to become an accomplice to the money laundering offence. The tribunal must therefore decide whether it investigates into the issue. One approach would be to inform the parties of its concerns and hear them on the issue. Given the tribunal's limited powers to compel the parties to submit evidence and that is has only limited

investigatory powers, this may be a futile exercise. This will particularly be so if the tribunal's suspicions are justified. If the parties indeed agreed to stage the arbitration proceedings they are unlikely to provide the necessary evidence to substantiate the tribunal's allegations.

In the second scenario, in which a party raises the "money-laundering defence", a tribunal does not have to worry about the *non ultra petita*. The most critical questions in this respect relate to the standard of proof which the arbitral tribunal should apply as well as to the allocation of the burden of proof. As regards the standard of proof, there is precedent available concerning allegations of bribery and corruption. In three of the most prominent cases, arbitral tribunals in general applied a high standard of proof requiring *"clear and convincing evidence"* (*EDF Ltd vs Romania* – ICSID ARB/05/13), *"clear and convincing evidence amounting to more than a mere preponderance"* (Westinghouse vs the Republic of the Philippines, ICC Case No 6401) or proof *"beyond doubt"* (*Hilmarton vs OTV*, ICC Case No 5622). As regards the burden of proof, it remains to be settled whether this burden should entirely rest upon the party invoking the money laundering defence or whether this standard should be alleviated, e.g. by requiring the counterparty to bring counterevidence in case the allegation prima facie appears to be grounded. At present, this will still be decided on a case-by-case basis.

At the enforcement stage, the question arises whether an arbitral award that is tainted by money-laundering allegations can be denied recognition and enforceability based on public policy grounds, Art. V (2) (b) New York Convention. Generally, the concept of public policy is construed narrowly. A public policy violation presupposes a clear violation of fundamental legal principles. Against the background of the precedent concerning arbitral proceedings involving corruption, there is a strong basis to argue that money laundering falls under the international *ordre public*. Money laundering is declared illegal by a number of international legal instruments, such as the Fourth EU Directive, and efforts to combat money laundering have intensified on a global level. After all, the money that is laundered regularly stems from a foregoing illegal activity, such as corruption. However, the views amongst courts in different states will differ on this view, as will be the standard of review that national courts will apply when being faced with *ordre public* defences.

Where does this leave practitioners? There are no clear guidelines but the issue remains relevant – not least because the legislator is further knitting the net. Therefore, arbitration practitioners should be aware of the basic principles and the discussion should continue.