

# Kluwer Arbitration Blog

## International Sales, Arbitration and Corruption: A CISG perspective

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Corruption is a sensitive issue for international merchants. According to the Transparency International's report "[Exporting Corruption](#)", enforcement against foreign bribery has dropped to its lowest level since it first began measuring it in 2009, which is alarming and reinforces the need for attention in arbitral proceedings.

In international sales contracts, one should consider the consequences of corruption on the validity of the contract, and the remedies to which the victim should be entitled, especially where the United Nations Convention on Contracts for the International Sale of Goods (CISG) is applicable. Corruption-related issues can also be extended to arbitration, as there are, for instance, issues of arbitrability or concerns with the powers of arbitrators. This short article intends to provide an answer to some of these questions, continuing the remarks made in this previous blog posts available [here](#), [here](#), [here](#) and [here](#).

### Arbitrability of corruption related issues

The arbitrability of issues involving corruption has come through a notable change in international arbitration practice.<sup>1)</sup>

Judge Gunnar Lagergren's pioneering view in the [ICC Case 1110/1963](#), that disputes involving corruption are non-arbitrable, no longer prevails. There is no doubt that arbitrators retain jurisdiction even when faced with a claim based on a contract tainted with corruption, subject to their own judgement on the validity and effectiveness of the arbitration agreement. The principles of Kompetenz-Kompetenz and separability enable arbitrators to distinguish the arbitration agreement from the main contract and rule on their own jurisdiction. On the contrary, lack of proper treatment of allegations or serious suspicions of underlying corruption may even amount to a breach of public policy under Article V(2)(b) of the New York Convention.

### Powers to investigate

The arbitrators have the discretion to investigate any suspicious circumstances in relation to the agreement of the parties or even their behaviour. Bearing in mind that the scope of such investigation is different from that of criminal proceedings, as it assesses the applicable remedies and civil consequences to a contractual relationship.

### **Staying the arbitral proceedings due to ongoing criminal investigations**

The arbitral tribunal may have to decide on a request to stay the arbitral proceedings whenever the domestic criminal investigations relating to the corruption allegations are still pending. The current practice in international arbitration grant the arbitrators discretion in deciding whether the arbitration should be stayed, given the circumstances of each case. It is, thus, a matter of weighing existing interests, efficiency, costs and the risks of conflicting decisions or jeopardy to either party's right to properly present its case. In the SCAI Case 300273-2013, P.O. 15, the request to stay the arbitral proceedings was rejected as it was not clear how the outcome of the criminal proceedings could affect the arbitration.

### **Contractual consequences of corruption**

Understanding the implications of corruption in international contracts requires distinguishing between contracts providing *for* corruption, also known as bribe agreements, and those procured *through* corruption. Although both categories of contracts are tainted by corruption, the outcome and appropriate remedies differ depending on the law applicable to the dispute.

Bribe agreements are generally seen as invalid and unenforceable, and prohibition of bribe agreements amounts to transnational public policy. Since bribe agreements are unenforceable, the practical principle in these cases is that "the money stays where it is". This is in line with well-known and widely accepted Roman law principle "*in pari turbitudine melior est causa possidentis*". Neither party to a bribe agreement may seek enforcement or restitution, for instance. In this sense, the arbitral tribunal in [World Duty Free Company v. Republic of Kenya, ICSID Case No. Arb/00/7](#) found that claims based on contracts tainted by corruption could not be upheld, as it would be contrary to transnational public policy. A similar reasoning could be used in commercial cases.

As for the second category, there are three possible outcomes: first, the main contract, obtained through corruption, is declared void; second, the injured party has the option between the invalidity of the agreement or its continuity; and third one, the main contract is deemed binding and effective, which limits the injured party's rights to other remedies, such as damages or price reduction.

Corruption related contracts with States generally fall under the second category, being the ones to contain valid obligations but having been procured through corruption, such as bid-rigging or collusion between State officials and private contractors or their agents.

Sometimes States can enter into bribe agreements. A government contract may be intentionally overpriced to allow the contractor to obtain additional funds to pay bribes to government officials. This will be an example of a bribe agreement involving a State entity. Except in these situations, a government contract tainted by corruption is not necessarily invalid or unenforceable, since its

ultimate purpose – supply of goods or service, public works – is a valid one. Normally the fate of the contract will be in the hands of the injured party, subject to constraints of unjust enrichment or other similar remedies to protect the contractor's rights to restitution or compensation. The contractual treatment of corruption in government contracts is generally more nuanced than the one reserved to bribe agreements between private parties.

### **CISG and corruption allegations**

CISG contracts may be tainted by corruption. An international sale of goods may hide bribe arrangements, such as increased prices to allow the seller to receive funds to bribe government officials. Or it may be entirely a sham: the buyer may withdraw its order and agree to pay damages to fund bribes by the seller.

In these cases, the CISG does not apply to the issue of validity of the contract (Article 4 sent. 2(a) CISG). The remedies of the CISG will only apply to the extent the contract is found to be valid entirely or in part. The contract may be partially valid if the corruption-tainted provisions may be detached from the rest of the agreement. In existing sales that hide funding for bribes, the discussion usually surrounds identifying which obligations are linked to the funding of bribes, and which other obligations are legitimate.<sup>2)</sup>

Since a contract obtained through corruption may not be void, but voidable, the injured party may choose to enforce it. However, the illegal origins may taint the goods and amount to a non-conformity. It is widely accepted that non-conformity may include non-physical features such as sustainability. In government contracts, honesty and abstention from corruption may be understood as implied terms. Therefore, non-conformity (Article 35 CISG) and avoidance for a fundamental breach (Article 25 CISG) may be available. The application of Article 35 CISG raises the issues of examination of the goods (Article 38 CISG) and notice (Article 39 CISG), which may be complex given that the corrupt practices may not become known immediately to the buyer. At any rate, if the seller is involved in the acts of corruption, it may not rely on the buyer's lack of timely notice (Article 40 CISG).

Damages may also apply under Article 74 CISG. To grant damages, the arbitrators must consider whether there has been an economic loss or a non-pecuniary loss, and whether the loss was foreseeable. In this regard, even the mere suspicion may entail damages if this suspicion impacts the use of the goods. Reputational damages would be especially appropriate for the remediation of corrupt practices in government contracts tainted with corruption when the goods in themselves are not physically defective.

Usually, governments are not allowed to purchase goods tainted by corruption, as it would run contrary to the underlying ethical constraints and moral obligations of a state entity. However, the public law response to corruption in public procurement is more complex and less all-or-nothing. In many jurisdictions there are mechanisms such as self-cleaning, non-prosecution agreements, leniency agreements or other forms to incentivize the private contractor to eliminate the effects of corruption through structural corporate changes and robust integrity programs. Requiring such measures may be a way to make the continuance of an originally corrupt contract compatible with the ethical commitments of a State entity. Under the CISG, it is open to investigation whether such corrective measures could amount to a requirement by the buyer for "the seller to remedy the lack

of conformity by repair” (Article 46(3) CISG).

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### References

- For a comprehensive view of the topic, see PEREIRA, Cesar; SOUZA-MCMURTRIE, Leonardo.
- ?1 Arbitragem e Corrupção: o que os árbitros podem (e devem) fazer. *Publicações da Escola da AGU*, ano 13, n. 2, Dec 2022, pp. 301-328
- ?2 SCHWENZER, Ingeborg. TEBEL, David, Suspicious, mere suspicions: non-conformity of the goods? in: 19 *Uniform Law Review* 2014, pp. 152-168.

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