Corruption, Embargos and Sanctions as a Bar to the Enforcement of Contracts in International Arbitration

A note on the decision of the Swiss Federal Supreme Court 4A_538/2012 dated 17 January 2013

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I. Introduction:

Many foreign companies hoping to break into new markets in Arab countries seek the assistance of local agents, representatives or other intermediaries (hereinafter *agents*). However, embargos and sanctions levelled against certain Arab countries often affect not only the foreign companies’ business, but also their contracts with local Arab agents. Another frequent source of disputes between agents and principals is the allegations of bribery or corruption. A 2013 judgement issued by the Swiss Federal Supreme Court (the “Supreme Court”), 1 in which it decided on a challenge of an arbitral award issued under the ICC Rules (the “Award”), 2 provides an example of how international arbitral tribunals might deal with allegations of illegality arising from the breach of international sanctions (*in casu*, the UN embargo against Iraq) and corruption. More specifically, the Award illustrates how an arbitral tribunal may assess the question of the validity of an agency agreement which allegedly involved corruption and breaches of international sanctions.

It is commonly accepted that economic sanctions adopted by the UN Security Council pursuant to Chapter VII of the UN Charter form part of international public policy. 3 When

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2. ICC Final Award, ICC Case No. 16684 (2012) ("ICC Award 16684"), unpublished.


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such sanctions are transposed into the national law that is designated by the parties to arbitration proceedings as the *lex contractus*, arbitral tribunals will give effect to such sanctions. Even where the UN sanctions have not been transposed into the domestic law of a given jurisdiction, arbitrators might apply them on the grounds that they form part of the public policy of that jurisdiction.

II. The background of the dispute before the ICC Arbitral Tribunal and the Swiss Federal Supreme Court:

On 6 August 1990, in reaction to the invasion of Kuwait by the Iraqi armed forces, the Security Council of the United Nations adopted Resolution No. 661 which instituted a general commercial embargo, banning all commercial exchanges and any activity that would promote commercial exchanges towards and from Iraq and Kuwait. Although not a member of the United Nations at the time, Switzerland implemented the Security Council Resolution by means of a Decree instituting economic measures against the Republic of Iraq. The embargo provisions were subsequently transposed into Swiss Law and became part of its public policy. The embargo was lifted in May 2003 following the adoption of Security Council Resolution No. 1483, save for the prohibition of sale or supply to Iraq of weapons and related materials.

The Award dealt with a dispute over the payment of fees under a representation agreement which had been executed between a French company (the "Principal") and an Iraqi representative (the "Representative") in 2000 (the "Representation Agreement", or the "Agreement") when the embargo against Iraq was still in force. The Principal, which


produced diesel engines for power plants, appointed the Iraqi company as its exclusive representative in Iraq. The Agreement was governed by Swiss substantive law and any dispute was made subject to arbitration in Lausanne (Switzerland).

Under the Agreement, the Representative was entitled to an 8.5% commission on any of the Principal's sales in Iraq to which it contributed. The parties also specifically agreed that the Representative would be entitled to a commission of EUR 6 million (in addition to the 8.5% commission) on a EUR 160 million sales contract concluded in 2002 between the Principal and a Syrian buyer of diesel engines which were ultimately destined for Iraq.

The dispute before the arbitral tribunal hinged on the validity of the Representation Agreement. The Principal argued that the Agreement should be declared null as it had been executed in breach of international public policy. Indeed, the Agreement was concluded while the embargo against Iraq was in force, and its object was the promotion of commercial exchanges with Iraq, which was banned under Resolution No. 661. The sales contract between the Principal and the Syrian buyer was similarly executed while the embargo was still in force. Although it provided for the delivery of goods to Syria, it made direct reference to a commercial offer that had previously been made to the Iraqi authorities, and the goods were ultimately delivered to Iraq, albeit in 2004, after the lifting of the UN sanctions.

The Principal also argued that the Agreement should not be enforced as the additional commission of EUR 6 million on the sale to the Syrian buyer had been used to pay bribes to Syrian officials and to finance terrorism.

In its Award, the arbitral tribunal ruled, in essence, that the Representation Agreement was a valid contract, despite having been executed during the UN embargo against Iraq and with regard to activities banned under the embargo. It dismissed the allegations of financing of terrorism and of corruption for lack of evidence, but nonetheless reduced the amount of the commissions to which the representative was entitled.

The Principal initiated proceedings to set aside the Award before the Swiss Federal Supreme Court, which has exclusive jurisdiction to decide all requests to set aside arbitral awards rendered in Switzerland. However, the Court rejected the request, and in doing so, addressed a number of important issues.

III. The arbitral tribunal's decision on the alleged invalidity of the Representation Agreement:

As mentioned above, the arbitral tribunal rejected the Principal's arguments that the Agreement was invalid due to the UN embargo against Iraq, and due to alleged corruption
and financing of terrorism. Before doing so, however, the arbitral tribunal also rejected the Representative’s argument that the Principal was estopped from maintaining that the Agreement was null and void, as it had partially performed it. This section summarises the arbitral tribunal’s reasoning on each of these issues, in turn.

A party is not *estopped* from challenging the validity of a contract that it has partially performed:

The Representative argued that the Principal, having partially performed the Representation Agreement, was *estopped* from maintaining that it was null and void. Indeed, even after the Principal had taken the view that the Agreement was null as a result of the UN embargo against Iraq, the parties had signed several amendments to the Agreement, *inter alia* extending its scope and the amount of the commission. The Principal had also paid part of the commission due under the Agreement for the conclusion of the sales contract with the Syrian buyer.

The arbitral tribunal found that there is no equivalent to the common law notion of estoppel under Swiss law, but that the prohibition of abuse of rights pursuant to Article 2(2) of the Swiss Civil Code (CC) was a related concept.9 It ruled, however, that the Principal was not barred from claiming the nullity of the Agreement under Article 2(2) CC as “[the Principal] certainly acted in good faith in claiming the nullity of the Agreement, since it considered that the rules implementing the United Nations Embargo against Iraq and in particular the Swiss Decree [implementing the UN measures] were part of the international public policy and could therefore not be waived by parties; there was consequently no abuse of rights on its part."

This finding is perfectly accurate in the circumstances. The parties’ conduct has indeed no impact on the validity of a contract if it is contrary to public policy. Whether that is the case, however, has to be established by the party alleging the breach of public policy (unless the tribunal assesses whether a contract is in breach of public policy on its own initiative). At that stage, the parties’ conduct is often a highly relevant factor considered by arbitral tribunals. For instance, a principal that has made payments to an agent under a contract in the past will find it difficult to persuade the arbitral tribunal that it should be released from making further payments because it alleges that it suddenly discovered that the contract provided for the payment of bribes. Short of a persuasive explanation for such past payments (or concrete proof of corruption), many tribunals will consider them as an element showing the absence of unlawful behaviour on the part of the agent.

9. Article 2 CC: “The manifest abuse of right is not protected by law”.
The Representation Agreement was not in breach of the UN sanctions against Iraq:

Article 20 of the Swiss Code of Obligations (“CO”) sets forth three alternative grounds on which a contract can be considered null and void, namely that (1) the contract is impossible to perform, (2) it is illegal, or (3) it violates bono mores. The Principal in the case at hand argued that the Representation Agreement was illegal. A contract is illegal if its content, its conclusion or its purpose is incompatible with mandatory provisions of Swiss law, such as measures implementing the UN embargo against Iraq.

The arbitral tribunal however found the Agreement to be valid since it was conditional upon the lifting of the embargo and was implemented only after that time. The arbitral tribunal noted that while some authors advocate that, irrespective of the subsequent lifting of the embargo, the validity of a contract should always be assessed at the time of execution, others consider that a contract which at the time of its actual performance is compatible with the Swiss legal order must not be annulled. In the opinion of the latter strand of doctrine, the lifting of the embargo would in fact resolve the nullity of a contract.

The arbitral tribunal acknowledged that the commissions due to the Representative under the Agreement were related to a contract entered into prior to the lifting of the embargo. It noted, however, that the goods were only delivered to Iraq after the sanctions were lifted. It also noted that the contract was a bilateral agreement with a Syrian buyer, even though the Syrian buyer had kept open the option of selling the goods on to Iraq if the embargo was lifted.

Ultimately, however, the decisive factor was not the timing of the performance of the contract triggering the Representative's commission, but the fact that the Representation Agreement itself was conditional upon the sanctions being lifted. The arbitral tribunal relied on the following provision of the Representation Agreement: “The Agent shall ensure that all acts accomplished in the Contractual Territory by [xxx] or for the account of [xxx] are administratively and legally valid and enforceable”. In light of this clause, the arbitral tribunal characterized the contract as a conditional agreement under Article 151 CO, that

10. Article 20 CO: “1. A contract is void if its terms are impossible, unlawful or immoral.
2. However, where the defect pertains only to certain terms of a contract, those terms alone are void unless there is cause to assume that the contract would not have been concluded without them’.

11. See for example the decision of the Swiss Federal Supreme Court 102 II 401 dated 21 December 1976.

12. Article 151 CO: “1. A contract is conditional if its binding nature is made independent on the occurrence of an event that is not certain to happen.
2. The contract takes effect as soon as this condition precedent occurs, unless the parties clearly intended otherwise.”

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is to say a contract which only becomes operative between the parties after the occurrence of an uncertain event. It went on to note that in the case before it that uncertain event was the lifting of the embargo against Iraq, which was by nature temporary and would cease once Iraqi troops had withdrawn from Kuwait (which ultimately occurred in May 2003).

As a result of the Representation Agreement being a conditional agreement, the arbitral tribunal concluded that “an agreement which was not in force could not have any effect whatsoever until the suspending condition was lifted, and certainly not the effect of promoting the sale of Embargoed goods”. It is on this basis that the arbitral tribunal dismissed the Principal’s argument that the Agreement should be declared null and void.

The Representation Agreement was not illegal due to corruption and financing of terrorism:

The Principal further argued that it should be released from paying any commission to the Representative on the basis that such commissions would in fact be destined to fund terrorist activities as well as to bribe public officials. It argued that no effect should be given to the Representation Agreement because these activities are illegal and in breach of Swiss public policy.

Insufficient evidence of corruption:

The Principal did not raise its argument that the Representative might have used its commissions to bribe public officials until a late stage of the proceedings, during the hearing and at the post-hearing brief stage. While conceding that there was no strict proof for its allegations, the Principal submitted that the arbitral tribunal should not order the payment of the commissions if it found that the Representative had indeed bribed public officials and that the Principal had agreed to pay the additional commission for that purpose.

The arbitral tribunal acknowledged that illegal activities such as bribery had the effect of rendering null and void the underlying contract under Article 20 CO. It noted, however, that the Principal had denied having been aware of any bribes, and had denied that it had agreed to pay commissions for the purpose of bribing public officials. In fact, the Principal had submitted that testimony given at the hearing by two of the Representative’s witnesses to the effect that the Representative had intended to make, or did make, payments to third parties, was not persuasive. In sum, the arbitrators found that the evidence submitted during the proceedings did not allow it to confirm that the additional commission agreed between the Parties was indeed meant to finance an illegitimate payment.
While noting the lack of compelling evidence, the arbitral tribunal did not rule out that part of the additional commission could have been used to bribe public officials. In the absence of concrete evidence, the arbitral tribunal examined whether there were other elements in support of the Principal's contention that the Representative had paid bribes. Referring to Article 17.2 of the 1998 ICC Rules, under which the arbitration was conducted, the tribunal noted that "In all cases the Arbitral Tribunal shall take account of the provisions of the contract and the relevant trade usages." The arbitral tribunal found that "it is the professional experience of this Arbitral Tribunal that a total commission of about 10% is considered in international commerce as legitimate compensation for the services rendered by a hard-working agent acting in a difficult environment. Anything above 10% (with tolerance) raises the suspicion that this incremental part is not for remunerating the work itself but rather for bribes or other payments".

The arbitral tribunal therefore considered that while the allegations of corruption were not established by the evidence submitted, the level of compensation agreed by the Parties, when assessed in light of the total amount of the contract, raised a suspicion that the part of the commission above 10% of the contract price would in fact not be destined to remunerate the work of the Representative but to corrupt officials. This finding was not, however, considered sufficient to declare the contract void. Nevertheless, even though the Principal had not sought a reduction of the commission, the arbitral tribunal proceeded to revise the amount of the commission to be paid to the Representative, limiting it to around 10% of the price of the relevant sales contract. For this purpose, it relied on Article 42.2 CO, which allows the tribunal to assess loss or damages on its own initiative in limited circumstances. It ruled that the 8.5% commission agreed upon in the Representation Agreement was due to the Representative, as well as that portion of the additional commission that the Parties had agreed to such that the total amount of the commission would not exceed approximately 11% of the net price of the contract with the Syrian buyer.

Insufficient evidence for financing of terrorism:

The Principal argued throughout the proceedings that it should be released from paying any commission to the Representative on the basis that one of its former general managers would fund a terrorist organization in Iraq. As a result, according to the Principal, the Representation Agreement would be a breach of Swiss public policy.

13. See also Article 21.2 of the 2012 ICC Rules.
14. Article 42.2 CO: "Where the exact value of the loss or damage cannot be quantified, the court shall estimate the value at its discretion in the light of the normal course of events and the steps taken by the injured party."
The Arbitral Tribunal noted that the Principal's allegations were solely based on accusations made by the Iraqi government against the former general manager of the Representative. It dismissed the Principal's argument for lack of evidence.

IV. The challenge of the arbitral award before the Swiss Federal Supreme Court:

The Principal initiated proceedings to set aside the Award before the Supreme Court, which has exclusive jurisdiction to decide all requests to set aside arbitral awards rendered in Switzerland.

The Principal relied on various grounds, including the alleged incompatibility with public policy of the Award's findings on the Principal's allegations of corruption.

Grounds for challenging an award before the Supreme Court:

The Supreme Court is not an appellate body for parties that are dissatisfied with an award rendered by an arbitral tribunal. As a result, when considering a request for annulment of an award, the Supreme Court will not revisit the factual findings of an arbitral tribunal or consider whether it correctly applied the law. Awards rendered in Switzerland can only be challenged on the five limited grounds set out in Article 190 of the Swiss Private International Law Act ("PILA"): 1.) improper constitution of the arbitral tribunal; 2.) lack of jurisdiction of the arbitral tribunal; 3.) ruling infra or ultra petita; 4.) violation of the right to be heard or of the equal treatment of the parties; or 5.) incompatibility of the award with public policy. 15

In the case before the Supreme Court, the Principal argued that by admitting the validity of a contract which was tainted with corruption, the arbitral tribunal had rendered an award which was incompatible with public policy, therefore giving rise to the annulment of the award on the basis of Article 190(2)(e) PILA. 16

The Award was found to be compatible with public policy:

In addressing the Principal's challenge, the Supreme Court recalled its standing case law that contracts made with the object of the paying bribes are null and void under Swiss

15. Article 190(2) PILA: "The award may only be annulled: a) if the sole arbitrator was not properly appointed or if the Arbitral tribunal was not properly constituted; b) if the Arbitral tribunal wrongly accepted or declined jurisdiction; c) if the Arbitral tribunal's decision went beyond the claims submitted to it, or failed to decide one of the items of the claim; d) if the principle of equal treatment of the parties or the right of the parties to be heard was violated; e) if the award is incompatible with public policy". (informal translation).

law and contrary to public policy. However, allegations of corruption must be established.\(^{17}\) The Supreme Court also recalled its well established position that in order for an award to be considered incompatible with public policy as a result of allegations of corruption, the award must have found the allegations of bribery to be averred but then failed to draw the necessary conclusions from its finding.\(^{18}\)

The Supreme Court found that nothing in the Award indicated that the arbitral tribunal had found that corruption had occurred. The arbitrators had reduced the commission to what they considered to be uncontroversial (10%) in light of commercial usages and their own experience. It is manifest from the Court's decision that it considered that the arbitral tribunal's legal reasoning was unfortunate, however it noted that the quality of the arbitral tribunal's reasoning was beyond the scope of review of the Supreme Court: "\textit{whatever the pertinence of the legal reasoning, which is not to be examined by the Federal Supreme Court, it cannot be concluded that the arbitrators would have considered as established the elements constituting bribery}."\(^{19}\)

The Court added that the Principal was ill-placed to assert that corruption had been established to the extent that it had challenged statements made by the Representative's witnesses to the effect that the Representative had considered making payments to third parties, or had actually made such payments.\(^{20}\)

The threshold for a challenge of an award on the ground of public policy is high. Up until 2012, only a single award has been set aside for breach of substantive public policy,\(^{21}\) and the Supreme Court has not yet annulled an award ruling on corruption allegations on this ground. On the other hand, corruption is a crime. In case of a crime, even if the 30-day

\(^{17}\) Decision of the Swiss Federal Supreme Court, para. 6.1.
\(^{18}\) Decision of the Swiss Federal Supreme Court, para.6.1: "Under the Swiss standard, promises of payments of bribes are contrary to \textit{mores} and therefore null as a result of the irregularity affecting their content. It is accepted that such promises are also a violation of public policy (...). However, in order for the corresponding violation to be admitted, the arbitral tribunal must have refused to consider [the corruption scheme] in its award, although corruption is established.* (translation provided by the authors) (original French : "\textit{Les promesses de versement de pots-de-vin, d'après la conception juridique suisse, sont contraires aux mœurs et, partant, nulles en raison du vice affectant leur contenu. Selon un point de vue confirmé, elles contreviennent également à l'ordre public (...). Encore faut-il, pour que le grief correspondant soit admis, que la corruption soit établie, mais que le Tribunal arbitral ait refusé d'en tenir compte dans sa sentence (...)."}

\(^{19}\) Decision of the Swiss Federal Supreme Court, para.6.2: "\textit{Quelle que soit la pertinence de ce raisonnement juridique, qui échappe à l'examen du Tribunal Fédéral, on ne peut pas en déduire que les arbitres ont considéré comme avérés les éléments constitutifs de la corruption.}"

\(^{20}\) Decision of the Swiss Federal Supreme Court, para.6.2.
\(^{21}\) Swiss Federal Supreme Court, Decision 4A_558/2011 of 27 March 2012, ASA Bull. 3/2012, p. 591. See also the commentary by Laurence Burger, \textit{For the first time, the Supreme Court sets aside an arbitral award on grounds of substantive public policy}, ASA Bull. 3/2012, p. 603.

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time limit for challenging an award has long expired, a party can still seek to annul the award by means of a request for revision. Thus, the Supreme Court has revised an award some 12 years after it was rendered. In this case, the principal who had lost the arbitration initiated criminal proceedings in France on the basis that a witness had given false testimony at the hearing. The French authorities found proof that a witness had indeed lied to the arbitrators as to the true nature of the contract giving rise to the dispute. The Defendant filed a motion before the Supreme Court to have the award revised. The Supreme Court relied on the findings of the French authorities to conclude that one of the parties had in fact misled the arbitral tribunal and was guilty of procedural fraud which had had a direct influence on the award. As a result, the Supreme Court annulled the award and directed the matter to the original arbitral tribunal or a new arbitral tribunal to be constituted.22

V. Conclusion:

Experience shows that international arbitral tribunals will go the extra mile to enforce contracts entered into among business people, although averred cases of bribery, corruption or breach of sanctions or embargos will be fatal to a contract. It is, however, incumbent on the party alleging illegality on the basis of corruption to prove its allegations, and arbitral tribunals tend to apply a high standard of proof to allegations of illegality that could lead to the contract being null and void. The Award is another example of this trend. As for the decision of the Supreme Court, it is an illustration of the Court’s restrictive approach when it comes to annulment of awards. This restrictive approach is not self-imposed, but a result of the limited review of arbitral awards allowed by Swiss law. As a result, parties invoking a case of illegality are well advised to adduce all necessary evidence in the arbitration. The facts established by the arbitral tribunal will bind the Supreme Court in any subsequent annulment proceedings.

In its decision, the Supreme Court did not address the unorthodox approach taken in the Award to assessing whether corruption had occurred or not. Other tribunals may not have reduced commissions that they considered to be suspiciously high but drawn the conclusion that a contract providing for such commissions was a contract which provided for bribery. Indeed, the level of fees due to a representative can be considered to be circumstantial evidence to establish corruption, leading to a finding that the contract is null and void.23 However, whether a fee is unusually high depends on the circumstances. Some

23. See for example ICC Case No. 8891 where in light of the level of the fees due and the services rendered by the representative, the arbitral tribunal concluded to the true object of the contract was to bribe public officials and therefore concluded to the nullity of the contract, Journal du Droit International, 2000, pp. 1076 ff.
tribunals have considered that, in light of the circumstances of the case, relatively high fees were either justified or should be revised to reflect the services provided by the representative. 24 There is no quick test. The particular circumstances of each case will be decisive. This explains why in one case, a commission of more than 3 to 5% of the total value of the contract awarded has been considered as conclusive evidence that part of the commission would be used for bribing public officials, while in another case a 27% commission was considered reasonable in light of all the circumstances. 25

The fact that parties agree on remuneration based on a percentage of procured contracts is not in itself suspicious. Percentage fees are the rule rather than the exception when it comes calculating the remuneration of agents. 26

There are also other criteria which arbitral tribunals can take into account when assessing allegations or suspicions of corruption, such as: the terms of the contract, and whether they are mere window dressing intended to hide the true intent of the parties; the endemic nature of corruption in certain countries or lines of business; whether the representative has an established business and whether it has close personal relationships with public officials interested in the underlying contract; whether the representative actually rendered services; and whether the agreement between the principal and the representative provides for unusual payment terms. 27 As a general

24. See for example ICC Case No. 7074 where the amount of the fees due to a representative was discussed; the tribunal considered that the representative had rendered its services and that the sales contract had been entered into, therefore the representative was entitled to the fees as agreed between the parties, published in ASA Bulletin, 1995, pp. 301-357; in ICC Case no. 8177 the arbitral tribunal proceeded to reduce the fees for being excessive in light of the services rendered, published in ICC Bulletin, Spring 2001, p. 85.


rule, however, it can be said that whatever the test and criteria chosen, arbitral tribunals tend to apply a high standard of proof standards when it comes to allegations of bribery.  