

# New York Courts and International Arbitration Tribunals Take Varying Approaches to Corruption Issues in Commercial Disputes

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When faced with questions of corruption in a commercial dispute, New York courts and international arbitration tribunals have historically taken different approaches. In particular, questions often arise pertaining to applicable law, consequences of corruption and issues of proof. These issues are critical in determining the outcome of a case when a party is resisting enforcement of a contract on the grounds that it was formed for a corrupt purpose or that the contract was tainted by corruption.

## Corruption and Applicable Law

A key issue in these cases is determining the relevant laws governing both the conduct and contract in question. Several New York courts have judged the legality of conduct based on the law in the place where the conduct occurred, whereas the consequences of any illegality have been determined by the contract's proper law (*e.g.*, *Korea Life Ins. Co., Ltd. v. Morgan Guar. Trust Co. of New York*, 269 F. Supp. 2d 424, 438 (S.D.N.Y. 2003)). This is consistent with the approach adopted in the Restatement (Second) on Conflict of Laws § 187(2)(b), which in certain circumstances applies a law different from the contract's governing law when an interested country's fundamental public policy would otherwise be violated. However, relying on General Obligations Law § 5-1401, some New York courts have found that this principle does not apply to commercial contracts worth at least \$250,000 with an express choice of New York governing law (*Supply & Building Co. v. Estee Lauder Intern., Inc.*, 2000 WL 22383 at \*3 (S.D.N.Y. Feb. 25, 2000)). Nevertheless, even if a court applies New York law, it may refuse to enforce a contract if it finds the contract violates the laws of other jurisdictions (*Lehman Bros. Commercial Corp. v. Minmetals Intern. Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 118, 138 (S.D.N.Y. 2000)).

On the other hand, international arbitration tribunals generally are not bound by a pre-existing set of conflict of laws principles and may carry out their own analyses to determine what laws will govern questions of corruption and its effect on contracts. For example, some tribunals have based their decision to decline to hear claims allegedly tainted by corruption on a principle of international public policy against corruption rather than the application of a particular national law (*e.g.*, ICC Case No. 1110 of 1963). Many other international tribunals have looked to the conflict of laws rules of the place of arbitration to determine which law should apply. Still others have considered the laws governing the contract, the mandatory rules (such as corruption laws) of the countries connected with the transaction, or the laws of the country in which any arbitral award is likely to be enforced. Under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention, a country may refuse to enforce any arbitral award on public policy grounds if the tribunal did not consider relevant anti-corruption laws. Accordingly, in international arbitration, a tribunal may apply a range of national and international laws beyond the law governing the contract and may deny effect to certain contract obligations.

## Consequences of Corruption

New York courts have refused to enforce contracts procured by, or involving, corruption, when the connection between the corrupt act and the obligation at issue is strong (*e.g.*, *Prote Contracting Co. v. Bd. of Educ. City of N.Y.* 230 A.D.2d 32, 40-41 (1997)). However, some courts have still enforced the contract if the plaintiff was unaware of any illegality or was clearly less culpable than the defendant (*Republic of Iraq v. ABB AG*, 768 F.3d 145, 162 (2d Cir. 2014)). Courts also have given plaintiffs some relief under different causes of action, such as restitution, despite refusing to enforce the contract (*Am. Buying Ins. Servs., Inc. v. S. Kornreich & Sons, Inc.*, 944 F. Supp. 240, 244-45 (S.D.N.Y. 1996)).

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Several arbitral decisions appear to categorically refuse to grant relief on any claim based on rights obtained or otherwise tainted by corruption. The tribunal, in a recent award, suggested this was necessary to promote “the rule of law” (*Metal-Tech Ltd v. Uzbekistan* (ICSID 2013)). Nonetheless, at least one tribunal awarded restitution to a claimant despite invalidating the contract due to corruption (*World Duty Free Co. Ltd. v. Kenya* (ICSID 2006)). The arbitration community also has criticized the blanket dismissal of any claims tainted by corruption, particularly when the other party also is involved in the corruption and may be enriched from a dismissal of the claims. Arbitral tribunals may have considered in unreported decisions, or will take into account in future proceedings, the relative culpability of the parties, or the extent of the connection between the corruption and claim, in similar ways to the approach taken by New York courts.

## Issues of Proof

Both New York courts and arbitral tribunals have ruled that contracts are presumed legal, and the burden is on the party alleging illegality to prove otherwise (*e.g.*, *Dias v. Tire Mart, Inc.*, 27 Misc. 2d 24, 33 (Sup. Ct. 1960); *ECE Projektmanagement Int'l GmbH v. Czech Republic* (UNCITRAL 2013)). However, some New York courts and international arbitration tribunals have ruled on issues of illegality, such as corruption, even when those issues are not raised by the parties. In either case, courts

and the majority of arbitral tribunals generally require “clear and convincing” evidence before finding corruption; however, the only evidence available is often circumstantial (*e.g.*, *Chevron Corp. v. Donziger*, 974 F. Supp. 2d 362, 559 (S.D.N.Y. 2014); *Fraport AG Frankfurt Airport Serv. Worldwide v. Philippines* (ICSID 2014)).

Parties before New York courts often have greater access to information, which may support allegations of corruption due to the wider variety of discovery mechanisms available in court proceedings than in arbitration. Given the difficulty of proving corruption in any forum, however, that benefit is arguably balanced by arbitration’s generally less strict rules of evidence. The difficulty in obtaining evidence in connection with arbitral proceedings, and a perceived strong international policy against corruption, has led some tribunals to reverse, in special circumstances, the burden of proof and require that claimants prove an absence of corruption when a reasonable suspicion was raised, or to require a lesser standard of proof of corruption (*e.g.*, ICC Cases No. 6497 of 1994 and 12990 of 2005). However, this does not appear to be the majority approach, and a recent leading foreign investment award affirmed the high standard of proof required for finding corruption (*Fraport* (ICSID 2014)). Accordingly, demonstrating proof of corruption remains a high hurdle in both international arbitration and New York litigation.