

Client Alert: Corruption in International Arbitration - Libya vs Sorelec (Paris Court of Appeal, 17 November 2020¹)

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In a landmark decision, the Paris Court of Appeal annulled an International Chamber of Commerce (ICC) arbitral award, finding that the underlying settlement, which was negotiated and concluded between the former Libyan Minister of Justice and a French company, was tainted by corruption. The court held that the Minister had bypassed the Libyan State Lawsuits Authority. Moreover, he agreed to the settlement quickly and on very favorable terms for the foreign claimant without documenting the negotiation process in any detail. According to the court, these actions provided sufficient evidence that the settlement was tainted by corruption, especially given Libya's overall high level of corruption.

The Decision of the Paris Court of Appeal

The judicial saga in this case began in 1979, when the French claimant company entered into a contract with the Libyan Ministry of Education for the construction of schools. The relationship was troubled from the beginning. In 2013, the claimant brought claims in an ICC arbitration against the Libyan state, which was represented by the State Lawsuits Authority who is competent to represent the state in disputes with foreign parties.

In parallel, the parties engaged in settlement negotiations, which resulted in a settlement agreement signed on behalf of Libya by the Minister of Justice for the “provisional government” of Libya in late March 2016. The arbitral tribunal issued the arbitral award based on this settlement agreement, which was negotiated directly by the Minister who bypassed the State Lawsuits Authority. The Libyan state then challenged the arbitral award in the Paris Court of Appeal.

The court annulled the arbitral award, finding that there were “compelling indications” the settlement was tainted by corruption. It emphasized that when the settlement was made, Libya's governmental structure was unclear, with two rival governments based in Tripoli and Tobruk, and the level of corruption in the country was high in general. Moreover, the settlement was negotiated and agreed in only one day, the negotiations were not documented, and the terms of the settlement were imbalanced, lacking any true concessions from the international claimant. Additionally, when the Minister concluded a settlement with very favorable terms for the foreign claimant, he bypassed the State Lawsuits Authority.

The court held that combatting corruption was a paramount goal under international law. Therefore, an arbitral award tainted by corruption was contrary to public order and must be annulled.

¹ RG 18/02568.

Establishing Corruption in International Arbitration

Corruption is a plague in international business. The Court takes a clear position regarding corruption in international arbitration and how respective allegations can be established based on circumstantial evidence.

In the absence of manifest evidence, corruption is often difficult to establish. In this case, the court can overcome these challenges by establishing principles when corruption may be established based on circumstantial evidence in countries with a high level of corruption. In the present case, the court referred to: (i) Libya's generally high level of corruption, (ii) the unclear governmental structure when the settlement was made, (iii) the respondent's failure to observe internal approval procedures, and (iv) the lack of properly documented negotiations. This approach is in line with a more recent trend at the international level to permit establishing corruption on the basis of circumstantial evidence.

Settling Disputes with Failing States

The decision, however, also provides important guidelines for settling disputes with failing states. Investor state disputes can drag on for years, and so can respective settlement negotiations, particularly if government structures are weak. As a result, foreign parties often are tempted (or may even be compelled) to take advantage of any "window of opportunity" to settle. Here, the court's decision shows the risks associated with such an approach – including for parties who do not use illicit means to achieve their objective.

Who represents the state?

A state is represented by its government, not only politically but also in commercial transactions and international disputes. But who acts for the failing state when governmental authority has eroded or there are two parallel governments?

On the international level, there are principally two approaches to this issue. Under the so-called "continuity doctrine," a government is treated as "the government" until it has been replaced by a new government. This means that the old government and its representatives remain in charge until a new government structure has evolved. In the present case, applying the continuity doctrine means that the State Lawsuits Authority continues to represent the state of Libya.

The other approach, the "one voice" doctrine, would ask whether the government is recognized internationally. This doctrine is advocated by English courts and argues that foreign policy and the courts must take an aligned approach and speak with one voice. Under this doctrine, a court or an arbitration tribunal must treat the body who is politically recognized on an international level as "the government."

Who authorizes a settlement?

The question of whether a state's representative actually has the authority to commit the state is one that arises frequently in international arbitration, in particular when concluding arbitration agreements. Here, international arbitral tribunals tend to take the view that the absence of internal approvals (*e.g.*, an arbitration clause needs ministerial consent or approval by the parliament) does not invalidate the arbitration clause. If a state submits to arbitration, it

cannot at a later point in time claim that it was not permitted to do so because this would be inconsistent with the doctrine of good faith.

In the present case, the court deviated from this principle by emphasizing that the settlement agreement signed by the Minister of Justice was subject to approval by the State Lawsuits Authority and that, not only was the approval not obtained, the Minister was also aware of that fact.

The particularly unstable political situation in Libya at the time when the settlement was made (and the assumption that the claimant took advantage of the unclear government structure) may have motivated the court's conclusion that the Minister bypassed the State Lawsuits Authority, thus invalidating the settlement. As a result, the French claimant was not entitled to rely on the principles of apparent authority. The court's decision should, however, serve as a warning that a foreign party must act with due diligence when entering into a settlement agreement with a government representative and must not disregard internal approval procedures.

How must settlement negotiations be documented?

When the court determined the settlement was tainted by corruption, it essentially relied on the fact that the settlement was negotiated quickly, and there was no detailed documentation of the negotiations. This approach may well have been influenced by the special circumstances of the case. From a more general perspective, however, alarm bells instantly start to ring.

Outlook

Settling investor state disputes is often a rather erratic process. An international investor is faced with changing (and at times competing) government representatives pursuing different agendas, making it difficult to maintain a principled approach in settlement negotiations. As a result, investors may feel required to take advantage of opportunities as they arise.

Also parties acting in full compliance with the law will need to be flexible and take into consideration an array of interests on the side of the host state. What is imperative, however, is to duly document any negotiations so that the commercial (or political) rationale of the outcome can be explained later.

If you would like more information about this topic, please contact us.

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