



FRA Insights

# How to bring evidence of corruption in international arbitration

By: [Amina Khoungui](#), Director, and [Derek Patterson](#), Principal

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Regulatory activity around the world has been broadening in the pursuit to uncover, sanction, and where possible undo the effects of corrupt activity. In parallel, and perhaps partly because of this, corruption has become a hot topic in international arbitration in recent years, especially in investor-state arbitrations. By way of example, it was deployed as a means to request the dismissal of a claim before arbitral tribunals and to obtain the annulment of an arbitral award before national courts.

The term corruption is a broad one, encompassing a wide variety of dishonest practices, including bribery, money laundering, embezzlement, bribery, misappropriation or other diversion of property, and false accounting and auditing. Tribunals have adopted various standards of proof for corruption allegations - "robust",

"clear and convincing" or "beyond reasonable doubt" to name a few - but most arbitral tribunal and national courts in annulment proceedings have relied on transactional red flags, i.e., circumstantial indicators of corruption, to guide their decision making. Examples of red flags include:

- Unusual payment modalities (e.g., cash, gifts or other indirect payments)
- Use of third-party intermediaries (TPIs) with little experience or who carry reputational risk (e.g. TPI investigated or fined by national or foreign regulators or authorities)
- Use of offshore or shell companies
- Circumvention of due diligence processes in selecting vendors
- Lack of details around and evidence of services rendered and billed

- High/unusual amounts of payment not benchmarked to activity levels or market prices
- Non-compliance with local tendering rules (e.g. unusual speed of bidding process)
- The absence of a well-designed and active compliance program.

Often these indicia should be considered together, as a pattern of behaviour, and not only as single occurrences.

Ultimately the legal characterisation of indicia of alleged corruption, the standards of proof applied to them, or their legal and procedural impacts are matters of law for the tribunal or court to decide upon. However, from a factual perspective, we share in this article our thoughts on practical approaches to identify relevant facts and explain how they may or may not constitute red flags in the context of a specific business transaction. We discuss various approaches available to support or rebut corruption allegations, and share case study examples where approaches were combined to evidence simple and more complex corruption schemes within a global business.

## The Forensic Tools

Unfortunately for dispute parties and their legal counsel, identifying glaringly clear evidence of corruption, such as a cash-stuffed Louis Vuitton bag, is fairly rare these days. International business transactions have become increasingly sophisticated, and so have the behaviours used to conceal corruption. For instance, in many cases, illicit payments to a third-party intermediary will not be a straightforward wire transfer to the intermediary's bank account. Rather, the payment may go through a sophisticated scheme involving a network of global related parties and indirect payments. An example is included in the case studies that follow.

In the absence of an obvious "smoking gun", identifying compelling red flags ideally requires the combination of accounting and financial data (structured data) analysis and document (unstructured data) review, with, to the extent appropriate, searches of public records and, if appropriate, supportive witness statements.

We discuss in this article three case studies of arrangements suggesting corruption, together with a description of how the analysis of data highlighted red flags.

## Case Studies

### “Simple” Scheme:

#### Direct payments to a third-party intermediary

One of the most often used arrangements used to make illicit payments to decision makers is to contract third-party consultants, agents or “business partners” in what appears on the surface to be a legitimate business relationship. However, commissions or fees paid to these third parties are then inflated above open market value. In this way, the TPI may then channel funds to the other persons, such as decision-makers, thus keeping the details of the ultimate distribution of funds outside of the company contracting with the TPI.

For example, an equipment manufacturer secured certain high-value sales contracts in Turkey. The manufacturer’s sales contracts were of a nature that often required the intervention and sign-off of influential government officials. An allegation was made that the manufacturer used TPIs to channel payments to these government officials, via the payment of unusually high commissions.

To substantiate these allegations, an iterative review of structured and unstructured data was performed, with findings in one population triggering a verification in the other. For example, identification and quantification of payments to the TPI in the accounting data, were matched to the corresponding contract, invoices and email correspondence in an email review. The review of correspondence yielded an email chain between the company and the TPI that clarified the purpose of the inflated commissions paid to the TPI. Further, the email review also revealed the existence of further TPIs and corruption schemes in other jurisdictions.

The red flags in these cases included the disproportionate commission amounts, the opaque ownership structure of the TPIs, and insufficient information regarding the management or financial situation of the company suggesting high risk in its engagement.

## Sophisticated Schemes:

### Diverted payments through credit notes

Where more elaborate schemes are deployed, more sophisticated analysis is required.

In one example, evidence was identified that the CEO of a legal entity (which was a customer of a selling company) in Southeast Asia distorted normal transaction flows to receive large kickbacks from the selling company via a complex scheme of credit notes. The selling company issued significant credit notes to the legal entity pursuant to the sales agreement, thus requiring a disbursement of funds to the legal entity to settle. However, the disbursement of funds pursuant to the credit notes did not go to the legal entity but to a different company created and controlled by the CEO and with a very similar name as the legal entity. The CEO and the selling company essentially diverted the money "owed" to the legal entity customer for the CEO's benefit.

This cash diversion left a large "negative" balance in the selling company's financial records (receivable account), since the credit

notes were still outstanding in that account. This scheme was uncovered by identifying these large outstanding credit notes in the customer account. By following through the supporting documentation and linking the credit notes to the sham company account, through a review of the accounting data and emails and public searches of corporate data, it was identified that millions of dollars were paid to the CEO to grant the underlying sales contract to the selling company. In this case, the clear circumvention of normal financial controls constituted a significant "red flag" to evidence corruption.

In the context of arbitration, access to accounting data and documents will be key to establish the existence of red flags and hence potential corruption. Counsel should therefore take this into account in the overall arbitration plan, as obtaining data and conducting the review is likely to require sufficient time and may influence the design of any potential discovery request to the adverse party.

## Sophisticated Schemes: Impaired Loans and Investments

In addition to the use of direct payments to third-party agents and kickback loops with credit notes, typologies can include other “creative” ways to channel illicit payments to decision-makers.

For example, granting loans to an entity whose ultimate beneficiary owner was the decision maker, in exchange for a favourable decision. The lender then “forgave” the debt and the debtor never reimbursed the loan, which amounted in the end to a cash gift. Indicia of red flags included the loan being

impaired and written off in the lender’s accounts.

Similar to the loan scheme, some companies have agreed to invest in corporations ultimately owned by a decision maker, in exchange for an undue advantage. The investment - oftentimes at inflated value - is officially presented as a legitimate business venture but is then deemed unrecoverable and requires to be impaired on the investor’s balance sheet. This also essentially amounts to a cash gift to the ultimate beneficiary.

## Take-Aways

Incorporating corruption red flag indicia within legal arguments can be a powerful means for arbitration parties and legal counsel to shape how an arbitration panel considers contractual arrangements and transactions. Incorporating the following into the arbitration strategy will help achieve this:

- Conduct the review using a robust and justifiable methodology. This will ensure the review can withstand pushback and scrutiny and carry the most weight with an arbitration panel;

- Ensure that adequate time and resources are planned into the arbitration process, as conducting an effective red flag indicia review takes time and will require access to company staff, systems and documents; and
- Consider what data and information is required from the opposing parties, as this will inform disclosure requests and will likely extend the timetable for completing the review.

Lastly though, also consider the wider effect of what is being identified, documented and asserted in submissions - might there be unintended consequences!

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## CONTACT THE AUTHORS



**Amina Khoungui**  
Director  
akhoungui@forensicrisk.com



**Derek Patterson**  
Principal  
dpatterson@forensicrisk.com

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