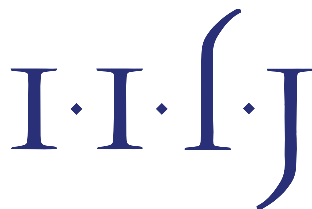

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Civil Remedies for Corruption in Government Contracting:

Zero Tolerance versus Proportional Liability[†]

Kevin E. Davis[*]

Abstract

Bribery in public contracting is a serious problem, particularly in societies with weak public institutions. The trend in the law applicable to contracts between governments and foreign firms is to refuse to enforce contracts procured through bribery. This zero-tolerance approach may have perverse consequences. Proof that a firm obtained a contract through bribery does not necessarily indicate the extent to which the firm has fallen short of its obligations to combat bribery. The zero-tolerance approach fails to take into account the extent to which the firm has not only attempted to prevent bribery but also monitored and punished employees who engage in bribery, cooperated with law enforcement authorities, and created value for the government in the course of performing its side of the contract. Subjecting bribe-payers to liability that is more proportional to fault seems preferable on a number of grounds.

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I. Introduction

In March 1989 Nasir Ibrahim Ali, a Dubai businessman, was given an audience with His Excellency Daniel arap Moi, the then President of Kenya. Ali was seeking the President's approval of a venture that would involve the establishment and operation of duty free complexes at the Nairobi and Mombasa International Airports. At Ali's side was Rashid Sajjad, a Kenyan businessman. Sajjad was carrying a brown briefcase containing US$500,000 in cash. The cash represented a portion of a sum of US $2 million that Sajjad had recently received from Ali. As they entered the room to meet the President, Sajjad left the briefcase by the wall. After the meeting Ali retrieved the briefcase and saw that the cash had been replaced with fresh corn. The President approved the project and on April 27, 1989 an agreement was signed.

Stories like this do not ordinarily come to light.[2] This story only became public after a dispute arose between Mr. Ali and the Kenyan government. According to Mr. Ali the Kenyan government violated its agreement with his company, World Duty Free Company Ltd., by essentially expropriating his interest in the company.[3] As contemplated by the agreement between the parties, World Duty Free sought to have this dispute resolved by a panel of arbitrators convened under the auspices of the International Center for the Settlement of Investment Disputes (ICSID). In the course of those proceedings Mr. Ali voluntarily provided the information about the circumstances under which his investment agreement came into being. He took the position that the payment

[2] For a survey of similar cases decided by international tribunals see, Hilmar Raeschke-Kessler & Dorothee Gottwald, Corruption in Foreign Investment – Contracts and Dispute Settlement between Investors, States, and Agents, 9 Journal of World Investment & Trade 5, 12 (2008) (referring to 11 cases of this kind).
[3] World Duty Free alleged that these events were triggered by its decision to co-operate with officials investigating the Goldenberg Fraud. World Duty Free v. Kenya, ICSID Case No. ARB/00/7, 46 I.L.M. 339 (2007), paras. 68-72 [hereinafter, *World Duty Free*].

to President Moi was "a gift of protocol or a personal donation made to the President to be used for public purposes within the framework of the Kenyan system of Harambee."[4] The lawyers for the Republic of Kenya argued that the payment was an illegal bribe.

The ICSID panel agreed with Kenya. It dismissed World Duty Free's claim on the ground that upholding a claim based on a contract obtained by bribery would be contrary to international public policy. The panel also concluded that Kenya was entitled to avoid the contract under English and Kenyan law, which the parties had chosen to govern their agreement. At least two other ICSID panels have taken similarly tough stances toward claims based on illegally obtained government contracts and the only international instruments directly on point appear to endorse this approach.[5]

There is little doubt that this sort of bribery in public contracting is a serious problem. It typically either increases the cost to the government of procuring goods and services or reduces the benefits that it receives in exchange for the resources under its control. In extreme cases bribery may induce public officials to award contracts that generate no benefit whatsoever or, even worse, cause affirmative harm. In addition, there is the harm that might be caused to members of the broader society represented by the government. Those harms include: loss of public faith in, and thus support for, the government; excessive investments in and conflicts over government positions; distortion of the composition of the public service; and, unjust skewing of the distribution of wealth in favor of public officials. These problems are generally considered to be particularly

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[4] *World Duty Free*, *supra*, para. 133.

[5] United Nations Convention Against Corruption, in force December 14, 2005 ["UN Convention"]; Civil Law Convention on Corruption, Council of Europe, European Treaty Series No. 174, November 4, 1999, in force November 1, 2003 ["Civil Law Convention"]. See generally, Theodore H. Moran, Combating Corrupt Payments in Foreign Investment Concessions: Closing the Loopholes, Extending the Tools (Center for Global Development, January 2008).

serious in relation to the governments of poor countries, especially when they deal with large multinational firms, but corruption in public contracting is also a problem for the governments of wealthier countries.[6]

This Article addresses the general question of how lawmakers – defined broadly to include government agencies, judges, arbitrators, and international bodies – ought to respond to the problem of bribery in government contracting.[7] More specifically, it focuses on the role played by the law governing the enforceability of contracts procured through bribery. The central argument is that although the tribunal in *World Duty Free* may have arrived at the correct result on the facts of that case – it is difficult to work up much sympathy for Mr. Ali or his claim – the zero-tolerance approach endorsed by the panel is, at least as a matter of policy, flawed and an alternative remedial approach is warranted.

The basic concern is that the zero-tolerance approach essentially punishes firms for two types of misconduct: 1) failing to prevent contracts from being procured through bribery and 2) making investments in reliance on those contracts rather than walking away. This approach seems misguided because it ignores the potential limits of preventive efforts and exit as well as the range of alternative ways in which both firms and governments can help to combat bribery in public contracting. No matter how unequivocally legal institutions state their opposition to enforcement of corruptly obtained contracts, there will be corruptible government officials and employees of private firms willing to deal with them. At the same time, even if there is nothing (short

[6] See generally, Susan Rose-Ackerman, Corruption and Government: Causes, Consequences and Reform (New York: Cambridge, 1999), 27-35.
[7] Throughout this paper the term "government" will be used to refer to a range of public actors, including states as well as local government authorities.

of shunning entire regimes) that firms can do to prevent their employees from resorting to bribery, they can still monitor and punish the ones who lapse, report them to law enforcement authorities, and create value for the government and society as a whole by continuing to invest in reliance upon their contracts. However, the zero-tolerance approach condemns firms unequivocally, regardless of whether they have taken any of these steps. The argument here is simply that a firm whose agents pay bribes ought to receive at least some credit on the basis of factors such as their role in exposing the extent of corruption and the value created by their investments.

Part II of this Article describes the complex web of legal doctrines that come into play when allegations of bribery in government contracting are raised, particularly in cases involving contracts with foreign firms, and the extent to which those doctrines provide room to deviate from the zero-tolerance approach. For practical reasons the focus is on situations where the relevant body of domestic law is either English law or the law of one of the United States of America. Part III describes and then critiques the policy arguments used to justify the zero-tolerance approach. Part IV sets out an alternative remedial approach, inspired by contemporary approaches to corporate criminal liability. Part V discusses how the proportional liability approach can be reconciled with existing doctrine. Part VI concludes.

II. Existing doctrine

Suppose that an agent or employee of a firm pays a bribe to a government official in order to induce the government to conclude a contract with that firm. Assuming that there is no binding legislation or contractual provision, what effect does this have on the

rights and duties of the parties to the contract? The answer is not entirely clear, partly because resolving these disputes may require the application of norms derived from both private law and public law. The situation is likely to be even more complicated when governments contract with foreign firms, particularly in cases involving governments of less developed countries. In these cases principles of private international law will determine what state's domestic laws ought to be used to resolve the dispute. In addition, some tribunals like to refer to principles of 'transnational law' to resolve transnational disputes. Finally, public international law comes into play to the extent that it requires states to adopt particular rules in their domestic law; where a dispute relating to the contract is heard in a forum governed by an international instrument such as a bilateral investment treaty ("BIT"); or where a breach of contract with a foreign investor might qualify as a breach of some other type of international obligation (besides those found in a BIT). The principles to be derived from each of these sources of law are outlined below.

As a preliminary matter though, it is worth noting that although it is difficult to describe the legal consequences of bribery in doctrinal terms, it is not so difficult to describe them in functional terms. In functional terms, proof of bribery commonly creates four main types of entitlements for the government (and correlative duties for the contractor). First of all, proof that a contract was obtained through bribery may give the government an entitlement to recover *compensation* for losses caused by the corrupt act. Those losses might be calculated by taking the difference between the benefits the government would have received if no bribery had taken place and the benefits they received by entering into the contract tainted by bribery. Second, proof of bribery may

give the government an entitlement to *disgorgement*, namely a right to recover any benefits the contractor earned as a consequence of the corrupt act. Third, the government might be given an entitlement to recover *punitive damages*, that is to say, supra-compensatory damages designed primarily to punish. Fourth, proof of bribery may give the government an entitlement to *avoid* its obligations under the contract. Those obligations may not be replaced by any other obligations. Alternatively, the government may become subject to an obligation either to pay for any value received pursuant to the contract – i.e. an obligation to make *restitution* – or to compensate the contractor to some extent for what it has invested in *reliance* on the contract. In principle, avoidance may be limited to obligations owed to the bribe-payer as opposed, for instance, to a person to whom the bribe-payer's assigns its rights. Avoidance may also take effect either retroactively (i.e. as of the time the contract is signed), or as of the time that the government gives notice of intention to avoid the contract.

Entitlements to compensation, avoidance or disgorgement can also vary along at least two additional dimensions. First, they may vary in *duration*. In some cases the government may lose entitlements conditioned upon proof of bribery if it fails to exercise them within a reasonable time after the relevant facts were or ought to have been discovered. Second, these entitlements may vary in terms of their *alienability*. In other words, the government may or may not be able to surrender its entitlements by, for example, agreeing not to assert them against assignees of the bribe-payer, compromising claims or unilaterally affirming the contract.

A. Private Law I: Agency Law

In the absence of any special statutory, constitutional or contractual provisions, contractual disputes between governments and private actors tend to be governed by the same doctrines that govern disputes between private actors. In other words, they are governed by private law. Private law also becomes applicable whenever the parties explicitly opt out of any special norms applicable to government contracts in favour of a specific body of private law.

In common law jurisdictions the private law norms that govern contracts procured through bribery can be derived by analogy from the principles that govern two distinct types of cases. First, there are the cases involving transactions resulting from a breach of trust on the part of a faithless agent. Second, since bribery is typically illegal, analogies can be drawn to other transactions tainted by some form of illegality. In the *World Duty Free* case the panel examined and applied both lines of cases, even though Lord Mustill, a former member of Britain's House of Lords, tendered an expert opinion expressing the view that as far as English law was concerned the cases on illegality "shed no light on the question before [him]."[8]

Following Lord Mustill's lead, it is convenient to begin with the principles of agency law. Many legal systems allow a principal whose agent has received a bribe in connection with a transaction to elect, as against its counterparty,[9] between what I have

[8] *World Duty Free*, *supra*, para. 164 (quoting Lord Mustill).
[9] The fact that the bribe has been paid by someone who themselves acts as an agent of the counterparty rather than a principal seems to be irrelevant to the application of these principles. So long as the bribe-payer is acting within the scope of their ostensible authority as an agent their principal is liable for the agent's bribery. Armagas Ltd. Appellants v. Mundogas S.A. Respondents [1986] A.C. 717 [1986] 2 W.L.R. 1063 HL.

called compensation and avoidance.[10] In common law jurisdictions the right to compensation may be characterized as either a claim in tort or a claim in equity for dishonestly assisting the agent in his breach of fiduciary duty.[11] It is not entirely clear though how the amount of compensation is to be calculated. In one case the court went along with the parties' suggestion to use the difference between the principal's position under the actual contracts negotiated by a corrupt agent and the contract that would have been negotiated by an honest and prudent negotiator owing undivided loyalty to the principal.[12] An alternative approach is to treat as a baseline the terms that would have been negotiated by the particular agent in question – as opposed to a hypothetical prudent person – if they had not been corrupted. The difference between these two approaches is that the former approach risks compensating the principal for having chosen an imprudent or even incompetent agent.[13] A third alternative is to allow the principal to recover the amount of the bribe from the bribe-payer.[14] This makes sense as a form of compensation if we assume that paying the bribe caused the bribe-payer to inflate the price charged to the principal by at least as much as the amount of the bribe.[15]

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[10] International Institute for the Unification of Private Law, UNIDROIT Principles of International Commercial Contracts 2004, available at http:// www.unidroit.org/english/principles/contracts/main.htm, ["UNIDROIT Principles"], Articles 2.27 (conflicts of interest) and 3.18 (damages); Restatement (Third) Agency § 8.02 ("An agent has a duty not to acquire a material benefit from a third party in connection with transactions conducted or other actions taken on behalf of the principal." Comment e provides that "the principal may recover monetary relief from the agent and, in appropriate circumstances, from any third party who participated in the agent's breach. A principal may avoid a contract entered into by the agent with a third party who participated in the agent's breach of duty.")

[11] There is disagreement about whether this tort is best classified as a form of deceit or as a sui generis tort. Compare Charles Mitchell, Civil liability for bribery, L.Q.R. 2001, 117(Apr), 207-213 (bribery is a sui generis tort of fraud) with K.R. Handley, Civil liability for bribery (No. 2). L.Q.R. 2001, 117(Oct), 536-538 (bribery is a form of deceit).

[12] Fyffes Group Ltd. and Others v. Templeman and Others [2000] 2 Lloyd's Rep. 643 QBD; Mahesan s/o Thambiah v. Malaysia Government Officers' Co-operative Housing Society Ltd. [1979] A.C. 374.

[13] Mitchell, supra.

[14] Continental Management, Inc. v. U. S., 527 F.2d 613 (Ct.Cl., 1975).

[15] Continental Management, Inc. v. U. S., 527 F.2d 613, 618-9 (Ct.Cl., 1975).

Agency law also provides the option of avoiding contracts procured through bribery. The general rule is that these contracts are voidable.[16] This means that the principal can avoid its contractual obligations to the bribe-payer.[17] The obligations are typically replaced by an obligation to make restitution, that is to say, to return any benefits conferred upon it by the counterparty on account of the contract.[18] The principal is also entitled to affirm the contract.[19] The UNIDROIT principles arguably require the right to avoid a contract to be exercised within a reasonable time.[20] There is some authority for the proposition that the right to avoid a contract procured through bribery can be waived as against innocent assignees of the bribe-payer.[21] This means, for example, that if a contract procured through bribery is assigned by the bribe-payer to a bank, the bank will be able to enforce the contract so long as the victim of the bribery 1) waived its right to assert defenses against an assignee that it would normally have against the bribe-payer and 2) the bank received the assignment in good faith without knowledge of the bribery.

Sometimes a principal whose agent has taken a bribe also has, at its option, an entitlement to disgorgement of the profits that the bribe-payer earned because the agent

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[16] The situation is slightly different if the agent lacks either actual or ostensible authority to conclude the contract. In that case, the contract is "void." Armagas Ltd. Appellants v. Mundogas S.A. Respondents [1986] A.C. 717 [1986] 2 W.L.R. 1063 HL; UNIDROIT Principles, Articles 2.2.5 and 2.2.7.

[17] Bankers Trust Co. v. Litton Sys., 599 F.2d 488 (2d Cir. 1979)

[18] UNIDROIT Principles, Article 3.17 (retroactive effect of avoidance).

[19] Logicrose Ltd. v. Southend United Football Club Ltd. [1988] 1 W.L.R. 1256 Ch D; Panama and South Pacific Telegraph Company v. India Rubber, Gutta Percha, and Telegraph Works Company (1874-75) L.R. 10 Ch. App. 515 [1872 P. 6.] CA in Chancery; Armagas Ltd. Appellants v. Mundogas S.A. Respondents [1986] A.C. 717 [1986] 2 W.L.R. 1063 HL; Ballin v. Fourteenth Street Store, 123 App.Div. 582, 108 N.Y.S. 26 (App.Div.1908), aff'd 195 N.Y. 580, 89 N.E. 1095 (Ct.App.1909),

[20] International Institute for the Unification of Private Law, UNIDROIT Principles of International Commercial Contracts 2004, available at http:// www.unidroit.org/english/principles/contracts/main.htm, UNIDROIT Principles Article 3.15 (time limits). These time limits apply to the right to avoid a contract that involves the agent in a conflict of interest. They do not seem to apply to cases where the contract is deemed ineffective under Article 2.2.5 because the agent lacked actual or ostensible authority.

[21] Bankers Trust Co. v. Litton Sys., 599 F.2d 488 (2d Cir. 1979).

failed to behave in an honest and prudent fashion. The courts which have awarded this kind of relief have reasoned by analogy to cases in which third parties who aided in other sorts of breach of fiduciary duty were made to account for their profits.[22] Disgorgement need not, however, mean an entitlement to recover all of the profits that the bribe-payer has earned on the contract. In one English case, *Fyffes*, the court held that the bribe-payer was not required to disgorge profits that it would have earned in the absence of the bribe.[23] In that particular case the court concluded that it was "highly probable" that in the absence of bribery the parties would have simply entered into a contract on terms less favourable to the bribe-payer and that the bribe-payer did not have to disgorge the profits it would have earned on that other contract. In the circumstances of that particular case the amount the bribe-payer would have been required to disgorge was the same as the amount of compensation required to put the principal in the position it would have been in if the bribe had not been paid.[24]

A final feature of agency law is that in some jurisdictions punitive damages can be awarded against the bribe-payer.[25] This is probably more likely to occur under U.S. law than the law of other jurisdictions. Typically the decision to award punitive damages is a discretionary one based on the outrageousness of the defendant's conduct.[26] There is some U.S. authority suggesting that the fact that a principal has made good faith efforts to avoid wrongdoing by an agent weighs against the imposition of punitive damages.[27]

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[22] Fyffes, supra citing, Cook v Deeks [1916] AC 554) (disgorgement provided against party who aided in breach of duty of loyalty) and Attorney General v. Guardian Newspapers (No.2) [1990] 1 AC 109 (the Spycatcher case) (disgorgement awarded against party who aided in breach of duty of confidentiality).
[23] Fyffes, supra, 672.
[24] Id.
[25] Jaclyn, Inc. v. Edison Bros. Stores, Inc., 406 A.2d 474, 492-4 (N.J.Super.L., 1979).
[26] Restatement (Second) Torts § 908.
[27] Kolstod v American Dental Assn 527 US 526, 544-546 (1999), per O'Connor J (stating that it may be inappropriate to hold employers who make good faith efforts to comply with the prohibition on sex

Meanwhile in the Commonwealth, even a moderately generous reading of the Privy Council's decision in *Meridian Global Funds Management Asia Ltd. v. Securities Commission* suggests that courts are permitted to take policy considerations into account when setting the rules which govern attribution of liability for agents' misconduct to organizational actors.[28]

B. Private law II: Illegality and Related Doctrines

Notwithstanding Lord Mustill's recommendation that we analyze the problem of contracts procured through bribery using agency law principles, it is also important to examine the second set of private law principles considered by the panel in the *World Duty Free* case, namely, the principles that govern contracts whose formation or performance involves activity that is illegal or otherwise deemed to be reprehensible.[29] Courts in the United States seem particularly willing to extend these principles to cases involving contracts procured through bribery.

We can begin our discussion with the cases involving illegality. Those cases typically involve situations in which illegality is raised as a defense to a claim for breach of contract. That defense rests on two distinct legal principles, both of which are motivated by the notion of respect for the rule-of-law.[30] The first principle is that a contract whose performance involves a legal wrong will not be enforced. The outer

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discrimination in Title VII of the Civil Rights Act of 1964 liable for punitive damages). For discussion of the conflicting views about the state of U.S. law on this point see, Exxon Shipping Co. v. Baker, 128 S.Ct. 2605, 2615-6.

[28] Meridian Global Funds Management Asia Ltd. v. Securities Commission, [1995] 3 W.L.R. 413.

[29] See generally, The Law Commission, Illegal Transactions: The Effect of Illegality on Contracts and Trusts, Law Commission Consultation Paper 30-188-01 (January 21, 1999); The Law Commission, The Illegality Defence. Consultation Paper No 189 (January 23, 2009); (Restatement (Second) of Contracts § 178 (1981). The UNIDROIT Principles explicitly decline to address the topic of whether contracts can be invalidated on the grounds of immorality or illegality. UNIDROIT Principles, Article 3.1 (matters not covered).

[30] The Law Commission draws a similar distinction in its consultation papers on the subject. See id.

bounds of this principle are unclear in many circumstances, including: when performance may but need not involve illegality; where performance of the contract represents only a minor step toward completion of the illegal act; or where only one party is aware of the illegality.[31] In any event, there are numerous decisions which apply this principle to bar enforcement of contracts whose performance entails paying a bribe, either directly or indirectly (the typical cases involve selling or buying agents who have paid bribes being barred from suing for their commissions).[32] It is not, however, obvious that the principle applies to a contract procured through bribery whose performance does not in and of itself involve any illegal conduct.

The second principle that underpins the defense of illegality is that a contract cannot be enforced by a party where some legal norm expressly or impliedly bars enforcement. This principle has the potential to affect virtually any contract procured through bribery. For instance, a court might hold that a criminal prohibition on bribery impliedly bars enforcement of any resulting contract by the briber, and possibly the recipient of the bribe as well. Even more plausibly, a tribunal might hold that a statute which prescribes a particular procedure for forming government contracts impliedly bars enforcement of contracts formed in violation of the procedure. Naturally, the idea that the civil consequences of violating a particular legal prohibition can be derived by implication even in the absence of express language grants adjudicators considerable discretion.

The defense of illegality is often virtually indistinguishable from two other doctrines, the unclean hands doctrine and the defense of public policy. In its

[31] Law Commission, Illegal Transactions, supra at 21-27.
[32] Oscanyan v. Arms Co., 103 U.S. 261 (1881); McConnell v. Commonwealth Pictures Corp., 166 N.E.2d 494, 497 (N.Y. 1960).

traditional form, the unclean hands doctrine "closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief, however improper may have been the behavior of the defendant."[33] In some jurisdictions the doctrine has been extended to bar plaintiffs from seeking legal as well as equitable relief.[34] In other cases, rather than referring to the unclean hands doctrine courts simply refer to something called the doctrine of public policy, which has similar features. The unclean hands doctrine and the doctrine of public policy are broader than the doctrine of illegality because the inequitable conduct or contravention of public policy that triggers these doctrines need not be strictly illegal.[35] Consequently, there is little doubt that paying a bribe can trigger the application of these doctrines against a party seeking a legal remedy, even in circumstances in which the bribe is not, strictly speaking, illegal.[36]

In functional terms, the defenses of illegality, public policy and unclean hands all provide entitlements to avoid illegal contracts, and, typically, in remarkably harsh ways.[37] First of all, when a party's entitlement to a contractual remedy is avoided on these grounds it usually is not replaced by an entitlement to restitution. The general rule is that there is no obligation to make restitution of benefits conferred under an illegal contract unless the plaintiff can show that it was less culpable than the defendant (*non in pari*

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[33] Precision Instr. Mfg. Co. v. Automative Maintenance Machinery Co., 324 U.S. 806, 814 (1945). See also, Holman v. Johnson (1775) 1 Cowp. 341

[34] See, for example, Adler v. Federal Republic of Nigeria, 219 F.3d 869 C.A.9 (Cal.,2000).

[35] McConnell v. Commonwealth Pictures Corp. 7 N.Y.2d 465, 470 (1960) ("The issue is not whether the acts alleged in the defenses would constitute the crime of commercial bribery under section 439 of the Penal Law, Consol.Laws, c. 40, although it appears that they would.")

[36] See, for example, Sirkin, supra (applying the doctrine of public policy to bar enforcement of contract procured through commercial bribery).

[37] See, for example, Adler v. Federal Republic of Nigeria, 219 F.3d 869 C.A.9 (Cal.,2000) (denying relief to a U.S. national who advanced over $5 million that he knew would be used to bribe Nigerian government officials in furtherance of what he understood to be an illegal agreement to defraud the Nigerian government).

delicto).[38] In practice this has been taken to mean that a bribe-payer is only entitled to restitution if it can show that it paid the bribe under duress or while mistaken about the legality of its conduct.[39] A second interesting facet of the doctrine of illegality is that several courts have held that contracts procured through illegal bribery cannot be ratified.[40] However, it has also been held that the defense of public policy simply does not arise if the principal of the agent who has been bribed is aware of the bribery.[41]

Courts appear to have some latitude in deciding whether to apply the defense of illegality.[42] Some commentators suggest that in exercising their judgment in this area it is important to maintain proportionality between the seriousness of the plaintiff's misconduct and the severity of the penal effect of denying relief.[43] Similarly, some of the courts asked to apply the doctrines of unclean hands or public policy have considered the relative seriousness of the misconduct of the plaintiff and the defendant and whether denying the plaintiff relief would unjustly enrich the defendant.[44]

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[38] Parkinson v. College of Ambulance, Limited, and Harrison, [1925] 2 K.B. 1; Mohamed v. Alaga & Co. (a firm) [2000] 1 W.L.R. 1815 CA (Civ Div); Restatement (Second) of Contracts § 198 (1981).
[39] Law Commission, The Illegality Defence, supra, 66. Restatement (Second) of Contracts § 198 (1981) comments a and b. For a critique of this construction of the *non in pari delicto* requirement see, Law Commission, The Illegality Defence, supra at 74-78.
[40] Sirkin v. Fourteenth St. Store, 124 A.D. 384, 391 (N.Y.A.D. 1 Dept., 1908). Ballin v. Fourteenth Street Store, 123 App.Div. 582, 108 N.Y.S. 26 (App.Div.1908), aff'd 195 N.Y. 580, 89 N.E. 1095 (Ct.App.1909),
[41] Ballin v. Fourteenth Street Store, 108 N.Y.S. 26 (App.Div.1908), aff'd , 89 N.E. 1095 (Ct.App.1909).
[42] See, for example, Marlwood Commercial Inc v. Kozeny et al., 2006 WL 1457378 [2006] EWHC 872 (Comm) QBD (Comm), para. 172 ("The mere proof of illegality will not cause the Court "to draw up its skirts and refuse all assistance to the plaintiff". The illegality or immorality must be central to the case, and not merely collateral."); Courage Ltd. v. Crehan, [2001] ECR I-6297; Goodfriend v. Goodfriend, [1972] S.C.R. 640, per Laskin J. The Law Commission has endorsed a flexible application of the illegality defence. See Law Commission, The Illegality Defence, supra at 76-78.
[43] Restatement (Second) of Contracts § 178 (1981).
[44] See, for example, Adler, supra; Nelson v. Nelson, [1995] HCA 25.

C. Public Law

In common law jurisdictions, contracts with the government are often governed by legal principles which resemble, but are not necessarily identical to, the principles that govern contracts with private actors.[45] Depending on the jurisdiction therefore, the principles that govern the effects of bribery on contracts between private actors, may or may not apply to government contracts procured through bribery.

To the extent that the legal principles in this area are the products of reasoning by analogy there are several reasons why it makes sense to reject the idea of drawing analogies from private law principles. To begin with, there are reasons why judges and lawmakers might look at bribery in public contracting as a species of illegality even if bribery in private settings is viewed as an agency problem. First, whereas bribery of an agent of a private firm is not always criminalized, bribery of government officials appears to be universally criminalized. Second, many jurisdictions have passed legislation specifying procedures that must be followed in the course of awarding public contracts. Examples include requirements to solicit bids through open advertising or to award the contract to the lowest qualified bidder. Contracts procured through bribery often contravene these types of procedural rules. When this happens, the performance of the contract as opposed to only its formation will be illegal, making these cases fall right into

[45] See, for example, Anne C. L. Davies, The Public Law of Government Contracts, 7 (2008) ("[Government contracts] are subject mainly to the ordinary private law of contract"). Compare ___.

the core of the doctrine of illegality.[46] Third, some may perceive bribery in government contracting as a more serious public policy concern than commercial bribery.[47]

At the same time, when the recipient of a bribe is a head of state like President Moi, analogies to either contracts formed by faithless agents or contracts tainted by illegality appear inapt. A head of state seems less like a faithless agent and more like an avaricious principal; a contract made by a head of state looks less like an illegal act that is contrary to public policy and more like a definitive expression of public policy. Courts and arbitral tribunals generally reject these arguments on the theory that the head of state is still an agent of the state and bound by the prohibitions on bribery of public officials set out in the law of virtually every jurisdiction.[48] But this response is not always wholly convincing.[49]

In the United Kingdom public contracts appear, if only on account of the standard terms incorporated in most public contracts, to be governed by principles resembling those of agency law. According to those standard terms, government contractors must promise not to provide inducements to any public officials in connection with the award or performance of a public contract. Violation of this prohibition gives the government an

[46] These contracts may also be *ultra vires*. For a discussion and critique of the principles applicable to *ultra vires* government contracts.s, under both municipal and international law, see, Theodor Meron, Repudiation of *Ultra Vires* State Contracts and the International Responsibility of States, 6 Int'l & Comp. L. Q. 273 (1957).
[47] See, for example, Jaclyn, Inc. v. Edison Bros. Stores, Inc., 406 A.2d 474, 485n (N.J.Super.L., 1979) (citing Manning Engineering, Inc. v. Hudson County Park Commission, 376 A.2d 1194, 1207-9 (N.J. 1977).
[48] World Duty Free, para. 185. See also, Republic of Philippines v. Westinghouse Elec. Corp., 774 F.Supp. 1438 (D.N.J, 1991) (rejecting argument that Ferdinand Marcos did not owe a fiduciary duty to the Republic of the Philippines).
[49] Consider, for example, the recent BAE affair in which the monarch of Saudi Arabia, which is a kingdom without a written constitution, explicitly condoned the alleged bribery of a public official in connection with a public contract. See, Nelson D. Schwartz and Lowell Bergman, Payload: Taking Aim at Corporate Bribery, New York Times, November 25, 2007. See also, R (on the application of Corner House Research and others) v. Director of the Serious Fraud Office [2008] UKHL 60.

entitlement to terminate the contract (or, in my terminology, to avoid it prospectively), and sue for compensation.[50]

The situation appears to be somewhat different in the United States, where many courts view bribery in public contracting through the lens of the doctrines surrounding illegal contracts. This has resulted in very harsh treatment of parties who pay bribes to obtain public contracts. A classic example is the leading New York case, *S. T. Grand, Inc. v. City of New York*. The case concerned a contractor who paid a bribe to obtain a no-bid contract to clean a New York City reservoir. The court held that not only was the contractor barred from recovering either its unpaid fees or the fair value of the work done, but in addition, the city could recover all of the fees it had already paid the vendor.[51] In other words, using the terminology introduced above, the court held that the city was entitled to retroactive avoidance without restitution.

New York's harsh approach to contracts obtained through bribery is widely followed by courts in the United States[52] and is embodied in the standard provisions that govern most federal government procurement contracts.[53] Other courts have added the wrinkle that the government is entitled to avoid these sorts of contracts even if the

[50] Office of Government Commerce, Model Terms and Conditions of Contracts for Goods, clause D1; Model Terms and Conditions of Contracts for Services, clause D1. Both these model agreements are available online at http://www.ogc.gov.uk/Model_terms_and_conditions_for_goods_and_services.asp.
[51] S. T. Grand, Inc. v. City of New York, 298 N.E.2d 105 (N.Y. 1973).
[52] K & R Engineering Co., Inc. v. U. S., 616 F.2d 469 (Ct. Cl., 1980); Pan-American Petroleum & Transport Co. v. U.S., 273 U.S. 456 (1927); Thomson v. Call, 699 P.2d 316 (Cal. Ct. App. 1985), cert. denied, 474 U.S. 1057 (1986); County of Essex v. First Union Nat. Bank, 891 A.2d 600 (N.J., 2006). See generally, Sheridan Strickland, Municipality of Anchorage v. Hitachi Cable, Ltd. — Time for Adoption of a Void Contract Remedy for Alaska Public Contracting Authorities, 6 Alaska L. Rev. 227, 238.
[53] The Federal Acquisition Regulation gives federal government agencies the authority to declare void and rescind contracts where a final conviction for bribery, conflict of interest or a similar violation has been entered. The agency may also recover the amounts expended and the property transferred by the agency under the terms of the contracts involved. See, 48 CFR Ch. 1, Subch. A, Pt. 3, Subpt. 3.7.

superiors of the corrupt official condoned the conflict of interest.[54] In a case involving a conflict of interest but not a bribe, the U.S. Supreme Court explained, "[Congress] recognized that an agent's superiors may not appreciate the nature of the agent's conflict, or that the superiors might, in fact, share the agent's conflict of interest. The prohibition was therefore designed to protect the United States, as a Government, from the mistakes, as well as the connivance, of its own officers and agents."[55]

It is worth noting, however, that even the New York courts have occasionally tempered their zeal to punish bribe-payers. The court in *S.T. Grand* acknowledged that in some cases a municipality would only be entitled to compensation for the harm caused by an illegally awarded contract, as opposed to retroactive avoidance.[56] It cited *Gerzof v. Sweeney,* an earlier New York case in which a contract to install a power generator was improperly awarded to the higher of two bidders (no allegation of bribery was involved) and the municipality was awarded damages for the loss caused by failing to contract with the lowest bidder.[57] The *S. T. Grand* court pointed out that the impropriety in *Gerzof* did not taint the municipality's determination of whether it needed a new generator, making it easy to determine the damages caused by the impropriety.[58] *Gerzof* also cited other New York cases suggesting that a person who transfers property (as opposed to providing services) under an illegal contract is entitled to restitution in kind (return of the very thing provided) where return is straightforward.[59] However, other courts in the U.S.A. have

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[54] Thomson v. Call, 699 P.2d 316, 326 (Cal.,1985); United States v. Mississippi Valley Generating Co., 364 U.S. 520, 561 (1961).
[55] United States v. Mississippi Valley Generating Co., 364 U.S. 520, 561 (1961).
[56] S. T. Grand, Inc. v. City of New York, 298 N.E.2d 105, 108-9 (N.Y. 1973).
[57] S. T. Grand, Inc. v. City of New York, 298 N.E.2d 105, 108-9 (N.Y. 1973), citing Gerzof v. Sweeney, 239 N.E.2d 521 (1968).
[58] S. T. Grand, Inc. v. City of New York, 298 N.E.2d 105, 109 (N.Y. 1973).
[59] See, Gerzof v. Sweeney, 239 N.E.2d 521, 524 (1968) citing, Spadanuta v. Incorporated Village of Rockville Centre, 15 N.Y.2d 755, 257 N.Y.S.2d 329 (N.Y. 1965).

explicitly rejected these efforts to mitigate the impact of avoiding illegal public contracts.[60]

D. Transnational Law

Disputes involving contracts with a transnational dimension can plausibly be adjudicated under the laws of at least two jurisdictions, but ordinarily the laws of one particular jurisdiction are ultimately applied. Typically, the contract itself will point to the law of either the jurisdiction of one of the parties or a prominent neutral jurisdiction such as England or New York. A tribunal called on to resolve a contractual dispute may choose to give effect to this kind of choice-of-law clause. Alternatively, if it decides to ignore the choice-of-law clause or in the absence of such clause, the tribunal may use its own choice-of-law principles to determine the jurisdiction whose laws govern. In either event, the substantive principles applied will be drawn from the internal law of one jurisdiction or another.

Even when they choose to apply a specific jurisdiction's laws to a transnational transaction, tribunals sometimes deviate from the principles that would govern a wholly domestic transaction in that jurisdiction. The usual motivation is to make some effort to strike a balance between the laws and policies of the chosen jurisdiction and conflicting laws or policies of other jurisdictions implicated by the transaction. So, for example, when deciding whether to avoid transactional contracts on the basis that they violate public policy, both domestic courts and arbitral tribunals often apply a narrow version of the doctrine of public policy known as "transnational public policy." Transnational public

[60] Thomson v. Call, 699 P.2d 316, 327-8 (Cal.,1985).

policy is supposed to embody values that reflect an international consensus as opposed to the potentially idiosyncratic values embodied in the conventional doctrine of public policy.[61]

This issue typically comes up in the case of contracts procured through bribery when there is some basis for arguing that the bribe recipient's legal system condoned the bribe. Some courts are not shy about enforcing their own conceptions of public policy in the face of inconsistent policies of other states. The U.S. Supreme Court's decision in *Oscanyan v. Arms Co.* exemplifies this approach.[62] In that case the Turkish consul-general in New York sued for the sum of $136,000 which he claimed was owed to him as a commission for exercising his influence to induce his government to purchase Winchester rifles from the defendant. The U.S. Supreme Court decided that this amounted to a contract to pay a bribe to a government official that was contrary to public policy under the laws of the United States. The court went on to decide that evidence that the contract was permitted by Turkish law was irrelevant, holding, "In any view of the contract here, whether it would be valid or invalid according to Turkish law and customs, it is intrinsically so vicious in its character and tendency, and so repugnant to all our notions of right and morality, that it can have no countenance in the courts of the United States."[63]

In more recent decisions tribunals have gone to great lengths to establish that bribery is not only contrary to the law of the location of the tribunal, but also contrary to the local law of the jurisdiction of the bribe-recipient and enough other jurisdictions to qualify as transnational public policy. They typically go on to point out that bribery is

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[61] World Duty Free, supra.
[62] Oscanyan v. Arms Co., supra.
[63] Oscanyan v. Arms Co., supra, 277-8.

condemned by a number of international conventions, including the Organization for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions,[64] the United Nations Convention Against Corruption,[65] as well as regional conventions and regional instruments produced by bodies such as the African Union,[66] the Council of Europe[67] and the Organization of American States.[68] So, for example, the arbitral tribunal in the *World Duty Free* case exhaustively surveyed all of these sources plus a number of arbitral awards before concluding, anti-climactically, that bribery was contrary to transnational public policy. This in turn formed the basis for the conclusion that "claims based on corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal."[69] (Recall however that its alternative ground for decision was that the contract was voidable under principles of agency law.)

E. Public International Law

There are several ways in which public international law is relevant to disputes involving contracts procured through bribery. First, even if the dispute is being resolved solely in accordance with a particular jurisdiction's internal laws, those laws may be shaped by international agreements that encourage particular remedies to be provided for bribery. Second, government contracts with private firms can sometimes be enforced in fora created by international instruments that have something to say about whether claims

[64] November 21, 1997, 37 I.L.M. 4 (1998).
[65] October 31, 2003, 43 I.L.M. 37 (2004).
[66] African Union Convention on Preventing and Combating Corruption, July 11, 2003, 43 I.L.M. 5 (2004).
[67] Civil Convention, supra.
[68] Inter-American Convention Against Corruption, March 29, 1996, 35 I.L.M. 724 (1996).
[69] World Duty Free, supra, para. 157.

based on tainted contracts can be heard. Third, unless it is accompanied by an appropriate offer of compensation, a government's repudiation or failure to perform a contract with a foreign firm may constitute a breach of that government's international obligations toward the firm's home state. However, in cases involving bribery international law may excuse such breaches, in much the same way that domestic law may excuse breaches of contracts procured through bribery.

Generally speaking, international law seems to encourage avoidance of contracts procured through bribery, in the sense of excusing the party whose agent was bribed from its obligations under both domestic and international law. To begin with, many states have signed international treaties that encourage them to permit contracts procured through bribery to be avoided under domestic law. Article 34 of the *United Nations Convention Against Corruption* provides "States Parties may consider corruption a relevant factor in legal proceedings to annul or rescind a contract, withdraw a concession or other similar instrument or take any other remedial action."[70] The Council of Europe's Civil Law Convention on Corruption speaks in more mandatory terms. Article 8 provides, "Each Party shall provide in its internal law for the possibility for all parties to a contract whose consent has been undermined by an act of corruption to be able to apply to the court for the contract to be declared void, notwithstanding their right to claim for damages."[71] Finally, international financial institutions (IFIs) may require governments which borrow from them to adopt anti-corruption clauses in their procurement contracts. Those clauses obligate the borrower to terminate or suspend the relevant procurement

[70] UN Convention, supra.
[71] Civil Law Convention, supra.

contracts and to demand restitution of funds advanced by the IFI if the contractor is sanctioned by the IFI for corruption.[72]

Another way in which international law can, in functional terms, allow governments to avoid their obligations under contracts procured through bribery is by preventing those claims from being heard in certain fora. By far the most important fora of this sort are arbitral tribunals created under bilateral investment treaties that allow investors to bring claims against host states. A pair of recent decisions suggest that the terms of many BITs preclude investors from bringing claims for breach of illegal contracts.[73] In one recent case the relevant provision of the BIT read as follows:

> "[t]he term 'investment shall mean any kind of asset *accepted in accordance with the respective laws and regulations* of either Contracting State…" [emphasis added].[74]

and,

> "Each Contracting State shall promote as far as possible investments in its terrority by investors of the other Contracting State and admit such

[72] See, for example, World Bank, Guidelines on Preventing and Combating Corruption in Projects financed by IBRD loans and IDA Credits and Grants (Anti-Corruption Guidelines) (2006), paragraph 9(d), (f).
[73] By way of comparison, the House of Lords has held that clauses that provide for commercial arbitration of disputes relating to a particular agreement typically permit arbitrators to consider claims that the agreement was procured through bribery. See, for example: Premium Nafta Products Limited v. Fili Shipping Company Limited, [2007] UKHL 40. Compare Hubco v. WAPDA, 16 Arbitration International 439 (2000) (Supreme Court of Pakistan) (refusing to enforce arbitration clause in relation to claims that a power purchase agreement was procured through corruption).
[74] Agreement between the Federal Republic of Germany and the Republic of the Philippines on the Promotion and Reciprocal Protection of Investments, 18 April 1997, in force 2 February 2000, Article 1(1).

investments *in accordance with its Constitution, laws and regulations*...."[75] [emphasis added]

At least two arbitral panels have used this or similar language as a basis for dismissing complaints brought by investors who breached the law of the host state in the course of concluding the contracts upon which their claims were based. In one case, *Inceysa Vallisoletanan S.K. v. Republic of El Salvador*,[76] the contract in question was procured through fraudulent misrepresentations about the foreign firm's financial condition and relevant experience. In the other case, *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*,[77] a panel concluded that a German investor had used secret shareholder agreements to secure control of the joint venture company responsible for building an airport terminal in violation of a local law that barred foreigners from exercising either de facto or de jure control over public utilities. Accordingly they ruled that the investor could not rely on the BIT for protection against expropriation of the terminal. Although neither of these cases involved bribery, it is not difficult to imagine how the reasoning used to resolve them could be extended to exempt a government from international liability under a BIT for ignoring its obligations under a contract procured through bribery (which is invariably illegal under the law of a host state).

Finally, leaving aside international obligations created by treaties such as BITs, there is also some reason to believe that proof of bribery allows a state to avoid any

[75] Agreement between the Federal Republic of Germany and the Republic of the Philippines on the Promotion and Reciprocal Protection of Investments, 18 April 1997, in force 2 February 2000, Article 2(1).
[76] ICSID Case No. ARB/03/26.
[77] ICSID Case No. ARB/03/25 (annulment proceeding pending).

obligations it might have to the home state of its counterparty under customary international law. For instance, in the famous *Tinoco Arbitration* it was held that there is no international obligation to honor a debt arising from a loan nominally made to the state if the creditor knew that the proceeds of the loan were being put to the personal use of a government official rather than legitimate government purposes.[78] In that case, the British government's claim against Costa Rica on behalf of the Royal Bank of Canada – which at the time qualified for British diplomatic protection – failed because the loan the bank was seeking to enforce was obviously used to finance the escape of a fleeing dictator and his brother.

III. The logic of the zero-tolerance approach

A. The case for zero-tolerance

The panel decision in *World Duty Free*, which is consistent with the American cases on the effects of bribery in public contracting, takes an uncompromising stance toward efforts to enforce government contracts procured through bribery. In these cases proof of bribery has meant giving the government an entitlement to retroactive avoidance without restitution, and it seems safe to assume that in some of these cases the government could have obtained compensation, disgorgement or punitive damages as well. The decisions in these cases clearly reflect the view that firms which deal with the government have an overriding obligation to combat bribery and endorse a *zero-tolerance* approach to the design of remedies for breach of that obligation.

[78] Arbitration Between Great Britain and Costa Rica, 18 Am. J. Int'l L. 147 (1924).

At first glance the package of remedies that make up the zero-tolerance approach appears to do a reasonably good job of satisfying four characteristic objectives of private law remedies for wrongs: expressing society's condemnation, protecting the victims from lasting harm, deterring future misconduct and maintaining the integrity of the legal system.

In the first place, the zero-tolerance approach satisfies the impulse to *condemn* bribery as immoral. Refusing to protect rights obtained through bribery signifies the wrongfulness of bribery.[79] This sort of condemnation arguably can serve the interests of both members of the legal system and the public at large.[80] It serves the interests of legal actors by allowing them to demonstrate their commitment to upholding the law – which they must do in order to maintain their integrity – by holding that bribe-payers are so contemptible that they do not even deserve to be heard.[81] At the same time, moral condemnation can also be instructive to the broader community. If many people take their cue from the law in forming beliefs about how they ought to behave, then having courts unequivocally denounce bribery might play a useful role in combating a culture of corruption.[82]

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[79] There are obviously exceptions to the blanket statement that bribery of public officials is wrongful. For example, bribes may be paid to avoid the application of unjust laws or laws that inefficiently inhibit productive activity. For a striking example see, Liebman v. Rosenthal, 57 N.Y.S.2d 875 (Sup. Ct.), aff'd, 59 N.Y.S.2d 148 (App. Div. 1945) (defendant agreed to pay bribe to secure visa for family trying to escape approaching German Army). Presently, however, there is a broad consensus that the bribery of government officials is wrongful and it seems appropriate for the law of government contracts to reflect that consensus.

[80] A liberal purist might argue that the law should not be concerned with enforcing morality. However, even liberalism seems to allow room for the law to enforce norms whose respect is essential to the functioning of a just society. See, for example, Seana Valentine Shiffrin, The Divergence of Contract and Promise, 120 Harv. L. Rev. 708, 714 (2007).

[81] On the significance of this sort of expression see, Elisabeth Anderson and Richard Pildes, Expressive Theories of Law: A General Restatement, 148 U. Penn. L. Rev. 1503, 1528-30 (2000).

[82] For a recent argument that contract law plays this sort of role see, for example, Seana Valentine Shiffrin, The Divergence of Contract and Promise 120 Harv. L. Rev. 708, 740-1 (2007).

A second virtue of the zero-tolerance approach is that it is also roughly consistent with the goal of trying to *protect* the government, and by extension the public it represents, from the dangers posed by contracts procured through bribery. The combined effect of avoiding a contract retroactively, refusing to award restitution, and allowing a claim for compensatory damages, plus the possibility of disgorgement or punitive damages, ought to leave the government at least as well off as it was before the corrupt contract was formed. In fact, if the contractor has transferred any value whatsoever to the government this package of remedies should leave the government better off than when the contract was formed. In this sense the zero-tolerance approach admirably serves the purpose of protecting the government and its constituents.

A third reason to respond to a contractor who has paid a bribe with zero-tolerance is to *deter* other parties from engaging in bribery in the future. If the goal is to encourage firms to prevent bribery then the penalties must be severe enough to ensure that failing to prevent bribery is no longer worthwhile for a rational contractor, even taking into account the fact that some instances of bribery will go undetected. This implies that the penalty for failing to prevent bribery should be equal - at the very least - to the benefit the firm would have expected to derive from causing or permitting bribery, adjusted upward to reflect the less than one hundred per cent probability of detection. The penalties imposed under the zero tolerance approach have at least the potential to approach this level.

Finally, a fourth argument in favor of the zero-tolerance approach comes into play in cases where performance of the corruptly procured contract would in-and-of-itself be illegal. Imagine, for example, if the contract provides a concession to log in an area protected by environmental legislation. In cases like this, granting an entitlement to

avoidance allows the court to refrain from recognizing a duty on the part of the bribe-recipient to violate the law. To recognize that someone has a duty to break the law would be inconsistent with the principle of respect for the rule of law, a principle which seems vital to the *integrity* of tribunals that claim to act in the name of the law. Therefore, the integrity of the legal system requires avoidance of contracts whose performance involves illegality, or at least, so the argument goes.[83]

B. Objections

So what are the objections to the zero-tolerance approach? The main problem is that under the zero-tolerance approach the magnitude of liability effectively depends on two factors: whether the firm in question has managed to prevent bribery and the extent to which the firm has invested in reliance upon the illicitly procured contract. The implicit justification for this approach seems to be that the best way for firms to fulfill their obligation to combat bribery in public contracting is to distance themselves from contracts procured through bribery, either by preventing such contracts from being formed in the first place or treating them as unenforceable. From this premise it follows that firms who fail to prevent their representatives from obtaining contracts through bribery deserve to be condemned unequivocally, that they ought to be discouraged from treating them as enforceable agreements, and, that other firms should be deterred from similar lapses.

However, the implicit premise is flawed. It is flawed because it fails to recognize either the full variety or the relative importance of the actions that firms and governments

[83] This argument seems to apply independently of the claim that legal integrity demands condemnation of bribery.

can take to mitigate the harm that might otherwise be caused by bribery in public contracting. By targeting only a subset of the forms of misconduct related to bribery in public contracting the zero-tolerance approach imposes equal condemnation on actions that ought to be condemned in different ways and differentiates actions that ought to attract identical reprobation.[84] It also fails to protect the interests of the government and the public in encouraging bribe-paying firms to take actions that offset the harms caused by bribery. Finally, it is doubtful that the zero-tolerance approach can be defended on the non-instrumental basis that it is necessary to uphold the integrity of the legal system.

1. There are several alternative methods of mitigating the consequences of bribery.

The zero-tolerance approach encourages firms to prevent contracts tainted by bribery from being formed. The most drastic step in this direction is to avoid contracting with governments whose officials solicit or are likely to solicit bribes. A less drastic step is to demand more onerous terms when dealing with such governments.

An appealing feature of both these kinds of preventive measures is that they promise to give governments an incentive to combat bribery – after all, bribery is not an individual crime, it is a corrupt bargain that always has at least two sides.[85] There is, however, no reason to presume that having firms offer less appealing terms to governments whom they perceive to be represented by corrupted officials will automatically create incentives for governments to combat corruption. To begin with, those incentives may be dulled by the fact that firms' managers often find it difficult to

[84] These defects are the same ones that plague any regime that imposes strict liability on corporate actors for agents' wrongdoing. See generally, Jennifer H. Arlen and Reinier Kraakman, Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes, 72 N.Y.U. L. Rev. 687 (1997).
[85] On the form those efforts might take see, Rose-Ackerman, supra, 39-88, 143-74.

observe the risk of corruption associated with particular governments. As a result, the terms of trade offered to any given government may not be very sensitive to its efforts to combat bribery, meaning that it will have little incentive to make such efforts. The incentives created by diminished trading prospects will also be muted if governments have short time horizons or if they are so thoroughly corrupt that the relevant decision-makers view the elimination of bribery as risk rather than a benefit. Ironically, if for any of these reasons the zero-tolerance approach fails to create incentives for governments to deter officials from soliciting bribes, it may have the perverse effect of inducing them to turn a blind eye to officials who conclude corrupt contracts, wait until the bribe-paying firms have made substantial expropriable investments in reliance upon the contracts, and then sue to have the contract avoided.

Of course, to the extent that governments fail – or are perceived to fail – to respond to incentives to combat bribery, having firms discriminate against them when contracting will tend to reduce the number of bribery-tainted contracts governments are able to form. However, this outcome may be achieved at a very high price, and that price may be paid not only by the contracting parties, but also by members of the broader society who stand to benefit from the formation and performance of government contracts. For instance, if the effect of the *World Duty Free* decision were to discourage all large firms from doing business with the government of Kenya the costs would be borne not only by the Kenyan government, in the form of foregone royalties and taxes, but also by Kenyans who would have been employed by the government's trading partners.

Prevention can also be costly when, as is often the case, bribes are likely to be paid by representatives of organizations rather than individuals acting on their own behalf. Prevention is still feasible for organizations: they can screen prospective employees for evidence of bad character, train them to believe that bribery is contrary to organizational values, closely supervise dealings with governments known to be corrupt (or corruptible), and refrain from giving agents excessively strong incentives to secure contracts. But those measures are likely to be costly. Those costs may be immaterial for small closely-held firms like World Duty Free Ltd. But for larger firms with more far-flung operations these sorts of 'compliance programs' may be very costly.

The fact that prevention is costly is not in itself an argument that it ought to be discouraged. What is significant is that prevention may be particularly costly when compared to the alternatives. Prevention here means any efforts to combat bribery undertaken before the bribe is paid. But efforts directed at bribes which have already been paid can also be effective means of combating bribery. For instance, an organization might commit itself to a scheme of self-policing – meaning both monitoring and punishment – in a way that convinces most employees that bribery is not worth their while. Moreover, if punishment imposed by the organization is likely to be insufficient, then the organization can adopt a policy of reporting individual bribe-payers to the press and public prosecutors, thereby exposing them to reputational, criminal and civil sanctions. The potent sanctions associated with public shaming and criminal prosecution may be sufficient to deter most individuals from paying bribes as well as to condemn those who succumb to temptation. This is particularly true now that developments in international law have led so many countries to claim the authority to launch criminal

prosecutions against people who pay bribes to foreign public officials.[86] In any given context self-policing and reporting may be more cost-effective than prevention as methods of deterring bribery.

Bribe-payers may also be able offset the harm caused by bribery in the inception of a contractual relationship through their subsequent conduct over the course of the relationship. At first this may sound implausible given that bribes are often paid to induce governments to sign contracts that are less advantageous to them than the ones that they would have signed in the absence of a bribe. But those contracts may still leave the government better off than it would have been in the absence of the contract. For example, World Duty Free presumably offset some of the harm caused by the manner in which it procured its concession as it invested in constructing, operating and maintaining its duty-free stores. Those actions not only benefited the Kenyan government – by boosting its royalties -- but also could conceivably have benefitted the broader population by generating employment and making the local airports more attractive to visitors.

2. The zero-tolerance approach focuses unduly on one method of combating bribery.

In light of the above, the difficulties with the zero-tolerance approach are twofold. First, while the magnitude of a firm's liability does depend on whether it has managed to prevent bribery, it does not depend on the extent to which the firm polices itself or decides to report bribery. Second, the magnitude of liability depends heavily on the extent to which the firm has chosen to invest in reliance on the contract.

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[86] See generally, John Hatchard, Recent Developments in Combating the Bribery of Foreign Public Officials: A Cause for Optimism? 85 U. D. M. L. Rev. 1 (2007) and the international instruments cited in notes __ supra.

The first concern is straightforward. Under the zero-tolerance approach, rather than being rewarded for self-policing or reporting, firms are effectively punished. This is because the information generated in the course of self-policing and – of course – reporting is likely to expose instances of failure to prevent bribery, which will in turn lead to harsh civil sanctions.[87] After seeing how World Duty Free was rewarded for its principal's bizarre self-reporting other firms have little reason to be forthcoming about their own misdeeds. Consequently, the zero-tolerance approach gives firms an overriding incentive to invest in prevention as opposed to self-policing and reporting. As noted above prevention may entail considerable direct costs for larger firms. Furthermore, firms' preventive efforts may fail to induce governments to make their own efforts to combat bribery. As we have seen, this can happen either because firms are unable to observe the risk of bribery associated with different governments or because those governments fail to respond to long-term economic incentives. Under these circumstances the only effective form of prevention is refusing to do business with certain governments entirely, which may have unacceptable private and social costs.[88]

The second concern about the zero-tolerance approach is that the avoidance remedy it prescribes has the perverse effect of discouraging firms from investing in potentially beneficial performance of their contractual obligations. Consider the incentive a concessionaire like World Duty Free has to invest in the maintenance and improvement of its property under a zero-tolerance regime, particularly as the political

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[87] Jennifer Arlen, The Potentially Perverse Effects of Corporate Criminal Liability, 23 Journal of Legal Studies 833 (1994).

[88] The argument in the text is consistent with Richard Craswell's argument that defenses to contractual liability based on the fact that the defendant's consent was improperly obtained should not be defined as 'property rules' when it would have been costly for the plaintiff to secure consent properly. See Richard Craswell, Property and Liability Rules in Unconscionability and Related Doctrines, 60 U. Chi. L. Rev. 1 (1993).

climate changes. The greater the risk that the stores might be yanked away if the circumstances surrounding the award of the concession come to light, the weaker the investor's incentive to make further investments. By contrast, if the penalty for the bribery were fixed independently of the amount invested then the concessionaire's incentives to maximize the value of the concession would be unaffected by the prospect of its bribery being detected and punished.[89]

The longer the duration of the government's entitlement to avoid the contract, the more significant is the counter-party's disincentive to make reliance investments. Giving the government a long-lived entitlement to avoid the contract effectively forces its counter-party to write an option on the government's contractual obligations. The longer the duration of the entitlement the more likely that option is to be exercised and so the less incentive the counter-party has to make (potentially) uncompensated investments in enhancing the value of the contract.

3. Enforcing contracts procured through bribery need not compromise legal integrity.

A response to the case in favor of the zero-tolerance approach has to deal with the argument that the integrity of the legal system demands avoidance of at least those

[89] The perversity only arises to the extent that factors such as explicit contractual obligations are insufficient to motivate the bribe-paying firm, but this is not an implausible scenario. It is often difficult to decide in advance what sort of behaviour counts as adequate performance and after the fact it is difficult for third-party decision-makers such as courts to determine whether adequate performance has been provided. For example, in theory a duty-free store concessionaire could be made to sign a detailed contract that spells out exactly how the stores will be built, operated and maintained. Every aspect of the design of the stores, the merchandise to be put on sale and the training of the staff could be spelled out in the contract. That, of course would be impractical. Not only would it take too long to write such a contract, even with all of the time in the world the parties may not be able to anticipate all of the possible changes in consumer demand and traffic patterns that might warrant deviations from the original plan. Moreover, the government would probably lack the expertise to assess the reasonableness of such a contract. This is why parties often rely upon simple profit-sharing agreements to create incentives for one another. However, those sorts of contracts only work if the promise to share the profits is credible, which typically entails legal enforceability. That is why the prospect of the government's obligation being avoided is so pernicious.

contracts whose performance involves illegality. As we have already discussed, this class of cases is potentially large because many legal systems seem to prohibit performance of government contracts that were not formed in accordance with prescribed procedures. There are two reasons why this argument is not compelling. First, it does not squarely apply to cases in which the legal system whose norms govern the enforceability of the contract is distinct from the legal system whose norms declare its performance illegal. This scenario is not uncommon in cases involving transnational activity, where the governing law of the contract might be different from the local law that makes it illegal for a particular contract to be performed. It does not automatically compromise the integrity of a tribunal to declare that a party has a duty to violate a law other than the one from which the tribunal derives its authority.

A second and more general point is that there is a distinction between holding that a contract is legally enforceable and holding that there is a legal duty to perform it. A tribunal which holds that a contract to grant an illegally awarded concession is enforceable but also says that the only available remedy is damages and not specific performance arguably manifests due respect for the law that would render performance illegal. For both these reasons the zero-tolerance approach should not be viewed as a necessary corollary of the need to maintain the integrity of the legal system.

IV. An alternative approach: proportional liability

A. General Principles

The force of the objections to the zero-tolerance approach suggests that in many circumstances it ought to be abandoned in a favor of a new approach. At the same time there are compelling pragmatic reasons to believe that any realistic alternative ought to respect as much of the underlying logic of the zero-tolerance approach as possible. That means beginning with the assumption that firms have an obligation to combat bribery in public contracting, not only for the sake of the governments with which they deal but also the members of the societies represented by those governments. It also means that the legal remedy for breaching that obligation should express society's condemnation of the violator's conduct; protect the government and the broader public from any harm that might flow from performance of the resulting contracts; deter similar violations and their associated harms; and, maintain the integrity of the legal system. In theory all of these principles are contestable, and they are not necessarily mutually compatible either. As a practical matter though, they appear to be too deeply embedded in most modern legal systems to be ignored. (We shall leave to another day the question of whether privately appointed arbitrators are justified in believing that their mandate is limited exclusively to the application of legal principles adopted by the parties.) [90]

These considerations generally point toward a remedial scheme which makes bribe-paying firms' liability proportional to their fault, where fault is conceived of as a measure that takes into account all of the dimensions along which a firm might attempt to combat bribery. In other words, the extent of liability – meaning, the quantum of damages awarded – should depend not only on proof that the firm failed to prevent bribery, but also on evidence of whether it made reasonable efforts to monitor, supervise

[90] For arguments that arbitrators ought to apply transnational public policy see, Catherine Kessedjian, "Transnational Public Policy" in Albert Jan van den Berg (ed.), *International Arbitration 2006: Back to Basics?* (2007) at pp. 857-870.

and punish its employees and co-operate with law enforcement authorities. Implementing this proposal would be consistent with imposing a certain 'residual' level of liability on bribe-paying firms for failing to prevent bribery. The existence of that 'residual' liability – which for reasons to be discussed in a moment might involve substantial amounts of money – ought to allay concerns that either the purpose or the effect of this proposal is to allow bribe-paying firms to escape condemnation. The key feature of proportional liability however, is that beyond this residual level the extent of liability ought to vary according to evidence that firm has engaged in self-policing or reporting.

To see how this might work in practice, consider two hypothetical cases.

> *Case 1:* The regional sales manager of a large multinational firm (Firm 1) pays a bribe through an intermediary styled as a "consultant", to an official of a poor country known to have weak public institutions. Assume that the bribe of $100,000 is paid in order to secure a contract to supply high-voltage transmission lines required to connect a newly constructed power plant to the national grid. The official improperly awards the contract to the bribe-paying firm without putting the contract out to tender. As a result the firm is able to charge a price of $10 million for goods with a fair market value of only $5 million. There is a change in government following the conclusion of the contract, but the government is first made aware of the bribe by a report from the firm, which discovers it as a result of its ongoing efforts to monitor its employees' compliance with anti-

bribery legislation. The information is also turned over to authorities in the firm's home jurisdiction responsible for enforcing criminal prohibitions against bribery.

Case 2: A bribe of $100,000 is paid by the chief executive officer and principal shareholder of a multinational firm (Firm 2) to an official of the federal government of a middle-income country in order to secure a logging concession covering an area in which logging is not usually permitted. The firm expects to pay a total of $5 million for the concession. Experts estimate that if the government had solicited bids for the concession the highest bidder would have paid $10 million. The bribe is discovered by other officials after an election which results in a change in the governing party.

The proportional liability approach suggests that Firm1 ought to be treated differently from Firm 2. Both firms ought to be punished for failing to prevent bribery, but Firm 2 should also be punished for failing to take steps after the bribe was paid to punish its officer or to report the offence to the authorities. In addition, whatever penalty is imposed on Firm 1, it should not encourage the firm to respond to a change in government by halting either deliveries under the contract or investments in additional capacity required to make those deliveries. These recommendations would be consistent with giving the government an entitlement to compensation from Firm 1; on these facts this would entail awarding damages of $5 million. They would also be consistent with

giving the government an entitlement to supra-compensatory damages from one or both firms. The proportional liability approach would not, however, be consistent with awarding identical levels of damages in the two cases. Nor would it be consistent with automatically avoiding the contracts and denying the firms any entitlement to restitution. However, depending on the reasons why logging is prohibited in the area subject to the concession, once it has begun exploiting the concession Firm 2 may have difficulty establishing that it has conferred net benefits upon the government. Similarly, once the government's entitlement to compensation is taken into account, Firm 2 may also have difficulty establishing that it would obtain any net benefit from preserving the government's obligation under the contract.

It is worth noting that the World Duty Free case lies somewhere in between these two hypothetical cases. On the one hand, like Firm 2, World Duty Free made essentially zero effort either to prevent bribery or to punish bribery after the fact. On the other hand, it did self-report (although perhaps inadvertently) and it may have had a stronger basis for arguing that its investments conferred a net benefit on the government of Kenya.

B. Rationale

Although the proportional liability approach set out above is concerned with the imposition of civil sanctions, it is inspired by the approach that has been taken to the imposition of criminal liability on organizational actors in certain leading jurisdictions.[91] Factors such as self-policing and reporting are relevant in determining either, in the case

[91] See generally, Arlen and Kraakman, supra; Brent Fisse & John Braithwaite, Corporations, Crime, and Accountability (1993); U.S. Sentencing Guidelines Manual, ch. 8, 487-531 (federal sentencing guidelines for organizational defendants).

of United States federal law, the appropriate sentence for corporate misconduct,[92] or, in Australia, whether an agent's misconduct ought to be attributed to the corporation in the first place.[93] In England, the Law Commission has recently proposed that if criminal liability is to be imposed on limited liability entities for bribes paid by their agents, it ought to be imposed only where the entities has negligently failed to prevent the bribe from being paid.[94]

The appeal of the proportional liability approach lies in the fact that it has the potential to satisfy all of the basic impulses that motivate the zero-tolerance approach. To begin with, making sure that the punishment fits the 'crime' enhances the expressive qualities of the remedy. Tailoring the manner in which a firm is condemned to reflect the wrongfulness of its conduct makes the remedy a more accurate expression of the moral concerns that motivate the sanction. In effect, it allows the legal system to say, something like, 'you are being condemned for *both* failing to prevent and report bribery.'

A remedial scheme that conditions a bribe-payer's liability on the specific set of wrongs committed by a firm also promises to create a better pattern of incentives for both firms and governments to combat bribery. For one thing, it provides firms with incentives to take steps to mitigate the impact of their mistakes. Perhaps more importantly, a well-designed scheme of proportional liability can induce firms that will not do everything possible to combat bribery to exert more limited effort. So for instance, treating self-policing or reporting of bribery as mitigating factors in setting liability encourages firms to offset the impact of mistakes at the prevention stage -

[92] See U.S. Sentencing Guidelines for Organizational Defendants, supra.
[93] Criminal Code Act 1995 (Cth), Part 2.5.
[94] Law Commission, Reforming Bribery. 19 November 2008.

whether those mistakes are deliberate or inadvertent.[95] At the same time, any residual liability triggered by the failure to prevent bribery creates incentives for firms to undertake various unobservable forms of prevention, including altering the terms upon which firms deal with corruptible governments.

The residual liability imposed on firms can also be tailored to optimize governments' incentives to combat bribery, including their incentives to pursue civil claims against bribe-paying firms. Imposing high-levels of residual liability on firms creates incentives for governments to discourage their officials from demanding bribes in order to improve its trading prospects. Moreover, the greater the portion of bribery-related losses that can be recovered through civil litigation the greater the government's incentive to sue. As we have already discussed, this pattern of incentives will only be desirable if prevention is relatively inexpensive, from the perspective of both firms and the broader society, and governments are likely to respond in an appropriate fashion to economic incentives. So, for instance, a high level of residual liability may be appropriate when firms deal with reasonably effective governments in jurisdictions which are familiar to them. In this setting encouraging firms to 'just say no' may be an effective method of inducing governments that want to attract trading partners to engage in prevention. Lower levels of residual liability may be appropriate though when firms deal with foreign governments that have only a limited presence in the international economy or which have received low scores on independent evaluations of governmental quality

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[95] An alternative approach would be to treat failure to self-police or report as aggravating factors in setting liability. However, using evidence of deliberate failure to report in this fashion will not be effective if the tribunal finds it difficult to observe such incidents. See Arlen and Kraakman, supra at 741.

and integrity.[96] In these settings encouraging firms to just say no is likely to have little impact on governments' behaviour, either because the relevant actors are too short-sighted or personally implicated in corrupt activity to change their ways, or because the more far-sighted actors expect firms with limited information to refrain from dealing with honest and corrupt governments alike.

Finally a remedial scheme that imposes liability proportional to fault need not be incompatible with the goal of protecting the government. Determining that liability ought to be proportional to fault requires that the relative liability imposed for different acts satisfy a criterion of proportionality. This says nothing about the absolute level of liability. As noted above, in principle there is no reason why the minimum level of liability under a proportional liability regime should not be sufficient in absolute terms to compensate the government for any harm caused by the wrongdoer's actions.

C. The Relevance of the Bribe-Recipient's Fault

At least one set of commentators has suggested that it would be appropriate to consider what might be called "comparative fault" in assessing bribe-paying firms' liability.[97] This would entail reducing those firms' liability – possibly to nothing – to the extent that the government has failed to take adequate steps to combat bribery.[98] This approach would arguably provide a desirable fine-tuning of the expressive content of a

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[96] For a general discussion of the limitations of these kinds of measures of institutional quality see, Kevin E. Davis, What Can the Rule of Law Variable Tell Us About Rule of Law Reforms, 26 Mich. J. Int'l L. 141 (2004).

[97] Hilmar Raeschke-Kessler and Dorothee Gottwald, Corruption in Foreign Investment – Contracts and Dispute Settlement between Investors, States and Agents, 9 J. of World Invest. & Trade 5, 19 ("The arbitral tribunal must also consider the role both parties have played in the corrupt activity.")

[98] The term comparative fault is being used here to designate an entire class of regimes whose common feature is that the victim's misconduct is a factor in determining the extent of the wrongdoer's liability. This definition covers both the regimes traditionally referred to as "comparative liability" and "strict liability with a defence of contributory negligence."

determination of liability[99] and, if the bribe-paying firm remains subject to a residual obligation to compensate the government, it need not be in tension with the objective of ensuring protection of the public purse.

However, introducing an element of comparative fault into the assessment of liability would also affect the incentives of firms and governments in complex and potentially undesirable ways.[100] To begin with, it may enhance the government's incentives to combat bribery. But if the government is short-sighted or thoroughly corrupt those incentives will have little impact on its behavior. At the same time, to the extent that governments' efforts to combat bribery can be expected to fail, introducing comparative fault will reduce the amount of liability that bribe-paying firms expect to bear, thereby diluting those firms' incentives to combat bribery. In addition, reducing the level of damages recoverable by a government that has failed to prevent bribery will reduce its incentives to initiate civil proceedings against bribe-paying firms. In light of these competing considerations, this Article takes no position on the merits of supplementing a proportional liability regime with comparative liability.

D. A Mandatory or a Default Rule?

For all the reasons given so far the proportional liability approach ought to appeal to any lawmaker charged with determining a bribe-paying firm's civil liability. But what if the parties to the corruptly-procured contract attempt to reject proportional liability in favor of a different approach, whether by including an explicit provision in the original

[99] For a discussion of why fairness supports comparative liability see, Gary T. Schwartz, Contributory and Comparative Negligence: A Reappraisal, 87 Yale L. J. 697 (1978) at 721-727.
[100] The analysis here parallels the analysis of the incentive effects of introducing a contributory negligence defence in product liability settings, with the government playing the role of the consumer. See generally, Steven Shavell, Foundations of Economic Analysis of Law (2004), 212-223.

agreement or through a subsequent effort to ratify it? This raises the question of whether the legal norms that establish a government's entitlements vis-à-vis bribe-paying firms ought to be mandatory rules, meaning that they bind the parties regardless of their wishes, or default rules, which the parties are free to vary.

The answer any particular lawmaker gives to this question ought to turn on whether the parties' reasons for disagreeing with the lawmaker's preferred approach are benign or malign. Consider first a benign explanation for rejecting the proportional liability approach. Parties to a contract may share the lawmaker's commitments to condemning past bribery, deterring future bribery and upholding the integrity of the legal system, yet still disagree with the lawmaker's approach to achieving those objectives. For instance, a particular pair of contracting parties may believe that the proportional liability approach is ill-suited to their situation because it will be too costly to administer; the sort of fact-intensive analysis of firms' compliance efforts called for by the proportional liability approach may simply be too expensive and time-consuming. Alternatively, they may dislike the level of unpredictability associated with the proportional liability approach. For either of these reasons firms might reasonably reject the proportional liability approach in favor of a simpler one such as some form of stipulated damages, or perhaps even the zero-tolerance approach. It would not be unreasonable for a lawmaker to defer to this decision on the grounds that the parties are likely to have a better sense than the lawmaker of how to achieve the common objective of combating bribery.

Unfortunately, there are also malign reasons why parties might reject a lawmaker's preferred approach to contracts procured through bribery. The main concern

is that the parties may place less weight than the lawmaker on the objective of combating bribery. In the extreme case where a contract is drafted by the same agents who have paid and received the bribe it may reflect a complete lack of interest in controlling bribery. Left to their own devices, corrupt agents can be expected to draft an agreement providing that the bribe-payer's firm faces no liability whatsoever. A similar problem can arise if the responsible members of the firm and the government are poorly informed about the risk of corruption on the part of their agents. Recall the U.S. Supreme Court's observation that, "an agent's superiors may not appreciate the nature of the agent's conflict, or [the superiors] might, in fact, share the agent's conflict of interest." [101] Yet another problem is that the parties may care about some but not all of the harm that the tribunal associates with bribery; in other words, where corruption creates externalities. For example, suppose that the government cares about the pecuniary losses it suffers as a result of bribery but is insensitive to harm inflicted on the broader society in the form of lost faith in government institutions or evasion of policies designed to protect health and safety or the environment. In any of these situations a lawmaker could reasonably decline to adopt the approach recommended by the parties.

Naturally, in many cases it will be difficult to determine why the parties have rejected the proportional liability approach. So for example, on the facts of the World Duty Free case it is easy to see that the tribunal should have rejected any claim that President Moi ratified his corrupt agreement on behalf of the Republic of Kenya. However, a case in which Moi ratified the corrupt agreement of another official would have been more difficult to resolve. Ratification by the legislative branch of the Kenyan government would be even more difficult to classify as malign or benign.

[101] United States v. Mississippi Valley Generating Co., 364 U.S. 520, 561 (1961).

V. Comparison to Existing Doctrine

In doctrinal terms, the proportional liability approach seems closer to the principles found in agency law than those found in the law of illegality and related doctrines (unless the latter set of doctrines is interpreted quite flexibly). This seems fitting given that the thrust of the analysis to this point is that in determining the legal effects of bribery in public contracting it is a mistake to focus too tightly on the illegal transaction and ignore the broader context. In many cases that context involves two organizations – often large ones – struggling to deal with the fact that they are compelled to interact through potentially unreliable agents. As Lord Mustill concluded in his expert opinion in the *World Duty Free* case, the agency law lens seems likely to offer a better view of the critical features of this problem than the somewhat broader lenses of illegality and related doctrines. This in turn implies that principles of public law, transnational public policy and public international law ought to be construed to allow the consequences of bribery in the procurement of government contracts to be determined primarily in accordance with principles of agency law.

One of the central features of agency law is that a principal is entitled to compensation from a person who bribes their agent in connection with a transaction concluded by the principal. This principle is generally consistent with the proportional liability approach. The proportional liability approach is also consistent with existing law which gives tribunals some flexibility in deciding whether to award punitive damages or other forms of supra-compensatory damages to an aggrieved principal. The analysis here suggests that whatever flexibility is available under existing law ought to be used to treat

the firm's efforts to control or police its employees and to cooperate with authorities as mitigating factors.[102]

Of course, there are many cases in which courts purporting to apply principles of agency law have held that a principal is entitled to avoid a contract procured through bribery. Those rulings are not necessarily consistent with the proportional liability approach. As we have already seen, avoidance is not a particularly good way either to provide compensation or to deter or to condemn. It also has the undesirable effect of discouraging bribe-payers from investing in reliance on a contract that might become forfeit. This all suggests that the idea of giving governments an automatic entitlement to avoid contracts procured through bribery should be rejected. This recommendation has to be qualified, however, to take into account cases in which an entitlement to avoid a contract serves as a good proxy for an entitlement to compensation for misconduct in the formation of the contract. The best examples are cases in which the contract is for the procurement of goods or services for which the government has no use whatsoever, and the only explanation for the existence of the contract is the fact that money changed hands illicitly. In a situation like that the only way to protect the public from harm is to excuse the government from its future obligations under the contract and to recover the cost of its performance to date. To the extent that the value of the contract to the government is difficult to ascertain, avoidance seems like an appropriate remedy. This

[102] It also seems reasonable to presume that the civil law ought to be less worried about creating incentives for self-policing and reporting when alternative methods of detecting and sanctioning bribery, such as investigation and prosecution by public authorities, are relatively effective. At the very least this argument weighs in favor of allowing criminal or administrative penalties imposed upon a bribe-paying firm to be offset against damages awarded in civil proceedings. More generally though, this argument implies that the principles which govern the imposition of criminal and administrative penalties on bribe-paying firms, including the principles concerning confiscation or forfeiture of proceeds of crime, may have to be re-examined in order to ensure that they are compatible with the proportional liability approach. On the potential magnitude of those penalties see, Richard Alexander, Corruption as a Financial Crime, 30 Comp. Law. 98 (2009).

may capture a large proportion of the cases in which contracts are procured through bribery.

Interestingly, it may be possible to reconcile the approach to avoidance dictated by the proportional liability approach – namely, that avoidance should not be permitted unless it is necessary to compensate the victim of the bribery – with principles of agency law. For instance, in one leading case the English rule was described as conferring an entitlement to avoid a contract only upon a party who has been "deprived of the disinterested advice of their agent by or at least to the knowledge of [the bribe-paying firm]."[103] This way of putting the matter arguably permits a distinction to be drawn between bribes which deprive the principal of disinterested advice on whether to enter into a transaction and bribes which deprive the principal of disinterested advice about the terms upon which to conclude such a transaction. The feasibility of drawing this kind of distinction is illustrated by the decisions in *Fyffes* and *Gerzof v. Sweeney*. There may also be room to argue that a bribe paid by the agent of a firm which has made reasonable efforts self-police and self-report should not be considered to have been paid "by or…to the knowledge" of the bribe-payer's principal, particularly in jurisdictions which adopt the flexible approach to attribution endorsed by the Privy Council in *Meridian*.

The proportional liability's approach to restitution is not difficult to reconcile with principles of agency law. Even in cases in which avoidance is inevitable, the proportional liability approach suggests that the government's obligations should typically be replaced with an obligation to make restitution. This is consistent with principles of agency law. Since the fact of the bribe creates a distinct possibility that the contract does not create anything of value for the government, the conventional

[103] Logicrose, supra at 1261.

requirement that the burden of proof be placed on the bribe-payer seems appropriate. But if the bribe-payer can satisfy that burden then there are strong reasons to grant restitution. To reiterate, there are more direct ways of expressing condemnation for the bribe-payer, protecting the public and deterring other firms; and, the prospect of avoidance without restitution can serve as an unfortunate disincentive for bribe-payers to make mutually beneficial investments. In addition, the duration of the entitlement to avoid a contract should be limited, perhaps following the UNIDROIT Principles which seem to require the entitlement to be exercised within a reasonable time.

Finally, the agency law principle that a contract procured through bribery can be either authorized (ex ante) or ratified (ex post) by the principal of the recipient of the bribe is consistent with the proportional liability approach recommended above in cases where the principal's motivations for opting out of the ordinary regime are benign. In many cases, though, the principal's motivations will be more suspect and so the more restrictive approach to authorization and ratification found in the law of illegality ought to be adopted.

VI. Conclusion

It may seem intuitive to respond to a problem as pernicious as bribery in public contracting with a tough zero-tolerance approach. However, this essay has presented an argument for a more nuanced response, one which takes into account the range of ways in which firms and governments can and should participate in combating bribery and the importance of adopting legal remedies that encourage them to explore all of those possibilities.