Remedies for Corruption in Government Contracting

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Draft of March 21, 2008.

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Abstract

Bribery in public contracting is a serious problem, particularly in many developing countries. 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 is misguided. 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. Specifically, the zero-tolerance approach does not 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.

* I am grateful to Jennifer Arlen, Franco Ferrari, Clayton Gillette, Robert Howse, Catherine Kessedjian and Benedict Kingsbury for helpful conversations about this paper. All errors remain my own.

## 1 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 Rajjad 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. 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.[1] 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 to President Moi was "a gift of protocol or a personal donation made to the President to

[1] 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, 46 I.L.M. 339 (2007), paras. 68-72.

be used for public purposes within the framework of the Kenyan system of Harambee."[2] 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 grounds 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 several international instruments appear to endorse this approach.[3]

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. It may also induce officials to award contracts to the firm willing to pay the highest bribe as opposed to the best firm for the job. In extreme cases bribery may induce public officials to award contracts that generate no benefit whatsoever for the public, or even worse, cause affirmative harm by violating existing laws or policies.[4] These problems are generally considered to be particularly serious in developing countries, but they also arise in developed countries.

This paper addresses the question of how the legal system ought to respond to the problem of bribery in public contracting. More specifically, it focuses on the role played

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[2] World Duty Free v. Kenya, 46 I.L.M. 339 (2007), para. 133.
[3] United Nations Convention Against Corruption, in force 14 December 2005; Civil Law Convention on Corruption, ETS no. 174, Strasbourg, 4.XI.1999. [Add proper cites.] See generally, Theodore H. Moran, Combating Corrupt Payments in Foreign Investment Concessions: Closing the Loopholes, Extending the Tools (Center for Global Development, January 2008).
[4] See generally, Susan Rose-Ackerman, Corruption and Government: Causes, Consequences and Reform (New York: Cambridge, 1999), 27-35.

by the law governing the enforceability of contracts procured through bribery. It argues that the zero-tolerance approach adopted by the panel in the *World Duty Free* case is flawed and recommends an alternative remedial approach.

The basic concern is that the zero-tolerance approach essentially punishes firms for two types of mistakes: failing to prevent contracts from being procured through bribery and 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 the range of different 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 private individuals willing to deal with them. At the same time, even if there is nothing (short of shunning entire regimes) that firms can do to prevent their individual 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. In concrete terms, the argument here is simply that a firm like World Duty Free should receive at least some credit for factors such as the benefits to Kenyan society that flowed from the investments it made in its concession and its role in exposing the extent of corruption in the Kenyan government.

The next section of the paper 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 shows which aspects of existing doctrine support the zero-tolerance approach. The third section describes and then critiques the logic used to justify the zero-tolerance approach. The fourth section sets out an alternative remedial approach. The final section concludes.

## 2 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. What effect does this have on the rights and duties of the parties to the contract?

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, proof of bribery may give the government an entitlement to *avoid* its obligations under the contract, either retroactively, as of the time the contract is signed (*ab initio*), or as of the time that the government gives notice of intention to avoid 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. Fourth, the government might be able to recover *punitive damages*, that is to say, supra-compensatory damages designed primarily to punish.

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 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.

Although it is not so difficult to describe the legal consequences of bribery in functional terms, tracing the legal doctrines that generate those consequences is fairly complicated. One reason for this is that the applicable doctrines are drawn 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 internal 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 (beside the ones found in a BIT).

The most convenient way to work through these doctrines is one source at a time.

*Private law*

In the absence of any special statutory or constitutional 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 public law or international norms in favour of a specific body of private law.

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 made 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 on English law stating that in his view the cases on illegality "shed no light" on the question before him.[5] Leaving this issue to the side for a moment, we shall examine how both lines of cases have been applied in common law jurisdictions.

We 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

[5] World Duty Free, supra, para. 164 (quoting Lord Mustill).

against its counterparty,[6] between what I have called compensation and avoidance.[7] 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.[8] 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.[9] 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.[10] A third alternative is to allow the principal to recover the amount of the bribe from the bribe-payer.[11] This makes sense if we assume that paying the bribe caused the bribe-

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[6] 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 (HL).

[7] 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.")

[8] 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).

[9] 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 (P.C.).

[10] Mitchell, supra.

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

payer to inflate the price charged to the principal by at least as much as the amount of the bribe.[12]

Agency law also provides the option of avoiding contracts procured through bribery. The general rule is that these contracts are voidable.[13] This means that the principal can avoid its contractual obligations to the bribe-payer.[14] 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.[15] The principal is also entitled to affirm the contract.[16] The UNIDROIT principles suggest that the right to avoid a contract must be exercised within a reasonable time.[17] 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.[18] This means, for example, that if a contract procured through bribery is assigned to a bank the bank will be able to enforce the contract so long as the victim of the bribery waived its right to assert defenses against an assignee that it would normally have against the bribe-payer and 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 briber earned because the agent failed to behave in an honest and prudent fashion. The courts that have awarded this kind of

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

[13] The situation is 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 (HL).

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

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

[16] 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 (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),

[17] UNIDROIT Principles, Article 3.15 (time limits).

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

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.[19] In the leading English case the bribe-payer's excess profits were found to be equal to the principal's losses and so the amounts required to effect compensation and disgorgement were identical. But that need not generally be true.

A final feature of agency law is that in some jurisdictions punitive damages can be awarded against the bribe-payer.[20] This is probably more likely to occur under American law than the law of other jurisdictions. Typically the decision to award punitive damages is a discretionary one based on the reprehensibility of the defendant's conduct.

This concludes our discussion of how agency law deals with contracts procured through bribery. So let us now turn to the second set of legal principles referred to 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.[21]

We can start 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

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[19] 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).
[20] Jaclyn, Inc. v. Edison Bros. Stores, Inc., 406 A.2d 474, 492-4 (N.J.Super.L., 1979).
[21] The Law Commission, Illegal Transactions: The Effect of Illegality on Contracts and Trusts, Law Commission Consultation Paper 30-188-01 (January 21, 1999); Restatement (Second) of Contracts § 178 (1981). The UNIDROIT Principles explicitly decline to address the topic of whether contracts can be invalidated avoided on the grounds of immorality or illegality. UNIDROIT Principles Article 3.1 (matters not covered).

of respect for the rule-of-law. The first principle is that a contract whose performance involves a legal wrong will not be enforced. The outer 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.[22] In any event, there are numerous decisions that apply this principle to bar enforcement of contracts whose performance entails paying a bribe, either directly or indirectly (These cases typically involve selling or buying agents who have paid bribes suing for their commissions).[23] It is not, however, obvious that the principle applies to a contract procured through bribery whose performance does not involve any illegal conduct.

The second principle that underpins the defense of illegality is that a party 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 that 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.

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[22] See generally, Law Commission, Illegal Transactions: The Effect of Illegality on Contracts and Trusts, Law Commission Consultation Paper 30-188-01 (January 21, 1999).
[23] Oscanyan v. Arms Co., 103 U.S. 261 (1881); McConnell v. Commonwealth Pictures Corp., 166 N.E.2d 494, 497 (N.Y. 1960).

The defense of illegality is often virtually indistinguishable from two other doctrines, the unclean hands doctrine and the defense of public policy. In its 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."[24] In some jurisdictions the doctrine has been extended to bar plaintiffs from seeking either legal or equitable relief.[25] In other cases, rather than referring to the equitable 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 the former pair of doctrines need not be strictly illegal.[26] Consequently, there is little doubt that paying a bribe can trigger the application of these doctrines against a party seeking a legal remedy, even if the bribe is not, strictly speaking, illegal.[27]

In functional terms, the defenses of illegality, public policy and unclean hands all provide an entitlement to avoid the illegal contract, but they do so in a particularly harsh way.[28] 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

[24] Precision Instr. Mfg. Co. v. Automative Maintenance Machinery Co., 324 U.S. 806, 814 (1945).
[25] See, for example, Adler v. Federal Republic of Nigeria, 219 F.3d 869 C.A.9 (Cal.,2000).
[26] 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.")
[27] See, for example, Sirkin, supra (applying the doctrine of public policy to bar enforcement of contract procured through commercial bribery).
[28] 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).

unless the plaintiff can show that it was less culpable than the defendant (*non in pari delicto*).[29] This suggests that in practice a bribe-payer is only likely to be entitled to restitution if it can show that it paid the bribe under duress or while mistaken about the legality of its conduct.[30] A second interesting facet of the doctrine of illegality is that several courts have held that contracts procured through illegal bribery cannot be ratified.[31] 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.[32]

Courts have discretion over whether to apply the defense of illegality. Commentators suggest that in exercising that discretion it is important to maintain proportionality between the seriousness of the plaintiff's misconduct and the severity of the penal effect of denying relief.[33] Similarly, courts that apply the doctrines of unclean hands or public policy consider the relative seriousness of the misconduct of the plaintiff and the defendant and whether denying the plaintiff relief would unjustly enrich the defendant.[34]

*Public law*

Contracts with the government are typically governed by somewhat different legal principles from contracts with private actors. As it turns out, when it comes to government contracts procured through bribery the applicable principles are more likely

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[29] 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).
[30] Restatement (Second) of Contracts § 198 (1981) comments a and b.
[31] 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),
[32] Ballin v. Fourteenth Street Store,, 108 N.Y.S. 26 (App.Div.1908), aff'd , 89 N.E. 1095 (Ct.App.1909).
[33] Restatement (Second) of Contracts § 178 (1981).
[34] Adler, supra.

to resemble the principles that govern contracts that are illegal or contrary to public policy than principles derived from agency law.

There are several reasons why judges and lawmakers look at bribery in public contracting as a species of illegality rather than an agency problem. First, whereas bribery of an agent of a private firm is not always criminalized, bribery of government official 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 the core of the doctrine of illegality. Third, some may perceive bribery in government contracting as a more serious public policy concern than commercial bribery.[35]

Whatever the reasons, viewing bribery in public contracting through the lens of the doctrines surrounding illegal contracts often results 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

[35] 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).

the vendor.[36] 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[37] and is embodied in the standard provisions that govern most federal government procurement contracts.[38] Other courts have added the wrinkle that the government is entitled to avoid these sorts of contracts even if the superiors of the corrupt official condoned the conflict of interest.[39] In a case involving a mere conflict of interest (as opposed to 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."[40]

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.[41] It cited *Gerzof v. Sweeney*, an earlier New York case in which a contract to install a power generator was

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[36] S. T. Grand, Inc. v. City of New York, 298 N.E.2d 105 (N.Y. 1973).
[37] 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.
[38] 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.
[39] Thomson v. Call, 699 P.2d 316, 326 (Cal.,1985); United States v. Mississippi Valley Generating Co., 364 U.S. 520, 561 (1961); [additional cases].
[40] United States v. Mississippi Valley Generating Co., 364 U.S. 520, 561 (1961).
[41] S. T. Grand, Inc. v. City of New York, 298 N.E.2d 105, 108-9 (N.Y. 1973).

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.[42] 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.[43] *Gerzof* itself 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.[44] However, other courts in the U.S.A. have explicitly rejected these efforts to mitigate the impact of avoiding illegal public contracts.[45]

*Transnational law*

Disputes involving contracts with a transnational dimension can plausibly be adjudicated under the internal 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 the jurisdiction of one of the partiess or a legally prominent 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 a clause, the tribunal may use its own choice of law principles to determine the jurisdiction whose laws govern. In

[42] 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).
[43] S. T. Grand, Inc. v. City of New York, 298 N.E.2d 105, 109 (N.Y. 1973).
[44] 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).
[45] Thomson v. Call, 699 P.2d 316, 327-8 (Cal.,1985).

either event, the relevant principles 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 agreement, tribunals sometimes deviate from the principles that would govern a wholly domestic transaction in that jurisdiction. The usual motivation is 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 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.[46]

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. 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

[46] World Duty Free, supra.

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."[47]

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 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,[48] the United Nations Convention Against Corruption,[49] as well as regional conventions and regional instruments produced by bodies such as the African Union,[50] the Council of Europe[51] and the Organization of American States.[52] 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."[53] (Recall however that its alternative ground for decision was that the contract was voidable under principles of agency law.)

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[47] Oscanyan v. Arms Co., 103 U.S. 261, 277-8 (1880).
[48] November 21, 1997, 37 I.L.M. 4 (1998).
[49] October 31, 2003, 43 I.L.M. 37 (2004).
[50] African Union Convention on Preventing and Combating Corruption, July 11, 2003, 43 I.L.M. 5 (2004).
[51] Inter-American Convention Against Corruption, March 29, 1996, 35 I.L.M. 724 (1996).
[52] Inter-American Convention Against Corruption, March 29, 1996, 35 I.L.M. 724 (1996).
[53] World Duty Free, para. 157.

It is a bit surprising that tribunals do not have more difficulty with cases involving bribery of heads of state like President Moi. When the recipient of a bribe is the head of state the analogies to either an agent's breach of fiduciary duty or an illegal private contract break down. A head of state seems less like a faithless agent and more like an avaricious principal; and 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.[54] There may, however, be rare fact patterns that confound this theory. An example seems to have arisen in the recent BAE affair. In that case, which has not yet led to litigation, the monarch of Saudi Arabia, which is a kingdom without a written constitution, explicitly condoned the bribery of a public official in connection with a public contract.[55]

*Public international law*

There are several ways in which 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 domestic 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

[54] 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).
[55] Nelson D. Schwartz and Lowell Bergman, Payload: Taking Aim At Corporate Bribery, New York Times, November 25, 2007.

created by international instruments that might have something to say about whether claims 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 provide excuses analogous to the ones available in domestic law.

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."[56] 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."[57]

International law can also allow governments to avoid, in effect, their obligations under contracts procured through bribery by preventing those claims from being heard in certain fora. By far the most important fora of this sort are arbitral tribunals created

[56] In force 14 December 2005,
[57] ETS no. 174, Strasbourg, 4.XI.1999.

under bilateral investment treaties that allow investors to bring claims against host states. A pair of recent decisions suggest that standard clauses included in many BITs preclude investors from bringing claims for breach of illegal contracts.

The clauses in question are the ones that define the kinds of investments protected by the BIT. The versions at issue in one of the recent cases 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].[58]

> and,

> "Each Contracting State shall promote as far as possible investments in its territory by investors of the other Contracting State and admit such investments *in accordance with its Constitution, laws and regulations*...."[59]

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,

[58] 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).
[59] 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).

*Inceysa Vallisoletanan S.K. v. Republic of El Salvador*,[60] the contract in question was procured through fraudulent misrepresentations about the foreign firm's financial condition and relevant experience. The other case, *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, was less straightforward. The dispute involved a contract with the Philippine government to build and operate an airport terminal. The other party to the contract was a joint venture between a German firm and several Philippine firms. After the terminal was built the Philippine government terminated the concession and expropriated the terminal. The German investor brought complaints against the Philippines, including one under the BIT between German and the Philippines. A majority of the panel that heard the complaint under the BIT concluded that the investor had used secret shareholder agreements to secure control of the joint venture company and thereby violated a local law that barred foreigners from exercising either de facto or de jure control over public utilities. They concluded that as a result the investment was not in accordance with the host state's law and so was not protected by the BIT. Although neither of these cases involved bribery, it is not difficult to imagine how their reasoning 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 obligations it might have owe under customary international law to the home state of a counterparty. For instance, there is at least one case suggesting that there is no international obligation to honor a debt arising from a loan nominally made to the state if

[60] ICSID Case No. ARB/03/26.

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. This was the holding of the famous *Tinoco Arbitration*.[61] 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. Another part of the *Tinoco Arbitration* supports the proposition that there is no international obligation to abide by a contract that was made in violation of local law. That aspect of the decision concerns an oil concession that was awarded by the Chamber of Deputies of Costa Rica when, according to the Constitution in force at the time, approval of the entire Congress was required.[62]

## 3 The logic of the zero-tolerance approach

### *The case for zero-tolerance*

Most of the domestic cases applying the doctrine of illegality as well as the recent ICSID panel decision in *World Duty Free* take 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 some of these tribunals would be willing to award compensation, if not disgorgement or punitive damages as well. These courts and tribunals clearly take the view that firms that deal with the government have an

[61] Arbitration Between Great Britain and Costa Rica, 18 Am. J. Int'l L. 147 (1924).
[62] Arbitration Between Great Britain and Costa Rica, 18 Am. J. Int'l L. 147, 169-74 (1924).

overriding obligation to combat bribery and they have adopted what might be called a zero-tolerance approach to the design of remedies for breach of that obligation.

At first glance the package of remedies that comprise the zero-tolerance approach does a reasonably good job of satisfying three characteristic objectives of private law remedies for wrongs: expressing society's condemnation, protecting the victims from lasting harm, and deterring future misconduct. First, the zero-tolerance approach satisfies the impulse to *condemn* bribery as immoral. Refusing to protect rights obtained through bribery signifies the wrongfulness of bribery. This sort of condemnation arguably can serve the interests of both members of the legal system and the public at large. It serves the interests of legal actors by allowing them to uphold their dignity; courts can show that bribe-payers are so contemptible that they do not even deserve to be heard.[63] 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.[64]

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.[65] 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

[63] 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).
[64] 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).
[65] See, for example, Seana Valentine Shiffrin, The Divergence of Contract and Promise, 120 Harv. L. Rev. 708, 714 (2007).

inefficiently inhibit productive activity.[66] There is, however, 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.

A second virtue of the zero-tolerance approach is that 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.

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[66] See, for example, Liebman v. Rosenthal, 57 N.Y.S.2d 875 (Sup. Ct.), aff'd, 59 N.Y.S.2d 148 (App. Div. 1945).

*Objections*

So what is the objection to the zero-tolerance approach? The root of the problem is that under the zero-tolerance approach liability is triggered by proof that the firm in question has failed to prevent bribery and the magnitude of liability increases to the extent that the firm treats the contract as an enforceable one and invests in reliance upon it. 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 should 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 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. 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.[67]

The list of actions that governments can take to mitigate the effects of bribery in public contracting begins with efforts to prevent bribery-tainted contracts from being formed. The most drastic step is to avoid entering into certain types of contracts, or even certain lines of business, altogether. There is also a whole raft of preventative techniques that come into play when, as is often the case, bribes are likely to be paid by representatives of organizations rather than individuals acting on their own behalf. For instance, those organizations 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.

Leaving aside prevention, organizations can also police themselves in ways that deter many of their agents from resorting to bribery. For instance, an organization might commit itself to a scheme of 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 the organization can adopt a policy of reporting individual bribe-payers to law enforcement authorities, thereby exposing them to criminal and civil sanctions.

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

[67] 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).

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. In such cases, simply leaving the contract in force will induce the bribe-payer to provide performance that leaves the government better off than it would be if the bribe-payer walked away.

Finally, it is important to appreciate that the bribe-payer and its agents are not the only actors who can try to prevent bribery or take steps after the fact to mitigate its impact. Bribery is not an individual crime. There are always two sides to a corrupt bargain. This means that actors on the receiving end of the bribe, namely the government and its agents, are also in a position to combat bribery. Just like an organizational bribe-payer, the government can try to prevent bribery by carefully screening, supervising and motivating its officials. It can also deter individual officials by monitoring and prosecuting them.[68] Finally, it can make the best of corruptly procured contracts by doing its best to induce the bribe-payer to provide valuable performance.

Considering the full range of steps that can be taken to combat bribery in public contracting puts the zero-tolerance approach in its proper perspective. Once prevention is set alongside all the other possible responses to the problem it ceases to stand out. Similarly, once the potential benefits of performing a contract procured through bribery are taken into account, encouraging contractors to walk away from such contracts seems less appealing.

One concern about prevention is that it may be prohibitively costly. In some cases the only way to prevent bribery completely may be to avoid doing business with

[68] See, for example, Rose-Ackerman, supra, 39-88, 143-74.

certain governments. The loss of potential gains from trade could have drastic consequences. For instance, if the effect of the *World Duty Free* decision was to discourage firms from doing business with the government of a country as large and as poor as Kenya the costs of preventing bribery would surely be regarded as excessive.

An exclusive focus on encouraging bribe-paying firms to prevent bribery seems particularly unreasonable to the extent that adequate deterrence can be achieved through criminal prosecutions of individual wrongdoers (both payers and recipients). In this case it may make sense to adopt a remedial approach that focuses on encouraging employers to monitor and report their employees. In other words, it may be that the best approach to a situation like the one considered in *World Duty Free* is to focus on encouraging firms from whom bribes are solicited to make full disclosure to the press and public prosecutors. As things stand under the zero-tolerance approach, seeing how World Duty Free was rewarded for its forthrightness other firms have little reason to follow its lead.

Similarly, rules that encourage bribe-payers to walk away from their contracts seem misguided when the contract is one that promises to yield net benefits for the government if left in force. This point seems particularly salient in a scenario where the contract procured through bribery is one like the concession to operate airport duty-free stores that was at issue in the *World Duty Free* case. What incentive does the concessionaire have to invest in the maintenance and improvement of its property under a zero-tolerance regime? The concessionaire's incentive to invest is obviously diminished by the fact that the stores might be yanked away from it any time once the circumstances surrounding the award of the concession come to light. By contrast, if the penalty for the bribery were simply a monetary fine, the concessionaire's incentives to maximize the value of the concession would be unaffected by the prospect of its bribery being detected and punished. It seems reasonable to presume that a government has an interest in inducing its concessionaire to maximize the value of their concessions, either directly because it receives a share of the profits or indirectly. (For example, Kenya presumably benefited from making the country's international airports more attractive to travelers). So from this perspective, the zero-tolerance regime has perverse consequences.

This last point requires a bit of qualification because the perversity only arises to the extent that factors such as explicit contractual obligations are insufficient to motivate the bribe-paying firm. However, that is not an uncommon situation. It is particularly unlikely to be feasible to use explicit contractual duties to motivate the bribe-payer. This is because 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 legally enforceability. That is why the prospect of the government's obligation being avoided is so pernicious.

## 4 An alternative approach: proportional liability

### *General principles*

The inevitable conclusion is that the zero-tolerance approach should be abandoned in a favor of a new approach. At the same time there are compelling pragmatic reasons to believe that any realistic alternative should 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. 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; and, deter similar violations and their associated harms. In theory all of these propositions are contestable, and they are not necessarily mutually compatible either. As a practical matter though, these propositions appear to be too deeply embedded in most modern legal systems to be ignored.

These considerations generally point toward a remedial scheme that makes 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 should depend not only on proof that the firm failed to prevent bribery, but also the extent to which it monitored and supervised its employees and co-operated with law enforcement authorities, together with the extent to which the incident was caused by the government's failure to do its part to eradicate corruption.

This approach 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 other firms. For one thing, it provides firms with incentives to take steps to mitigate the impact of their mistakes. Perhaps more optimistically, a well-designed remedial scheme of proportional liability can induce firms that will not do everything possible combat bribery to focus on steps that the law deems most important. So for instance, treating failure to report bribery as either an aggravating or a mitigating factor in setting liability encourages firms to offset the impact of mistakes at the prevention stage - whether those mistakes are deliberate or inadvertent - by engaging in self-policing, reporting individual wrongdoers to the authorities, and making socially beneficial investments.

Finally a remedial scheme that imposes liability proportional to fault need not be incompatible with the goal of protecting the public. 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. In principle, there is no reason why the minimum level of liability under a proportional liability regime should be sufficient in absolute terms to compensate the public for any harm caused by the wrongdoer's actions.

By contrast, the zero-tolerance approach fails to satisfy the criterion of proportionality, primarily because of its reliance on the overly blunt remedy of automatic avoidance upon proof of bribery. The potential impact of avoidance depends on value of the performance promised to the firm and the extent to which the firm is able to prevent bribery. It does not depend on the extent to which the firm polices itself or decides to report bribery to the authorities and depends in the wrong way upon the extent to which the firm has chosen to invest in reliance on the contract.[69]

This is not to say, however, that the proportional liability approach is perfect. One major concern is that imposing liability proportional to fault may be appropriate for the purposes of properly condemning the bribe-payer, but it may be incompatible with the goals of either efficiently deterring future misconduct or protecting the public from ongoing harm. Conflicts with the principle of deterrence can be sidestepped though. Efficient deterrence requires setting liability for an undesirable action at an amount equal to a function of the harm caused by the action and the probability that liability will actually be imposed. If the same function is used to define the sum of money that is 'proportional to fault' then there should be no conflict between proportional liability and efficient deterrence.

[69] This argument reflects, in part, an application of 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).

There is, however, more potential for conflict with the goal of protecting the public from harm. Adequate protection demands that a minimum not a maximum amount of liability be imposed. So there is no conflict when the amount of liability that is proportional to fault exceeds the amount required to provide compensation. The difficulty arises in the opposite case when the bribe-payer is not very culpable at all and so the amount of liability that is proportional to its fault is not sufficient to provide full compensation. This could, for example, occur in a situation where a harmful bribe is paid by a rogue employee in violation of vigorously enforced company policies, the company cooperates fully in the investigation and prosecution of the agent, and the employee has insufficient assets to provide compensation himself. Also troublesome are situations in which the bribe-paying firm is *relatively* blameless because the government official essentially extorted the bribe. In situations like this, where liability has to be used to condemn or deter the actions of two distinct actors, and the only available remedies involve a transfer of resources from one actor to the other, a rule that forces the bribe-payer to compensate the recipient is not necessarily compatible with the ideas of deterring and condemning the most culpable actor. Unfortunately, there is no obvious solution to either of these potential conflicts between the proportional liability approach and the objective of achieving adequate protection.

*Implications for legal doctrine*

In doctrinal terms, implementing this proportional liability approach would involve adopting principles closer to those found in agency law than in the law of illegality and related doctrines. This seems fitting given that 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 somewhat broader doctrines such as illegality.

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 only potential conflict arises where, as noted above, the principal – in this case the government whose official was bribed - seems significantly more culpable than the bribe-payer. This might arise, for instance, where a government official extracts a bribe from a firm by improperly and unexpectedly threatening to repudiate an existing contract after the firm has made substantial investments in reliance upon it and in circumstances where the firm has no meaningful legal recourse. Even in this sort of case though it is debatable whether the firm or the people represented by the official ought to bear the risk of this kind of official misconduct. In any event, existing law may provide a defense of duress in this sort of situation.

The proportional liability approach is also consistent with existing law that gives tribunals discretion to award an aggrieved principal disgorgement or even, in some jurisdictions, punitive damages. However, the analysis here suggests that this discretion should be exercised in a fashion that treats the firm's efforts to control or police its employees and to cooperate with authorities as either mitigating or aggravating factors. In addition, if that discretion is exercised in a principled fashion the tribunal should take into account the extent to which in any particular case other sanctions such as harm to the firm's reputation or criminal penalties serve the same purposes as these sorts of supra-compensatory damage awards.

Interestingly though, the proportional liability approach is not consistent with current principles of agency law to the extent that it routinely gives a principal an entitlement to avoid a contract procured through bribery. 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 suggest 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 two broad classes of cases. First of all, there are many 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 inappropriately. In a situation like this 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 may capture a large number of cases. This class of cases would not, however, capture cases like *Gerzof v. Sweeney* where the bribe did not taint the determination of whether the contract was required and the value of the contractors' performance could be established by referring to the price that would have been charged as a result of competitive bidding.

A second class of cases in which avoidance seems appropriate comprises those in which enforcement of the government's obligations would be truly illegal since it would require violating an express statutory direction. For example, a concession agreement that violates explicit restrictions on foreign ownership in the relevant sector or clear environmental laws should be void. This outcome is dictated by the principle of respect for the rule of law. However, it need not be radically inconsistent with the proportional liability approach. In many cases a firm that signs and relies upon a clearly illegal contract of this sort can be considered highly culpable because the illegality is readily apparent. Cases of this sort may also overlap with the cases described in the preceding paragraph because it may be virtually impossible to quantify the harm that flows from this sort of blatant illegality. In these cases avoidance may be the only reasonable way to protect the interests of the public.

Even in cases where avoidance is inevitable though, the government's obligations should typically be replaced with an obligation to make restitution. Since the fact of the bribe creates a distinct possibility that the contract does not create anything of value for the government, the conventional 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.

If the government is going to be given an entitlement to avoidance it also generally makes sense to allow it to surrender that right by ratifying the contract. The possibility that a tainted contract will be ratified should, at the margins, enhance a bribe-payer's incentive to rely upon it. A further step in this direction would be to limit the duration of the entitlement to avoid a contract, perhaps following the UNIDROIT principles which require the entitlement to be exercised within a reasonable time. 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 uncompensated investments in enhancing the value of the contract.

A government's rights to ratify the contract will, however, have to be limited in at least two respects. First, ratification obviously makes no sense (on rule-of-law grounds) in cases where performance of the contract would clearly be illegal. Second, permitting ratification can be problematic where there is doubt about whether the person purporting to ratify the transaction is trustworthy. Consider, for example, whether it would have been appropriate to permit President Moi to ratify a Kenyan government contract procured through bribery of one of his cabinet members. 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."[70]

Similar concerns weigh against permitting the government to waive its entitlement to avoid obligations owed to assignees of the bribe-payer. Making the entitlement to avoid obligations owed to assignees inalienable seems appropriate where performance would be illegal. It also seems appropriate where the conditions under which the waiver is signed are suspicious.

## 5 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 that 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.

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