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## International Arbitration and Money Laundering

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# INTERNATIONAL ARBITRATION AND MONEY LAUNDERING

ANDREW DE LOTBINIÈRE MCDUGALL \*

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## I. INTRODUCTION

While money laundering has received a significant amount of attention recently, it is not a recent phenomenon. The concept of "money laundering" originates from the practice of American criminal organizations in the 1920s, where coin-laundries (laundromats) were used as a means of concealing the criminal origin of their revenues.<sup>1</sup> What is recent is the level of international concern regarding money laundering, which has increased significantly since the 1980s. The result has been the creation of a complex international and national legal framework over the last twenty-five years that has developed in a rather haphazard way. The impact of this legal framework on international arbitration has become a topic of growing prominence in the field,<sup>2</sup> and is the subject of this article.

### A. WHAT IS "MONEY LAUNDERING"?

Money laundering has been defined as "the process by which criminals attempt to hide and disguise the true origin and ownership of the proceeds of their criminal activities, thereby avoiding prosecution, conviction, and confiscation of the criminal funds."<sup>3</sup> Money laundering generally involves a three-stage process:<sup>4</sup>

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1. See Peter W. Schroth, *Bank Confidentiality and the War on Money Laundering in the United States*, 42 AM. J. COMP. L. 369, 375 (1994).

2. For example, in November 2002, the International Chamber of Commerce Institute of World Business Law held a conference on the topic of "Arbitration – Money Laundering, Corruption and Fraud." To view the published proceedings, see ARBITRATION: MONEY LAUNDERING, CORRUPTION AND FRAUD (Kristine Karsten & Andrew Berkeley eds., 2003) [hereinafter ICC PAPERS] (comprising scholarly articles addressing money laundering from various perspectives including that of both the arbitrator and the law firm); see also INT'L BAR ASS'N, 8TH ANNUAL INTERNATIONAL ARBITRATION DAY: NEW CHALLENGES AND RECURRING ISSUES IN A CHANGING ARBITRATION WORLD, at [http://www.ibanet.org/images/downloads/Geneva%20\(18-19%20March\).pdf](http://www.ibanet.org/images/downloads/Geneva%20(18-19%20March).pdf) (last visited Sept. 12, 2005).

3. See JOINT MONEY LAUNDERING STEERING GROUP, PREVENTION OF MONEY LAUNDERING – GUIDANCE NOTES FOR THE FINANCIAL SECTOR 5 (2003).

4. See WORLD BANK & INT'L MONETARY FUND, REFERENCE GUIDE TO ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM I-7 [hereinafter REFERENCE GUIDE], available at [http://www1.worldbank.org/finance/html/amlcft/docs/Ref\\_Guide\\_EN/v2/01-Ch01\\_EN\\_v2.pdf](http://www1.worldbank.org/finance/html/amlcft/docs/Ref_Guide_EN/v2/01-Ch01_EN_v2.pdf) (last visited Sept. 12, 2005).

- “soaking,” “smurfing” or “placing,” which is aimed at putting proceeds from criminal activity into the banking system by way of cash deposit in local currency;<sup>5</sup>

- “washing” or “layering,” which is aimed at separating the proceeds from their original source (this is usually achieved through a series of transactions, including co-mingling of clean and dirty money);<sup>6</sup> and

- “drying” or “integrating,” which is aimed at converting the washed money into legitimate investments.<sup>7</sup>

## B. WHERE DOES INTERNATIONAL ARBITRATION FIT IN?

The following are but a few examples of how money laundering can relate to the resolution of international commercial disputes by arbitration. One example is where criminal organizations have recourse to international arbitration as the very means of laundering their money, such as where a commercial dispute is simulated between two related corporate entities that appear on their face to be unrelated. Company A commences a fake claim for damages based on forged evidence against Company B; Company A obtains an arbitral award for damages against Company B; and Company B pays damages to Company A out of proceeds obtained from criminal activity.<sup>8</sup> Unlike judicial proceedings, international arbitration offers at least a degree of confidentiality, the freedom to organize the proceedings, and the ability to appoint accomplices as arbitrators.

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5. See *id.* at I-7 (explaining that money launderers often break up the assets into less conspicuous amounts before they disperse the funds in several bank accounts).

6. See *id.* at I-8 (describing ways in which a money launderer can convert illegal funds); JAN DALHUISEN, *DALHUISEN ON INTERNATIONAL COMMERCIAL, FINANCIAL AND TRADE LAW* 482 (2004).

7. See REFERENCE GUIDE, *supra* note 4, at I-9 (claiming that purchasing real estate, securities, or other luxury goods are common ways to integrate laundered money).

8. See Kristine Karsten, *Money Laundering: How It Works and Why You Should Be Concerned*, in ICC PAPERS, *supra* note 2, at 19. For an example of a deliberate scheme involving an award fabricated to defraud creditors' rights and priorities in bankruptcy, see Lars Heuman & Göran Millqvist, *Swedish Supreme Court Refuses to Enforce an Arbitral Award Pursuant to the Public Policy Provision of the New York Convention*, 20 J. INT'L ARB. 493 (2003).

Hopefully, such abuse of the arbitral process is, and will remain, rare.

More frequent, in the author's experience, are cases where an apparently legitimate contract ends up in arbitration that, in fact, involves money laundering. Consistent with the three-stage money laundering process described above, money laundering can involve quite ordinary trade transactions, and money laundering schemes involving the import and export of commodities are not uncommon. Such transactions can give rise to a wide array of what appear to be legitimate commercial disputes.<sup>9</sup>

One such example is where a money launderer acquires commodities in a foreign country using dirty money at a price significantly higher than that offered on the spot market. The seller is so eager to sell its products with an additional margin that it is either unaware of, or prepared to turn a blind eye to, the dubious origin of the funds offered as payment.<sup>10</sup> Having acquired the commodities, the buyer resells them on its home market at the spot price.<sup>11</sup> This may result in a loss to the buyer, but that is not a concern because the money launderer is then able to account for seemingly legitimate revenues.<sup>12</sup>

Another such example, which is one the author has encountered, is where the purpose of a supposedly legitimate contract is to illegitimately divert the assets of one party for the benefit of the other party, and money laundering is used as a part of the scheme. A series of arbitrations, in which the author was counsel, uncovered the following scheme:<sup>13</sup> Company A and Company B entered into a joint

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9. See FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING, ANNUAL REPORT 2002-2003 4, para. 16 (June 20, 2003) [hereinafter FATF ANNUAL REPORT], available at <http://www.fatf-gafi.org/dataoecd/13/0/34328221.pdf> (last visited Sept. 12, 2005).

10. See Karsten, *supra* note 8, at 18-20 (explaining that a transaction cost of 20% or more is usually acceptable to the buyer of the commodities since this allows them to reinvest the funds with little attention).

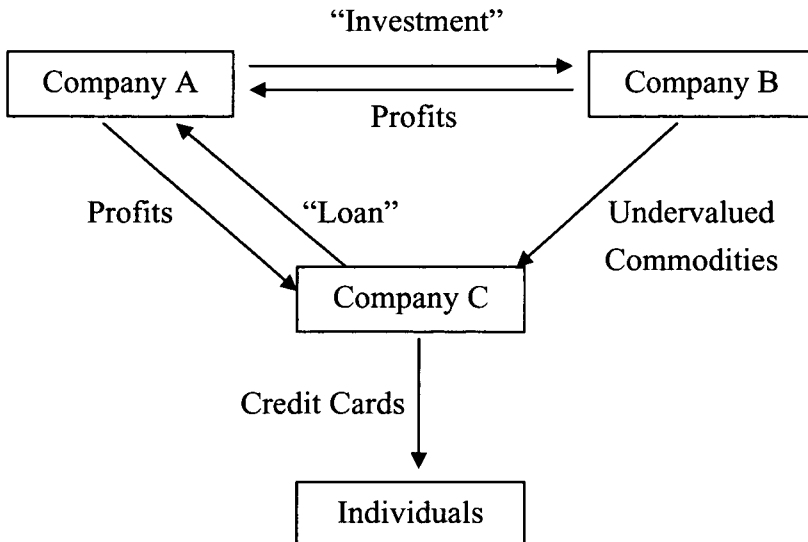
11. See *id.* at 21-22. The spot price is the delivery price of a given commodity on the market. Investor Words, *Glossary*, at [http://www.investorwords.com/4663/spot\\_price.html](http://www.investorwords.com/4663/spot_price.html) (last visited Sept. 12, 2005).

12. See Karsten, *supra* note 8, at 19-20.

13. See diagram, *infra*.

venture agreement whereby Company A agreed to invest in Company B in exchange for a share of the profits from Company B's business. Company A obtained funds from Company C in order to make the investment. Company C meanwhile entered into contracts with Company B to buy commodities at prices lower than those on the spot market. Company C sold the commodities for a profit and used some of the profit to lend the necessary funds to Company A for the investment in Company B, forgiving the loan as a bad debt. Company A thus obtained a share of Company B's profits by investing money that Company C had illegitimately diverted from Company B, and Company A did not have to pay the "loaned" investment money back to Company C.

When Company B distributed Company A's share of the profits from the joint venture, Company A funneled some of those profits to Company C. Company C, therefore, had initial profit obtained from the sale of commodities and profits obtained from the joint venture. Then the individuals behind the scheme extracted these illegitimate profits from Company C by way of, among other things, Company C credit cards used for personal expenses.



This particular scheme, which involved money laundering as defined above, was in fact even more complex. It involved several

other corporate entities that had entered into numerous transactions with Company B, all intended to illegitimately divert Company B's assets. It also involved a second joint venture between Company A and Company B. International arbitration exposed this scheme when new owners acquired Company B, and the new management terminated the two joint ventures with Company A. Each joint venture agreement contained an arbitration clause, and Company A commenced arbitrations against Company B for breach of each joint venture agreement and damages.

C. HOW SHOULD AN ARBITRAL TRIBUNAL PROCEED IF A CONTRACT INVOLVES MONEY LAUNDERING BUT IS VALID AND ENFORCEABLE UNDER ITS GOVERNING SUBSTANTIVE LAW?

What should an arbitral tribunal do if a contract involves money laundering, but, as one party argued in the series of arbitrations described above, the contract is valid and enforceable under its governing substantive law? One view is that an arbitral tribunal should not "turn a blind eye" but, rather, should find a way to refuse to give effect to such a highly objectionable contract.<sup>14</sup> If so, how should an arbitral tribunal proceed?

The present article does not attempt to answer this question definitively. It explores three different options open to an arbitral tribunal confronted with such a scenario to hold the contract invalid or unenforceable: (a) to refuse jurisdiction over the dispute, (b) to apply a principle of international public policy, or (c) to give precedence to the mandatory provisions of another law over the governing substantive law of the contract.<sup>15</sup>

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14. See *Westacre Investments Co. v. Jugoimport-SPDR Holding Co. Ltd.*, [1998] 2 Lloyd's Rep. 111, 131 (Q.B.).

15. This article does not address the question of the standard of proof required to prove money laundering before an international arbitral tribunal. Some consider the necessary requirement of proof to be "clear and convincing" evidence, which is a standard of proof higher than "by a preponderance of the evidence," but lower than "beyond a reasonable doubt." For a further discussion on this subject, see ICC PAPERS, *supra* note 2, at 172-77 (examining generally the debate that followed the ICC Conference). For more information regarding burden and standard of proof before international tribunals, see generally MOSTABA KAZAZI, BURDEN OF PROOF AND RELATED ISSUES: A STUDY ON EVIDENCE BEFORE INTERNATIONAL TRIBUNALS 39 (1996).

Before addressing these options, it is necessary to consider the existing legal framework in connection with money laundering. It is this legal framework that arbitrators should have in mind when considering what to do when faced with a dispute involving money laundering.

## II. LEGAL FRAMEWORK

The following overview of the international and national legal framework regarding money laundering is intended to demonstrate how this legal framework has evolved over the last twenty-five years and is not meant to be exhaustive.

### A. INTERNATIONAL

Since a 1980 recommendation of the Council of Europe,<sup>16</sup> international bodies have given money laundering a significant amount of attention. These international institutions consider international cooperation more important because of the effect of globalization on money laundering.<sup>17</sup> In general, institutional agreements take a two-pronged approach. First, the agreement criminalizes money laundering. Second, it imposes duties on intermediaries—most notably banks, but also, more recently, accountants and lawyers.

#### *1. International Conventions*

In 1988 in Vienna, the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (“Vienna Convention”) was signed.<sup>18</sup> It has been ratified by 170 countries.<sup>19</sup>

16. Recommendation No. R (80) 10 of the Committee of Ministers to Member States on Measures Against Transfer and the Safekeeping of Funds of Criminal Origin [*Mesures contre le transfert et la mise à l’abri des capitaux d’origine criminelle*], Committee of Ministers, 321st mtg. (1980) [hereinafter Recommendations].

17. See Herbert V. Morais, *The Quest for International Standards: Global Governance vs. Sovereignty*, 50 U. KAS. L. REV. 779, 790 (2002) (explaining that globalization has created competition in financial markets, which could reward countries that offer lax regulatory schemes with valuable foreign investment).

18. Dec. 20, 1988, 1582 U.N.T.S. 164, U.N. Doc. E/CONF.82/14 (1988), reprinted in 28 I.L.M. 493 [hereinafter Vienna Convention].



Pursuant to Article 3 of the Vienna Convention, signatories agree to establish as criminal offences:

(1) "The conversion or transfer of property, knowing that such property is derived" from drug trafficking offences, "or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions;"<sup>20</sup>

(2) "The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from [a drug trafficking offence or from an act of participation in such an offence or offences];"<sup>21</sup> and

(3) "The acquisition, possession or use of property, knowing . . . that such property was derived from [a drug trafficking offence]" (adoption of this third offence is subject to each signatory's "constitutional principles and basic concepts of its legal system.".)<sup>22</sup>

While Article 3 of the Vienna Convention only criminalizes money laundering of proceeds from drug trafficking, drug trafficking being the "predicate offence" (i.e., the offence that generated the proceeds which were laundered), it has served as a blueprint for subsequent initiatives to combat money laundering. For example, the United Nations Convention Against Transnational Organized Crime ("Palermo Convention"), opened for signature in Palermo on November 15, 2000, requires signatories to, in similar terms to Article 3 of the Vienna Convention, criminalize the laundering of the proceeds of "serious crime."<sup>23</sup> The Convention defines "serious crime" as "conduct constituting an offence punishable by a

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19. See United Nations, Office on Drugs and Crime, Monthly Status of Treaty Adherence (listing the signatories to the Vienna Convention), *available at* [http://www.unodc.org/unodc/en/treaty\\_adherence.html#1988](http://www.unodc.org/unodc/en/treaty_adherence.html#1988) (last modified Jan. 1, 2005).

20. Vienna Convention, *supra* note 18, art. 3(1)(b)(i).

21. *Id.* art. 3(1)(b)(ii).

22. *Id.* art. 3(c)(i).

23. G.A. Res. 22, U.N. GAOR, 55th Sess., Annex 1, art. 6, U.N. Doc. A/RES/55/25 (2000), *reprinted in* 40 I.L.M. 335 [hereinafter Palermo Convention].

maximum deprivation of liberty of at least four years or a more serious penalty.”<sup>24</sup> This has broadened the range of predicate offences upon which the prosecution of money laundering may be based.<sup>25</sup>

In addition, the Organisation for Economic Co-operation and Development Convention on Combating Bribery of Foreign Public Officials, opened for signature in Paris on December 17, 1997, requires signatories to make bribery of foreign public officials a predicate offence when local law considers bribery of domestic officials a predicate offence.<sup>26</sup> The United Nations Convention on the Suppression of the Financing of Terrorism, opened for signature on January 10, 2000, also addresses money laundering as it relates to the financing of terrorism.<sup>27</sup>

## 2. *Group of Seven: FATF Forty Recommendations*

At its 1989 Paris summit, the Group of Seven<sup>28</sup> established a special body to cope with the issue of money laundering—the Financial Action Task Force on Money Laundering (“FATF”). The FATF’s principal mandates are to spread awareness of the problem of money laundering and to monitor current money laundering trends and potential counter-measures.<sup>29</sup> It was also conceived as a “policy-

24. *Id.* art. 2(b).

25. *Cf.* Vienna Convention, *supra* note 18, arts. 2-3 (limiting the scope of predicate offences to those types discussed in the Convention).

26. *See* S. TREATY DOC. NO. 105-43, art. 7 (1998).

27. G.A. Res. 109, U.N. GAOR, 54th Sess., U.N. Doc. A/RES/54/109 (1999), reprinted in 39 I.L.M. 270. For a review of the relationship between the frameworks used for combating money laundering and the financing of terrorism, see Bruce Zagaris, *The Merging of the Anti-Money Laundering and Counter-Terrorism Financial Enforcement Regimes After September 11, 2001*, 22 *BERKELEY J. INT’L L.* 123 (2004).

28. Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

29. *See* Financial Action Task Force on Money Laundering, *Mission*, at [http://www.fatf-gafi.org/pages/0,2966,en\\_32250379\\_32236846\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/pages/0,2966,en_32250379_32236846_1_1_1_1,00.html) (last visited Sept. 16, 2005).

making" body, a role in which it has been particularly successful.<sup>30</sup> The FATF has developed a set of recommendations, the so-called "Forty Recommendations," addressed to governments and other institutions, and updated regularly to take account of new developments in the field (the most recent update was in 2003).<sup>31</sup> Although they lack binding force, the Forty Recommendations are often presented as the benchmark for national money laundering policies.<sup>32</sup>

Pursuant to Recommendation 1 of the Forty Recommendations, countries are encouraged to criminalize money laundering on the basis of the Vienna and Palermo Conventions.<sup>33</sup> The FATF recommends that the offence of money laundering be applied to "all serious offences, with a view to including the widest range of predicate offences."<sup>34</sup> Most of the Forty Recommendations urge member countries to impose various obligations (most notably, reporting, customer due diligence, and record-keeping obligations) on financial institutions and some other non-financial businesses and professionals.<sup>35</sup>

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30. See Rebecca Gregory, *The Lawyer's Role: Will Uncle Sam Want You in the Fight Against Money Laundering and Terrorism?*, 72 U. MO. KC L. REV. 23, 31 (2003).

31. See Financial Action Task Force on Money Laundering, *The Forty Recommendations* (June 20, 2003) [hereinafter *Forty Recommendations*], available at <http://www.fatf-gafi.org/dataoecd/38/47/34030579.PDF> (last visited Sept. 15, 2005).

32. See Gregory, *supra* note 30, at 31-32; see also Financial Action Task Force on Money Laundering, *Annual Review of Non-Cooperative Countries or Territories*, at 3 (June 20, 2003), available at <http://www.fatf-gafi.org/dataoecd/14/30/33922392.PDF> (last visited Sept. 15, 2005).

33. See *Forty Recommendations*, *supra* note 31, at 1 (allowing member countries to determine whether to implement this categorically or as a threshold). A categorical approach would entail a list of crimes that would serve as the predicate offence, while a threshold approach would set a minimum level of punishment as the determining measure. *Id.*

34. *Id.* (suggesting, at a minimum, that all "serious offences" under local law as well as all crimes punishable by a maximum penalty of more than one year constitute predicate offences to trigger money laundering statutes).

35. *Id.* at 2-8 (addressing Recommendations 4 through 25 to non-government entities, and even requiring them to take prospective action to combat threats that may arise with the development of new technologies).

In 2000, the FATF identified and blacklisted certain countries and territories that had proved reluctant to cooperate in the global fight against money laundering—the so-called Non-Cooperative Countries and Territories (“NCCTs”).<sup>36</sup> The necessary incentive to cooperate has been provided by threats of counter-measures by FATF’s members, such as restrictions on financial transactions.<sup>37</sup> The number of countries identified as NCCTs has dropped from the twenty-three first listed in the FATF’s 2000 report to three as of February 11, 2005.<sup>38</sup>

### 3. *European Union*<sup>39</sup>

In 1990, ten years after the 1980 recommendation of the Council of Europe discussed above,<sup>40</sup> the Council of Europe adopted the Convention on Laundering, Tracing, Seizure and Confiscation of Proceeds from Crime (“Council Convention”).<sup>41</sup> The Council Convention has been ratified by some forty States, including non-members of the Council such as Australia.<sup>42</sup> The key feature of the

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36. See Financial Action Task Force on Money Laundering, *Review to Identify Non-Cooperative Countries and Territories*, at 2 (June 22, 2000), available at <http://www.fatf-gafi.org/dataoecd/56/43/33921824.pdf> (last visited Sept. 12, 2005).

37. See Todd Doyle, *Cleaning Up Anti-Money Laundering Strategies: Current FATF Tactics Needlessly Violate International Law*, 24 HOUS. J. INT’L L. 279, 298 (2002) (arguing that, while the threat of “ultimate recourse” has been successful in encouraging nations to comply, taking the threatened action would violate the Vienna Convention on the Law of Treaties).

38. See Financial Action Task Force on Money Laundering, *Current NCCT List* (noting that Myanmar, Nauru, and Nigeria are the only remaining non-compliant nations), at [http://www.fatf-gafi.org/document/4/0,2340,en\\_32250379\\_32236992\\_33916420\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/4/0,2340,en_32250379_32236992_33916420_1_1_1_1,00.html) (last visited Sept. 12, 2005).

39. Other regional organizations have also been active in the field. See Organization of American States, Inter-American Drug Abuse Control Commission, *Model Regulations Concerning Laundering Offences Connected to Illicit Drug Trafficking and Other Serious Offences*, available at [http://www.cicad.oas.org/lavado\\_activos/eng/Model\\_regula\\_eng12\\_02/REGLAM\\_ENTO%20LAVADO%20-%20ING%20jul04.pdf](http://www.cicad.oas.org/lavado_activos/eng/Model_regula_eng12_02/REGLAM_ENTO%20LAVADO%20-%20ING%20jul04.pdf) (last visited Sept. 15, 2005).

40. Recommendations, *supra* note 16.

41. Nov. 8, 1990, Europ. T.S. No. 141, reprinted in 30 I.L.M. 148 [hereinafter Council Convention].

42. See Council of Europe, *Chart of Signatures and Ratifications* (noting that important countries that have not signed include Canada and the United States),

Council Convention is that it requires signatories to extend the scope of the offence of money laundering to the proceeds of serious offences other than drug trafficking.<sup>43</sup> However, determining the relevant “predicate offences” is left to the discretion of the signatories.<sup>44</sup>

On June 10, 1991, the Council of the European Communities adopted the Directive on the Prevention of the Use of the Financial System for the Purpose of Money Laundering (“First EU Directive”).<sup>45</sup> With reference to international instruments such as the Vienna Convention and the Council Convention, the First EU Directive follows a two-pronged approach requiring Member States to criminalize money laundering and to impose a number of obligations on credit and financial institutions.<sup>46</sup> Credit and financial institutions are required to apply the “Know Your Customer” principle and to carry out identification of their clients.<sup>47</sup> The First EU Directive also imposes certain record-keeping, investigation and reporting obligations.<sup>48</sup> Furthermore, the First EU Directive prohibits tipping-off (i.e., unwarranted disclosure of reporting to the client), and includes a safe-harbor provision that protects credit and financial institutions against potential claims for breach of confidence.<sup>49</sup>

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available at <http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=141&CM=2&DF=2/27/05&CL=ENG> (last visited July 27, 2005).

43. Council Convention, *supra* note 41, art. 6.

44. *Id.* art. 6.4.

45. Council Directive 91/308/EEC, 1991 O.J. (L 166) 77 [hereinafter First EU Directive] (seeking to obtain European Community action against money laundering and the proceeds of criminal activity, while striking a balance with the Community’s goal of achieving a single market).

46. *Id.* arts. 2-3 (mandating that each Member State prohibits money laundering in addition to imposing detailed identification measures on financial institutions when customers open new accounts, transact large sums of money, or conduct suspicious transactions).

47. *Id.* art. 3 (providing narrow exceptions to the identification requirement for pension schemes and certain financial institutions).

48. *Id.* arts. 4-6.

49. *Id.* arts. 8-9 (explaining that the success of money laundering investigations depends on the good faith cooperation of financial institutions).

Originally, the scope of the First EU Directive was limited.<sup>50</sup> It was only concerned with the proceeds from offences recognized by the Vienna Convention (i.e., proceeds from drug trafficking), although Member States were free to broaden the scope of offences covered.<sup>51</sup> However, the First EU Directive was amended on December 4, 2001 by a Directive of the European Parliament and the Council of the European Union ("Second EU Directive").<sup>52</sup> The scope of the Second EU Directive is wider with respect to (i) predicate offences, and (ii) institutions and persons subject to the various obligations. The Second EU Directive now covers laundering of proceeds from "serious crimes," which must include the activities of criminal organizations, serious fraud, corruption, and offences that are severely punished under the penal law of the Member State.<sup>53</sup> The various obligations provided for under the First EU Directive are now imposed on a broader array of institutions and professionals, including real estate agents, auditors and lawyers.<sup>54</sup>

On June 30, 2004, the European Commission proposed a third directive ("Third EU Directive"), which would further amend the First EU Directive to take account of the 2003 update of the FATF's Forty Recommendations.<sup>55</sup> Among other things, the Third EU Directive contemplates extending the scope of predicate offences to

50. Compare First EU Directive, *supra* note 45, at 79, art. 1 (defining "criminal activity" as a crime specified in the Vienna Convention or as designated as a criminal act by the Member State), with Council Directive 2001/97/EC, art. 1, 2001 O.J. (L 344) 76, 77 [hereinafter Second EU Directive] (determining that "criminal activity" includes a violation of a crime specified in the Vienna Convention, fraud, corruption, offences that generate substantial proceeds and are punishable by imprisonment, the activities or criminal organizations as defined in Article 1 of Joint Action 98/733/JHA, and any other offence that the Member State designates as a criminal activity).

51. See First EU Directive, *supra* note 45, at 78, art. 1 ("'Criminal activity' means a crime specified in Article 3(1)(a) of the Vienna Convention and any other criminal activity designated as such for the purposes of this Directive by each Member State.").

52. See Second EU Directive, *supra* note 50.

53. See *id.* at 78, art. 1(E).

54. See *id.* at 78-79, art. 2.

55. See Proposal for a Directive of the European Parliament and of the Council on the Prevention of the Use of the Financial System for the Purpose of Money Laundering, Including Terrorist Financing, COM(04)448 final.

include terrorist activities and all offences which are punishable by deprivation of liberty or a detention order for a maximum of more than one year.<sup>56</sup> The Third EU Directive was approved by the European Parliament on May 26, 2005 and was adopted by the European Council of Economic and Finance Ministers on June 7, 2005.<sup>57</sup> Publication of the Third EU Directive is expected to take place towards the end of 2005.<sup>58</sup> Member States of the European Union have agreed to implement the Third EU Directive within two years after its publication.<sup>59</sup>

## B. NATIONAL

Specific national legal frameworks complement the diverse international bodies addressing money laundering. This section provides a description of the legal frameworks in three different countries—the United States, the United Kingdom, and France.

### 1. *United States*

The first money laundering offences in the United States were created by the Money Laundering Controls Act of 1986.<sup>60</sup> Section 1956 of the U.S. Code criminalizes the conduct of financial transactions involving the proceeds of “specified unlawful activity” and aiming at (i) promoting the carrying on of “specified unlawful activity,” (ii) concealing or disguising the proceeds of “specified unlawful activity,” or (iii) avoiding transaction reporting requirements.<sup>61</sup> Section 1956 also prohibits international transportation of monetary instruments representing proceeds of

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56. *See id.*

57. *See* Press Release, European Commission, Adoption of Anti-Money Laundering Directive Will Strike a Blow Against Crime and Terrorism (June 7, 2005), available at <http://www.europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/682&format=HTML&aged=0&language=EN&guiLanguage=fr> (last visited Sept. 15, 2005).

58. *Id.*

59. *Id.*

60. 18 U.S.C. §§ 1956-1957 (2000). For a thorough discussion, see Peter J. Kacarab, *An In Depth Analysis of the New Money Laundering Statutes*, 8 AKRON TAX J. 1 (1991).

61. § 1956(a).

“specified unlawful activity.”<sup>62</sup> Offenders are liable to be fined or imprisoned for up to twenty years.<sup>63</sup> Section 1957 criminalizes the conduct of “monetary transactions” for an amount exceeding \$10,000 in property derived from “specified unlawful activity.”<sup>64</sup> Offenders are liable to be fined or imprisoned for up to ten years.<sup>65</sup> The term “specified unlawful activity” includes a wide range of serious offences, including offences against foreign nations, with the notable exception of tax evasion.<sup>66</sup>

Reporting obligations have long been imposed on banks. As early as 1970, the Currency and Foreign Transactions Reporting Act<sup>67</sup> (and the Bank Secrecy Act<sup>68</sup>) provided for the reporting of large physical currency transactions. In 1992, the Annuzio-Wylie Anti-Money Laundering Act imposed reporting “suspicious transactions” in a number of circumstances and obliged banks to keep records of wire-transfers.<sup>69</sup> The overall framework was further developed in 2001 when Congress passed the U.S.A. Patriot Act.<sup>70</sup>

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62. *Id.*

63. *Id.* (determining that a violation of Section 1956 could also include punishment in the form of a fine of not more than \$500,000 or “twice the value of the property involved in the transaction, whichever is greater”).

64. § 1957(a).

65. § 1957(b).

66. § 1956(c)(7); see Kacarab, *supra* note 60, at 12 (noting the clear intent of Congress to establish broad reaching money laundering statutes with respect to the types of criminal activity included, and discussing the exclusion of tax evasion).

67. Pub. L. No. 91-508, 84 Stat. 1114 (1970).

68. Pub. L. No. 91-508, 84 Stat. 1118 (1970); see also 31 C.F.R. 103 (2004).

69. See Pub. L. No. 102-550, 106 Stat. 4044 (1992) (codified as amended in scattered sections of 12, 18 & 31 U.S.C.) (implementing the mandatory recording of wire transfers and international transactions, the reporting of suspicious transactions and the integration of anti-money laundering policies and training at financial institutions in an attempt to combat the pervasiveness of money laundering).

70. Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 315, 115 Stat. 272, 308-09 (2001).



## 2. United Kingdom

In the United Kingdom, a self-contained piece of legislation called the Proceeds of Crime Act 2002 ("PCA") was adopted on July 24, 2002.<sup>71</sup> It brings together the provisions relating to the laundering of the proceeds of drug trafficking and other crimes previously contained in the Drug Trafficking Act 1994<sup>72</sup> and the Criminal Justice Act 1988.<sup>73</sup>

The PCA is a detailed piece of legislation. Sections 327 to 330 set out three different offences punishable by a maximum penalty of fourteen years imprisonment and/or an unlimited fine.<sup>74</sup> Section 327 of the PCA makes it an offence for a person to conceal, disguise, convert, transfer or remove criminal property from the United Kingdom.<sup>75</sup> The provision defines "criminal property" as a person's benefit from criminal conduct or property which represents such benefit and where the alleged offender knows or suspects that the property is such.<sup>76</sup> The broad definition of "criminal conduct" includes any conduct giving rise to a criminal offence in the United Kingdom or, in respect to conduct outside the United Kingdom, anything which would have constituted an offence in the United Kingdom had it been committed there.<sup>77</sup> The scope of predicate offences is accordingly very broad.<sup>78</sup>

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71. c. 29, pt. 7.

72. c. 37, pt. III, § 49.

73. c. 33, pt. VI, § 93A.

74. Proceeds of Crime Act §§ 327-30 (criminalizing offences such as concealing criminal property, entering into an arrangement with an individual suspected of facilitating the use or control of criminal property, and acquiring, using and possessing criminal property).

75. *Id.* § 327 (stating that concealing or disguising criminal property includes less culpable action such as concealing the source, location, or ownership of such property).

76. *Id.* §§ 340(1), (3), (9).

77. *Id.* §§ 340(1), (11) (defining money laundering as any offence defined in the Proceeds of Crime Act, Sections 327, 328 or 329, aiding, abetting, counseling or procuring the commission of those offences or an attempt, conspiracy, or incitement to commit any of the offences in Sections 327 through 329).

78. *Id.* § 340(4).

Section 328 of the PCA makes it an offence for a person to enter or become concerned in an arrangement which he or she knows or suspects facilitates the acquisition, retention, use or control of criminal property by or on behalf of another person.<sup>79</sup> Section 329 makes it an offence for a person to acquire, use or possess criminal property.<sup>80</sup> This section contains a defense that protects persons acquiring, using, or having possession of the relevant property for adequate consideration.<sup>81</sup> However, the provision of goods and services which a person knows or suspects to be assisting a third party to carry out criminal conduct does not qualify for this defense.<sup>82</sup> Moreover, the defense is not available where the consideration paid in respect to goods is significantly less than the value of the property concerned.<sup>83</sup>

The PCA also implements the provisions of the First EU Directive on the reporting of suspicious transactions and the prohibition against tipping-off.<sup>84</sup> Failure to comply with these obligations is a criminal offence punishable by a maximum penalty of five years imprisonment and/or an unlimited fine.<sup>85</sup>

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79. *Id.* § 328(1).

80. *Id.* § 329(1).

81. *Id.* § 329(2) (allowing an individual to use the defense that he or she made an authorized disclosure regarding such property or knowledge of such property, or intended to make disclosure and had a reasonable excuse for not disclosing).

82. *Id.*

83. *Id.* §§ 329(3)(a)-(b).

84. *Id.* §§ 330-31 (requiring disclosure in a variety of instances, and setting forth the offence of failure to disclose which is conditioned on three factors: suspicion or knowledge that another person is engaged in money laundering, which became known to the individual through business in the regulated sector, and the individual does not disclose as soon as possible). The Act does not deem a person to have committed the offence of "tipping off" if the person did not know that his disclosure would be prejudicial to the investigation or if he disclosed in the process of carrying out an enforcement role. *Id.* § 333.

85. *Id.* § 334(2).

### 3. France

In 1987, France made the laundering of proceeds from drug trafficking a punishable offence.<sup>86</sup> Some nine years later, in 1996, France amended its Criminal Code to include the general offence of money laundering.<sup>87</sup> Article 324-1 of the Criminal Code now reads: "*Le blanchiment est le fait de faciliter, par tous moyens, la justification mensongère de l'origine des biens ou des revenus de l'auteur d'un crime ou d'un délit ayant procuré à celui-ci un profit direct ou indirect.*" ["Money laundering consists of facilitating by any means the disguise of the true source of property or income of the author of a crime that procured for the author of the crime a direct or indirect profit."].

French law does not limit the scope of the money laundering offence to certain types of predicate offences. Rather, any offence punishable by imprisonment qualifies as a predicate offence. Under the French Criminal Code, money laundering is punishable by a maximum penalty of five years imprisonment and/or a fine. Under certain circumstances (repeated money laundering activities, activities of a criminal organization, or drug trafficking), money laundering is punishable by a maximum of ten years imprisonment and/or a fine. The language of the French Criminal Code is broad. Its lack of detail has been criticized as being a source of uncertainty, which, so far, has not been remedied by a consistent body of case law.<sup>88</sup>

With respect to obligations imposed on intermediaries, the provisions of the First and Second EU Directives have been implemented in the French Financial and Monetary Code.<sup>89</sup> The reporting obligations are limited to the laundering of proceeds of

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86. Law No. 87-1157 of December 31, 1987 [*Loi 87-1157 relative à la lutte contre le trafic des stupéfiants et modifiant certaines dispositions du Code Pénal* (31 décembre 1987)].

87. Law No. 96-392 of May 13, 1996 [*Loi 96-392 relative à la lutte contre le blanchiment et le trafic des stupéfiants et à la coopération internationale en matière de saisie et de confiscation des produits du crime* (13 mai 1996)].

88. See generally Bernard Bouloc, *Aspects Juridiques du Blanchiment*, 23-24 GAZETTE DU PALAIS 13 (2004).

89. Code Monétaire et Financier [C. MON. FIN.], tit. VI, bk. V.

drug trafficking or other activities of a criminal organization.<sup>90</sup> Failure to report has not been made an offence in France; instead, it entails disciplinary sanctions. By contrast, tipping-off is punishable by a fine.<sup>91</sup>

### III. IMPACT ON INTERNATIONAL ARBITRATION

The question posited in Part I above is how an arbitral tribunal should proceed if faced with a dispute where the contract at issue, which involves money laundering, is valid and enforceable under its governing substantive law. As noted above, this question must be considered in light of the legal framework regarding money laundering described above in Part II.

This Part explores three different ways in which an arbitral tribunal confronted with this scenario can hold a contract invalid or unenforceable: (a) by refusing jurisdiction over the dispute, (b) by applying a principle of international public policy, or (c) by giving precedence to the mandatory provisions of another law over the governing substantive law of the contract.<sup>92</sup>

#### A. JURISDICTION

Should an arbitral tribunal in such a situation refuse jurisdiction on the basis that a dispute involving money laundering is not arbitrable? While arbitrators have no jurisdiction to impose criminal sanctions on a party, this question concerns the contractual or “civil law” consequences of money laundering.<sup>93</sup> An analogy can be drawn with cases involving claims of corruption or bribery.<sup>94</sup> In each case, the

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90. *Id.* art. L. 562-2.

91. *Id.* art. L. 574-1.

92. As noted *supra* note 15, this article does not address the question of the standard of proof required to prove money laundering before an international arbitral tribunal.

93. See ALAN REDFERN & MARTIN HUNTER, *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* 7 (4th ed. 2004).

94. See *id.* at 142.

first issue is whether the arbitrators have jurisdiction to consider claims based on the illegality of the underlying contract.<sup>95</sup>

With respect to corruption, this issue was debated following the well-known arbitral decision in 1963 of Judge Lagergren in International Chamber of Commerce ("ICC") Case No. 1110.<sup>96</sup> Confronted with allegations and evidence that the contract between a British company and an Argentine intermediary contemplated bribing Argentine public officials, Judge Lagergren, acting as sole arbitrator, found that he did not have jurisdiction to decide the merits of the case.<sup>97</sup> In his words, by entering into such an objectionable contract, the parties "have forfeited any right to ask for assistance of the machinery of justice (national courts or arbitral tribunal) in settling their disputes."<sup>98</sup>

For some time, Judge Lagergren's findings were referred to in support of the position that corruption, and, more generally, illegality claims, are not arbitrable.<sup>99</sup> However, the tide with respect to arbitrability seems to have turned, not least because the approach of refusing jurisdiction provided unscrupulous defendants with a wealth of delay tactics by simply alleging, inter alia, corruption or bribery.<sup>100</sup>

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95. See *id.* at 143 (determining that generally an allegation of illegality itself does not preclude the tribunal of jurisdiction).

96. See ICC Case No. 1110, Award, reprinted in J. Gillis Wetter, *Issues of Corruption Before International Arbitral Tribunals: The Authentic Text and True Meaning of Judge Gunnar Lagergren's 1963 Award in ICC Case. No. 1110*, 10 ARB. INT. 277, 291 (1994).

97. *Id.* at 291-94.

98. *Id.* at 294.

99. See FOUCHARD, GAILLARD, GOLDMAN ON INTERNATIONAL COMMERCIAL ARBITRATION 354 (E. Gaillard & J. Savage eds., 1999) [hereinafter FOUCHARD].

100. See Richard Kreindler, *Aspects of Illegality in the Formation and Performance of Contracts*, in INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION 209, 216 (Albert Jan van den Berg ed., 2003) (explaining that in cases where the party seeking relief through arbitration is the party that committed the illegality, the tribunal seemingly has two choices: condone the illegality by accepting jurisdiction in order to find against the non-performing defendant or deny jurisdiction due to illegality and essentially abscond the defaulting defendant).

For example, in 1993, the issue of jurisdiction was dealt with by the Swiss Federal Tribunal in *Nat'l Power Corp. v. Westinghouse*.<sup>101</sup> In that case, the Swiss Federal Tribunal dismissed a challenge brought against an arbitral award, noting that the arbitral tribunal had concluded that corruption allegations had not been proven after a detailed review of the evidence on the record. The Swiss Federal Tribunal rejected the Lagergren approach to jurisdiction and held that the arbitral tribunal had jurisdiction to determine whether acts of corruption had in fact occurred.

In addition, in 1998, in *Westacre Investments Inc. v. Jugoimport-SPDR Holding Co. Ltd.*, the High Court of England and Wales was confronted with a similar issue when requested to enforce an ICC award made in Switzerland.<sup>102</sup> Westacre and Jugoimport entered into a "consultancy" agreement whereby Westacre agreed to assist Jugoimport in obtaining defense contracts from the government of Kuwait.<sup>103</sup> Westacre commenced arbitration to obtain payment of its fees under the agreement, and Jugoimport resisted the claim arguing that the agreement contemplated bribing Kuwaiti officials.<sup>104</sup> The arbitral tribunal accepted jurisdiction, but found the allegations of bribery unsubstantiated.<sup>105</sup> In accepting jurisdiction to enforce the award, the High Court of England and Wales stated:

It is necessary to consider both on the one hand the desirability of giving effect to the public policy against enforcement of corrupt transactions and on the other hand the public policy of sustaining international arbitration agreements. One consequence of the arbitrators being accorded jurisdiction might be that they gave effect to a

101. *Tribunal Federal, Lere Cour Civile, Recours de Droit Public du 2 Septembre 1993, National Power Corporation (Philippines) c/ Westinghouse (USA)*, 12 ASA BULL. 244 (1994).

102. *Westacre Investments Inc. v. Jugoimport-SPDR Holding Co. Ltd.*, [1998] 2 Lloyd's Rep. 111, 114 (Q.B.) (citing the defendants' grounds for challenging the enforcement of the award as contrary to public policy).

103. *Id.*

104. *Id.* at 115-16.

105. *Id.* at 117 (refusing to invalidate jurisdiction due to the agreement's infringement on public policy, and finding that the defendants failed to establish their claims that the agreement was void because the parties had intended to obtain a contract through bribing the Kuwaiti government).

contract which on the face of the award was held to involve the payment of bribes. It would then be a matter for consideration at the enforcement stage whether, although the arbitrators had jurisdiction to determine the issue, the award should be enforced because they had exceeded their jurisdiction in giving effect to an illegal contract or had misconducted themselves or because enforcement would be contrary to public policy. . . . Insofar as it involves determination of questions of fact, that is an everyday feature of international arbitration . . . . If much weight were to be attached to that consideration it is difficult to see that arbitrators would ever be accorded jurisdiction to determine issues of illegality.<sup>106</sup>

In light of case law such as this, it now appears to be accepted that arbitrators have jurisdiction over disputes involving allegations or evidence of corruption.<sup>107</sup> There are no compelling reasons why this should not also be the case for money laundering. Indeed, it has been pointed out that the question often confronting arbitrators and the party alleging corruption is not jurisdiction but, rather, the nature of proving the objectionable conduct and, if proved, determining the consequences of such conduct under the applicable law.<sup>108</sup> This is the author's experience with respect to money laundering.

Therefore, with respect to the first option as to how an arbitral tribunal should proceed if faced with a contract involving money laundering that is valid and enforceable under its governing substantive law, the widely accepted view supports the conclusion that the arbitral tribunal should not refuse jurisdiction simply because of allegations or evidence of money laundering.<sup>109</sup>

## B. INTERNATIONAL PUBLIC POLICY

Assuming an arbitral tribunal accepts jurisdiction in such a situation, should it apply a principle of international public policy to

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106. *Id.* at 128-29 (internal citations omitted).

107. See FOUCHARD, *supra* note 99, at 355; REDFERN & HUNTER, *supra* note 90, at 143.

108. See REDFERN & HUNTER, *supra* note 93, at 143.

109. See *id.*

hold invalid or unenforceable a contract tainted by money laundering?

Under most international instruments and national laws, public policy is one of the few grounds upon which an arbitral award may be set aside or enforcement of an arbitral award may be refused.<sup>110</sup> Consequently, it is not disputed that arbitrators can depart from the provisions of the governing substantive law of the contract when to apply such law would be contrary to public policy and would, accordingly, imperil the award.<sup>111</sup> While the term public policy as it is used in these instruments refers to a domestic conception of public policy (i.e., that of the court asked to set aside or refuse enforcement of the arbitral award), it is generally accepted that when arbitrators disregard the provisions of the *lex contractus* they should not be restricted by any such domestic conception and should take into consideration the requirements of what has been termed “transnational” or “truly international” public policy.<sup>112</sup> In the ICC case quoted above, Judge Lagergren stated: “[I]t cannot be contested that there exists a general principle of law recognized by civilised nations that contracts which seriously violate bonos mores or international public policy are invalid or at least unenforceable and that they cannot be sanctioned by courts or arbitrators.”<sup>113</sup>

The difficult question is how to determine the content of international public policy as applied by international arbitrators. While corruption and bribery were for a long time widely used trade practices encouraged by certain States, the prohibition against corruption and bribery has now arguably reached the level of a

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110. See, e.g., Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, art. V(2)(B), 330 U.N.T.S. 3, 21 U.S.T. 2517; U.N. Commission on International Trade Law (UNCITRAL), Model Law on International Commercial Arbitration, U.N. GAOR, 40th Sess., Supp. No. 18, art. 34(b)(i), U.N. Doc. A/40/17 (1985), *reprinted in* 24 I.L.M. 1302.

111. See FOUCHARD, *supra* note 99, at 861.

112. See generally P. Lalive, *Ordre Public Transnational et Arbitrage International*, 1986 REV. ARB. 329; FOUCHARD, *supra* note 99, at 860-61; W. LAURENCE CRAIG ET AL., INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION 344-46 (3d ed. 2000).

113. ICC Case No. 1110, Award, *reprinted in* Wetter, *supra* note 96, at 293, § 16 (emphasis added).



principle of international public policy.<sup>114</sup> As recently noted by the International Arbitration Committee of the International Law Association: "Following the 1997 OECD Convention on Combating the Bribery of Officials in International Transactions which reflects the mounting international concern about the prevalence of corrupt trading practices, it is arguable that there is an international consensus that corruption and bribery are contrary to international public policy."<sup>115</sup>

Can the same thing be said of money laundering? As described in Part II above, the extensive international and national legal framework that consists of a significant number of international instruments condemning money laundering and the ever-growing number of countries criminalizing money laundering have led some to argue that the prohibition against money laundering is effectively a principle of international public policy, which arbitrators should take into consideration.<sup>116</sup>

Indeed, the increasingly sophisticated international and national legal framework for combating money laundering described in Part II above conveys the impression that the international community at large considers this type of conduct highly objectionable. In particular, the FATF's Forty Recommendations appear to have become an accepted standard, notably through the policy of blacklisting non-cooperative countries. Arguably, the persistence of these remaining few should not impede a principle of international public policy from emerging, since total unanimity for such a principle to exist has never been required.<sup>117</sup>

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114. See generally FRANCOIS KNOEPFLER, *CORRUPTION ET ARBITRAGE INTERNATIONAL* 359 *et seq.* (1998); Bruno Oppetit, *Le paradoxe de la Corruption à l'épreuve du Droit du Commerce International*, 114 J. DU DROIT INT'L 5 (1987).

115. INT'L LAW ASS'N, COMM. ON INT'L COMMERCIAL ARB., INTERIM REPORT ON PUBLIC POLICY AS A BAR TO ENFORCEMENT OF INTERNATIONAL ARBITRAL AWARDS 22 (2000).

116. See Bernardo Cremades & David Cairns, *Transnational Public Policy in International Arbitral Decision-Making*, in ICC PAPERS, *supra* note 2, at 68. At the same conference, it was suggested by Professor Antonio Crivellaro that money laundering may have reached the status of an international crime [*crimina juris gentium*]. *Arbitration Case Law on Bribery*, in ICC PAPERS, *supra* note 2.

117. See FOUCHARD, *supra* note 99, at 863 ("To require total unanimity would be to deprive the application of public policy of all meaning in international

However, this apparent convergence is misleading. There is no consensus as to precisely what constitutes “money laundering.” In particular, there is no consensus as to the predicate offences upon which the offence of money laundering may be based.

The case of tax evasion is a good example. Tax evasion has been made a predicate offence in several Member States of the European Union, and, when money laundering was first criminalized in Russia in January 1997, the legislature was concerned exclusively with operations involving tax evasion and capital flight.<sup>118</sup> However, neither the FATF’s Forty Recommendations nor the First or Second EU Directives specifically require that tax evasion be considered a predicate offence.<sup>119</sup> Indeed, the extension of the anti-money laundering legal framework to tax offences has been questioned in terms of efficacy of the whole system.<sup>120</sup> As is noted in Part II above, while French law criminalizes the laundering of the proceeds from tax evasion, the law in the United States does not include tax offences as predicate offences.<sup>121</sup>

On the other hand, an international consensus does exist regarding certain predicate offences.<sup>122</sup> In light of the large number of countries (over 170) that have ratified the Vienna Convention, it would appear that the laundering of the proceeds from drug trafficking is contrary to a widely accepted norm of international public policy. But what about white-collar crime, the illegitimate diversion of corporate

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arbitration as, by definition, for public policy to come into play, at least one law—the law which would otherwise apply—must be contrary to the fundamental conception of justice which is reflected by public policy.”).

118. See FATF ANNUAL REPORT, *supra* note 9, at 14.

119. See *Forty Recommendations*, *supra* note 31, at 1; *Second EU Directive*, *supra* note 50, art. 1(E).

120. See DALHUISEN, *supra* 6, at 483. Professor Dalhuisen appears concerned with the overburdening of financial institutions that such an evolution might entail. See generally on this issue, P. Alldridge, *Are Tax Evasion Offences Predicate Offences for Money Laundering?*, 4 J. MONEY LAUNDERING CONTROL 350 (2001).

121. See Mariano-Florentino Cuellar, *The Tenuous Relationship Between the Fight Against Money Laundering and the Disruption of Criminal Finance*, 93 J. CRIM. L. & CRIMINOLOGY 311, 384 (2003).

122. See *Forty Recommendations*, *supra* note 31, at 12 (defining “designated categories of offences” to include fraud, smuggling, piracy, forgery, market manipulation, insider trading, and various other crimes).

assets (such as in the example encountered by the author referred to in Part I above), and certain tax offences?

In sum, it would appear that an arbitral tribunal may indeed apply a principle of international public policy to hold invalid or unenforceable a contract involving money laundering that is valid and enforceable under its governing substantive law. However, the strength of such a decision when enforcing the award or in the face of a challenge to the award is likely to depend upon the relevant national courts' perception of the definition of money laundering applied by the arbitral tribunal, including the predicate offence upon which the money laundering is based. The more consistent the arbitral tribunal's decision is in this regard with the likely perception of the relevant national courts (which can be discerned from the international and legal framework on money laundering), the higher the chances of success in defending and enforcing the arbitral award before those national courts.

It has been noted that it would often be easier for arbitrators to resort to mandatory provisions of a law other than the *lex contractus* rather than to try to apply a principle of international public policy and that, in doing so, the burden of proof imposed on the party alleging the illegality would be diminished.<sup>123</sup> This leads to the third option open to arbitrators as described below.

### C. MANDATORY RULES

The third option, described in Part I above, is the question of whether an arbitral tribunal faced with a contract involving money laundering that is valid and enforceable under its governing substantive law may, assuming it accepts jurisdiction, resort to the mandatory provisions of a law different than the governing substantive law agreed to by the parties in the contract. In other words, in such a situation can arbitrators resort to the so-called "mandatory rules" method to hold the contract invalid or unenforceable?

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123. See FOUCHARD, *supra* note 99, at 855 (explaining that adherence to the rules of one jurisdiction alleviates the difficulties in defining a larger international public policy).

At the outset, it is important to distinguish between two kinds of cases. The first kind is where the arbitral tribunal only takes account of the prohibition imposed by another law as a fact and then draws the consequences of this prohibition, if any, under the *lex contractus*.<sup>124</sup> The second kind is where the arbitral tribunal directly applies a prohibitive rule of a foreign law to the contract and overrides the provisions of the *lex contractus*.<sup>125</sup> The latter is the mandatory rules method, which has been described as follows:

The mandatory rules method involves identifying rules which, in their own legal system, reflect essential policy, and then evaluating, given the closeness of the connections between the case and that legal system and the ‘consequences of their application or non-application,’ if it is appropriate to apply those rules in the case at hand.<sup>126</sup>

While far from being unanimously supported, this method has nonetheless gained recognition in European courts following its adoption in Article 7 of the 1980 Rome Convention of the Law Applicable to Contractual Obligations (“Rome Convention”).<sup>127</sup> The mandatory rules method is also recognized in Article 9 of the 1991 Resolution of the Institute of International Law, which provides that:

If regard is to be had to mandatory provisions . . . of a law other than that of the forum or that chosen by the parties, then such provisions can only prevent the chosen law from being applied if there is a close link between the contract and the country of that law and if they further such aims as are generally accepted by the international community.<sup>128</sup>

In the field of international arbitration, the mandatory rules method is contentious, as it leads to disregarding the express choice

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124. See Pierre Mayer, *Mandatory Rules of Law in International Arbitration*, 2 *ARB. INT’L* 274, 281 (1986).

125. See *id.* at 282-83.

126. FOUCHARD, *supra* note 99, at 852.

127. See Convention on the Law Applicable to Contractual Obligations, 1980 O.J. (L 266) 1, reprinted in 19 *I.L.M.* 1492. The United Kingdom, Germany and Luxembourg have made a reservation with respect to Article 7 of the Rome Convention.

128. FOUCHARD, *supra* note 99, at 853.

of substantive law of the parties. However, as pointed out by one author, "the *pacta sunt servanda* principle may have to give way to more powerful considerations."<sup>129</sup> As an example of more powerful considerations, that author refers to the prohibition of "contracts in the pursuit of immoral aims, involving corruption or trade in illegal drugs."<sup>130</sup>

Regardless of the theoretical debate, arbitral tribunals have been prepared to apply the mandatory provisions of laws other than the *lex contractus*. At times, they have even relied directly upon Article 7 of the Rome Convention.<sup>131</sup> Generally, it has been noted that: "*Despite respectable arguments to the contrary, most international arbitral tribunals would in all likelihood be extremely reluctant to require a party to perform—or to pay damages for its failure to perform—when a mandatory national law in effect at the place of performance forbids such performance.*"<sup>132</sup>

The most striking examples of the application of the mandatory rules method are found in the area of competition law, where parties have resisted enforcement of contracts alleging a violation of the competition provisions of the Treaty Establishing the European Community<sup>133</sup> or American anti-trust law.<sup>134</sup> This approach is even encouraged by national courts. For example, in the landmark case of *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, the United States Supreme Court held that arbitrators sitting in Japan deciding upon a contractual dispute governed by Swiss substantive

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129. Mayer, *supra* note 124, at 284.

130. *Id.*

131. See Amsterdam Grain Trade Association, Award of January 11, 1982, 1983 Y.B. COMMERCIAL ARB. 158, 160. The award states: "appeal-arbitrators could give effect to mandatory provisions of the law of another country, if a close link exists between the case and that country; in so deciding, the nature and extent of these provisions must be taken into account, as well as the consequences of application or nonapplication." *Id.*

132. CRAIG ET AL., *supra* note 112, at 341 (emphasis added).

133. February 7, 1992, 1992 O.J. (C 224) 573, pt. 3.

134. See Sherman Antitrust Act, 15 U.S.C. § 1 et seq. (2000).

law were competent to apply the provisions of American anti-trust law.<sup>135</sup>

In sum, therefore, it appears to be accepted, at least to a degree, that arbitrators may take into consideration mandatory provisions of laws other than the *lex contractus* and that this approach may be used with respect to mandatory provisions prohibiting money laundering. If one follows the description of the mandatory rules method first quoted above, one must consider the closeness of that other law to the case and the consequences of application or non-application of the prohibition. In matters of money laundering, the laws that arguably appear most closely connected to the case are the law of the place of performance, the national law of each of the parties, and the law of the seat of the arbitration.

The connection of the case with the law of the place of performance is obvious. The consequences of non-application of relevant prohibitive provisions of the law of the place of performance regarding money laundering to a contract tainted by money laundering are that the arbitrators would be allowing the relevant parties to carry out criminalized activities in that country. It is interesting in this regard to consider the decision of the House of Lords in *Regazzoni v. K.C. Sethia, Ltd.*<sup>136</sup> In this case, Regazzoni, a Swiss resident, contracted with K.C. Sethia, an English company, to export goods from India to South Africa.<sup>137</sup> The contract was governed by English substantive law and contained an arbitration clause.<sup>138</sup> K.C. Sethia refused to perform the contract, alleging that the Government of India had prohibited exportation of goods to South Africa because of apartheid.<sup>139</sup> Regazzoni commenced arbitration, and the case made its way to the House of Lords.<sup>140</sup> The

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135. 473 U.S. 614, 638-39 (1985) (holding that the expansion of international trade and the use of international arbitration to resolve disputes creates situations where countries must occasionally "cede jurisdiction of a claim arising under domestic law to a foreign or transnational tribunal").

136. [1957] 3 All E.R. 286.

137. *Id.*

138. *Id.* at 290.

139. *Id.* at 286.

140. *Id.* at 287.

House of Lords refused to enforce the contract because it contemplated performance of acts in violation of the laws of a friendly country.<sup>141</sup> Viscount Simonds stated in *obiter*: "For an English court will not enforce a penal law at the suit of a foreign state, yet *it would be surprising if it would enforce a contract which required the commission of a crime in that state.*"<sup>142</sup>

As for the national laws of the parties, a survey conducted of the published arbitral awards dealing with mandatory rules revealed that arbitrators are more reluctant to apply the provisions of the law of the parties than those of the law of the place of performance.<sup>143</sup> The approach should perhaps be different in matters of money laundering, which involve committing a criminal offence. It is an accepted principle of international law that a State's criminal jurisdiction extends to its territory *and* to its nationals.<sup>144</sup> Accordingly, a State could claim to have provisions regarding money laundering that regulate not only activities within its territory, but also activities of its nationals outside its borders (it should be noted that not all States claim to have criminal law regulating conduct of their nationals abroad).<sup>145</sup> Should arbitrators refuse to apply such prohibitive provisions, this would allow the parties to frustrate such a State's public policy.<sup>146</sup> This should be sufficient for arbitrators to take such provisions into consideration.

Finally, there are the mandatory provisions of the law of the seat of the arbitration. The law of the seat is not necessarily closely connected to the case.<sup>147</sup> However, there are reasons why arbitrators should take the mandatory provisions of the law of the seat into account. An award enforcing a contract tainted by money laundering

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141. *Id.* at 286.

142. *Id.* at 292 (emphasis added).

143. See Mayer, *supra* note 124, at 283 (construing Yves Derains, *Les normes d'application immédiate dans la jurisprudence internationale*).

144. See IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 299-302 (6th ed. 2003).

145. See *id.* at 301.

146. See *id.* (asserting the importance of a State's right to adopt principles it considers "best and most suitable" in order to regulate criminal activity).

147. See *id.* at 290.

where such money laundering is prohibited by the law of the seat would expose the award to a challenge at the seat and to refusal of any enforcement of the award at the seat.<sup>148</sup> Ignoring this risk would be difficult to reconcile with the duty of the arbitral tribunal under the rules of some arbitral institutions to ensure that the award is “enforceable at law.”<sup>149</sup> Moreover, an arbitrator that knowingly enforces a contract tainted by money laundering prohibited by the law of the seat runs the risk of committing a criminal offence at the seat by “facilitating” the operation.<sup>150</sup>

Therefore, the arbitral tribunal may indeed use the mandatory rules method (i.e., giving precedence to the mandatory provisions of a law other than the *lex contractus*) to hold invalid or unenforceable a contract involving money laundering that is valid and enforceable under the *lex contractus*. In doing so, the arbitral tribunal should have particular regard for the mandatory provisions of the law of the place of performance and of the law of the seat of the arbitration. Arguably, it should also have regard for the national laws of the parties. In any event, the arbitral tribunal should consider the consequences of the application or non-application of such mandatory provisions prohibiting money laundering on the enforceability of the award and the award’s ability to withstand a challenge.

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148. *See id.*

149. *See, e.g.,* International Chamber of Commerce, *Rules of Arbitration*, at 31, art. 35 (1998), 36 I.L.M. 1604 (“In all matters not expressly provided for in these Rules, the Court and the Arbitral Tribunal shall act in the spirit of these Rules and shall make every effort to make sure that the Award is enforceable at law.”); London Court of International Arbitration, *Arbitration; Rules, Clauses & Costs*, art. 32.2 (“In all matters not expressly provided for in these Rules, the LCIA Court, the Arbitral Tribunal and the parties shall act in the spirit of these Rules and shall make every reasonable effort to ensure that an award is legally enforceable.”), available at <http://www.lcia-arbitration.com/arb/uk.htm#recom> (last visited Sept. 15, 2005).

150. *See* Pierre-Yves Tschanz and Jean-Marie Vulliemin, *Chronique de Jurisprudence Etrangère: Suisse*, 2001 REV. ARB. 885, 907, n.64 (expressing doubt that the arbitrators would commit such an offence). *But see* Homayoon Arfazadeh, *Considérations Pragmatiques sur la Compétence des Arbitres et du Juge en Matière de Corruption*, 19 ASA BULL. 672, 683 (2001).



## CONCLUSION

The introduction to this article refers to the impact on international arbitration of the expanding legal framework on money laundering and how this has become a topic of growing prominence in the field of arbitration.<sup>151</sup> Indeed, a necessary consequence of the expansion of the legal framework to combat money laundering is that more commercial transactions will run afoul of the framework's provisions and more disputes arising from such transactions will end up before international arbitral tribunals.

Where the contract at issue involves money laundering that is proven to the satisfaction of the arbitral tribunal, and the contract is invalid or unenforceable under the substantive law governing the contract, there should be no real debate. The only issue might be whether the arbitral tribunal should accept jurisdiction over the dispute. However, as noted in Part III above, it now appears to be widely accepted that an arbitral tribunal should accept jurisdiction to decide such disputes.

Where there should be debate, with good reason, is when the contract at issue involves money laundering, which is proven to the satisfaction of the arbitral tribunal, but the contract would be valid and enforceable under its governing substantive law. It is worth repeating the view referred to in Part I above that an arbitral tribunal should not "turn a blind eye" but, rather, should find a way to refuse to give effect to such a highly objectionable contract.<sup>152</sup> If so, how should an arbitral tribunal proceed?

For the reasons given, the widely accepted view would appear to be that refusing jurisdiction simply because of allegations or evidence of money laundering should not be an option. However, two options open to an arbitral tribunal in this situation are: (i) to apply a principle of international public policy, or (ii) to give

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151. See *supra* Part I (explaining how the process of money laundering involves the use of contracts or commercial disputes which use arbitration as a means of dispute resolution).

152. See *Westacre Invs. Co. v. Jugoimport-SPDR Holding Co. Ltd.*, [1998] 2 Lloyd's Rep. 111, 131 (Q.B.) ("The public policy of sustaining international arbitration awards on the facts of this case outweighs the public policy in discouraging international commercial corruption.").

precedence to the mandatory provisions of another law over the governing substantive law of the contract. Each one of these options has its strengths and weaknesses for the reasons stated above. Ultimately, the strength of a decision to employ either option will depend upon how it is perceived by any national courts faced with a request to enforce or set aside the arbitral award.

In the case of applying a principle of international public policy to hold the contract invalid or unenforceable, this will likely depend upon the relevant national court's perception of the definition of money laundering applied by the arbitral tribunal, including the predicate offence upon which the money laundering is based. The more consistent the arbitral tribunal's decision is in this regard with the likely perception of those national courts (which can be discerned from the international and legal framework on money laundering), the higher the chances of success in defending and enforcing the arbitral award before those national courts.

In the case of using the mandatory rules method to hold the contract invalid or unenforceable, the perception of the national court from the jurisdiction upon whose mandatory provisions the arbitral tribunal relied in making its award is likely to be more favorable to the award. In any event, the arbitrators must take into consideration any duty they have with respect to the enforceability of the award and the possibility, however remote, of them committing an offence at the seat of arbitration by rendering an award that holds valid and enforceable a contract involving money laundering.

The author expects that the discussion regarding the impact on international arbitration of the legal framework on money laundering will continue for some time, particularly if the legal framework continues to evolve at a rapid pace. Not a great deal has been written on this subject, and there are many issues ripe for further consideration that are not dealt with here: Which party should bear the burden of proof (or of evidence), are any presumptions applicable, and does this burden shift at any point? What should be the standard of proof? How should an arbitral tribunal address differences in predicate offences? How should the origin of the criminal proceeds be proven? Should the arbitral tribunal raise money laundering as an issue of its own motion and, if so, what is the threshold for doing so? Do the arbitrators have an obligation to

disclose or report allegations or evidence of money laundering and, if so, to whom? The author looks forward to further discussion of these issues.