FCPA and the Newly Amended Anti-Bribery Law in Russia
Compliance Strategies for Expanded Enforcement of Corruption Laws

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FCPA in Russia

Webinar

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Overview of the business climate in Russia: legal perspective

• Amendments to the Russian Criminal and Administrative Codes & Ratification of the OECD Anti-Bribery Convention

• Level of anti-corruption control has been increased:


  ✓ Since 2010 the amount of registered bribes has decreased by over 30%.

  ✓ In recent years 25 deputy-governors, 15 city mayors and 13 regional ministers were accused of receiving bribes. For example, Viatcheslav Dudka (ex-governor of one of the constituent entities of the Russian Federation) was sentenced for 9.5 years in jail.

• Corruption remains at high levels, in particular, in:

  ✓ Overregulated industries
  ✓ Profitable industries
  ✓ Public procurement
Corruption practices under Russian law

• Russian criminal code:
  ✓ commercial bribery
  ✓ acceptance of bribe (80% of all corruption practices)
  ✓ giving bribe
  ✓ intermediacy in giving or accepting bribe
  ✓ forgery by an official
  ✓ abuse of office etc.

• Russian code on administrative violations:
  ✓ unlawful remuneration on behalf of legal entity
  ✓ electors’ bribe
  ✓ unlawful financing of electoral campaign etc.
What are common FCPA issues in Russia?

• A bribe is not just about cash payments and can take many forms

• Bribes can be disguised in many ways

• “Red Flag” areas for bribes include:
  ✓ Gifts
  ✓ Hospitality
  ✓ Travel expenses
  ✓ Payments to an intermediary or third-party vendor
How Bribes are paid

• Bribes via agents are particularly common: due diligence of agents, consultants and other third parties is essential

  • An agent receives 25% commission from a company, out of which the agent can pay a bribe to a decision maker on a contract

    (Note: still a bribe even though this may happen without that company’s knowledge)

• Hospitality or travel expenses

  • A company pays for the decision maker to go on an all-expenses paid holiday for the decision maker and his family, which may be disguised as a ‘training course’
  • Frequent and excessive hospitality
How Bribes are paid

• Charitable donations

  • As a condition of a planning permission a condition is imposed that a company contributes to the building of a school – but some of the funds are channeled through to the decision maker

• Facilitation payments

  • Payments made to secure or expedite a routine government action like processing a visa or clearing products through customs
Recent amendments in Russian anti-corruption legislation

- As of 1 January 2013 every commercial organization must have anti-corruption compliance measures (Article 13.3 of Russian Anti-Corruption law N 273-FZ)

- Federal Law N 97-FZ dated 4 May 2011:
  - introduces intermediacy in giving or accepting bribe as an independent form of crime;
  - fixes the dependence of the amount of bribe and the amount of fine provided for relevant crime

- Federal Law N 79-FZ dated 7 May 2013 prohibits Russian officials to hold foreign bank accounts
Legal Framework: The Gathering Pace of Enforcement

• Foreign Corrupt Practices Act [US 1977]
• OECD Anti-Bribery Convention [1997]
• Inter-American Convention Against Corruption [1997]
• ADB-OECD Action Plan for Asia-Pacific [2001]
• Council of Europe Criminal Convention on Corruption [2002]
• UN Convention Against Corruption [2003]
• African Union Convention on Preventing and Combating Corruption [2004]
• G20 Anti-Corruption Action Plan [2010]
• Bribery Act [UK 2010]
• Russian Penal Code and Code on administrative violations
• Federal Anti-Corruption Law No.273-FZ [Russia 2008]
FCPA v UKBA: What are the differences?

• Important: Both the FCPA and UKBA are extraterritorial in nature, they cover bribery of foreign governmental officials outside either the US or UK.
• Further, they are enforced by either the US Department of Justice or UK Serious Fraud Office.

Scope of the FCPA

• FCPA only applies to bribery involving an FPO
• UKBA applies to all types of bribery
• FCPA requires payment to FPO to be made corruptly
• UKBA only requires an intention to influence
FCPA v UKBA: What are the differences? (2)

• FCPA Allows facilitation payments (but……..)
• UKBA contains no such exemption

• FCPA may not lead to debarment from tendering for Government contracts
• UKBA may lead to automatic debarment from EU tendering
FCPA and UKBA: Gift and Corporate Entertainment

• The Act does not aim to criminalize normal and reasonable corporate entertainment

• Corporate entertainment is unlikely to breach the Act if it is:
  • reasonable or proportionate
  • has a bona fide business purpose
  • is not intended to influence

• Unduly lavish hospitality could give rise to inference of impropriety

• As part of the “adequate procedures”, a clear record of all corporate entertainment should be maintained
FCPA and UKBA: Facilitation Payments

- These are small payments to expedite routine official action

- Permissible in certain circumstances under foreign legislation (e.g. US FCPA) but illegal under the Bribery Act

- Use of such payments is less likely to attract prosecution unless it is systemic or combined with other unlawful conduct

- However, must be prohibited under codes of conduct
FCPA and UKBA: Relevance to clients in Russia

- Local Anti bribery and corruption laws
- Acquisitions of, mergers or joint ventures with, or investment into, Russian entities by organizations subject to the UKBA and/or FCPA
- It is critical to ensure by adequate and proportionate due diligence (having regard to the investment and the risk of bribery) that the target company is in compliance with relevant anti-bribery and corruption legislation and guidelines
- Companies positioning themselves for acquisition, mergers, joint ventures or inward investment need to ensure they meet the necessary standards
KEY RISK AREAS: DEALINGS WITH THIRD PARTIES

- Bribes paid via agents are particularly common: due diligence of agents, consultants and other third parties is essential.

- It is critical to ensure by adequate and proportionate due diligence (having regard to the risk of bribery) that any third party who is to provide services for a company is in compliance with relevant anti-bribery and corruption legislation and guidelines and meets the company’s anti bribery and corruption requirements.

- Why important?....around 90% of reported FCPA cases involve third party intermediaries.

- Procurement of Goods and Services Policy.
Identifying and Managing Corruption Risk in Russia

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Identifying Corruption Risk
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- A “red flag” is a fact or circumstance that the U.S. enforcement agencies might consider sufficient to put a company on notice of a likelihood that bribery or corruption may occur in connection with a potential transaction.

- The presence of a “red flag” does not necessarily mean that a transaction is unlawful, but it effectively imposes a duty to conduct additional diligence and/or implement more stringent controls.
Identifying Corruption “Red Flags”

“Red Flags” are risk factors that should not be ignored when choosing to proceed with a business relationship, including for example:

- A history of corruption in the country
- A pattern of corruption in an industry
- Requests by the business partner for unusual financial arrangements (e.g., offshore payments, advance payments, third-party payments, cash payments)
- Unusually high or commercially unreasonable commissions in relation to services to be performed
- Lack of transparency in expenses and accounting records
- Any family or business relationships between a business partner and government officials
- Recommendation by a government official or government-owned or controlled entity to enter into the business relationship
- Apparent lack of qualifications on the part of the business partner
- Any misrepresentations by the business partner in connection with a proposed transaction
- Any pattern of or reputation for corrupt, illegal, improper, or unethical conduct
- Refusal (or even reluctance) by a prospective business partner to cooperate with requests for information
- Refusal by a prospective business partner to provide compliance certification
Corruption Red Flags in Russia

- Because knowledge of corruption climate in Russia is so well-known and tales of endemic corruption are widespread, you may be deemed to be on notice of “red flag” before you even enter the market.

- A major risk in Russia involves reliance on and use of third parties, including agents, intermediaries, resellers, distributors, and joint venture partners.
  - This underscores the need for heightened scrutiny of business partners in the region.

- Don’t be surprised by a lack of transparency
  - This can make the due diligence harder than in other places, but not impossible.
Corruption Red Flags in Russia

- Lack of transparency is a “red flag”
- Examples of non-transparent practices include:
  - Complicated ownership arrangements
    - know who your business partner really is
  - Use of or affiliations with shell companies
  - Use of offshore holding companies
  - Use of offshore bank accounts
  - Use of fake invoices and stamps
  - Use of sham counterparties to create unrecorded cash (obnalichka/obnalichvanie)
    - Illegal under Russian law
    - Not often (or selectively) enforced
    - Difficult (but not impossible) to detect in audit
    - Often used for tax avoidance and money laundering…
    - …but may also be used to pay bribes.
Corruption Red Flags in Russia

- These non-transparent practices make it difficult to “follow the money.”

- None of these practices is a violation of the FCPA/UK Bribery Act (though they may violate other laws), but they are “red flags” that should be investigated further and managed to reduce risk.
Identifying Corruption Risk

Starts with a Robust Compliance Program

- A clearly defined corporate policy, backed by commitment from senior management
- Dissemination of policy to all employees
- Periodic training and emphasis on the requirements of the policy, identifying red flags, and associated controls and procedures, including internal reporting
- Periodic compliance certifications from relevant personnel
- Periodic audit testing, particularly in high-risk areas and new acquisitions
Identifying Corruption Risk

Why is this necessary?

- No statutory requirement for compliance program

- **BUT**, corporate liability often turns on extent to which company had procedures in place to prevent violations or simply ignored “red flags.”

- Under the U.K. Bribery Act, companies are strictly liable for “failing to prevent bribery” unless they can show “adequate procedures” to detect and prevent bribery.
Identifying Corruption Risks

- Policy should require **commercially reasonable due diligence** regarding prospective foreign business partners.
  - Investigate business reputation and integrity
  - Failure to conduct adequate due diligence will likely cause the government to take the position that the “knowledge” element has been satisfied if a problem later arises—
    - Conscious disregard, willful blindness and deliberate ignorance
  - By contrast, commercially reasonable diligence can mitigate the “knowledge” element.
Commercially Reasonable Due Diligence

What Should Due Diligence Include?
Due diligence should include the following general assessment—

- What is the competence, expertise, and reputation of the foreign business partner?
- Are there any relationships between foreign business partner and government officials?
- Is the compensation reasonable – e.g., is it commercially justified, consistent with market for similar services?
  - Carefully scrutinize “success fees” or other payments
- Is the proposed relationship legal and enforceable under local law?
- Apply a common sense “smell test”
Commercially Reasonable Due Diligence

What Should Due Diligence Include?

- Due diligence **CAN** include any combination of the following activities, escalating as necessary to address specific red flags:
  - Initial “desktop” due diligence (in English and Russian)
  - Written questionnaire
  - Third-party investigative agency report
  - International Company Profile from U.S. Commercial Service
Commercially Reasonable Due Diligence

What Should Due Diligence Include? (Cont’d)

- Bank account information, including declarations and signatories
- Corporate registration and related permits, licenses, etc.
- Proof of ownership – share certificates, share registration
- In-person interviews (the greater the risk, the greater the benefit of independent review)
- Request recent audit reports
- Conduct discrete preliminary audit of bank statements, expenses, and sample transactions
- Perform full audit of books and records
- Seek local counsel opinion where necessary regarding legality of proposed relationship
Commercially Reasonable Due Diligence

What Should Due Diligence Include?

- Due Diligence Summary Report
  - Diaries and other records of your due diligence activities
- Who performs the work?
  - In house
  - Outside counsel
  - Other third parties
- Where risks are higher, an independent assessment has greater value
Managing Corruption Risk
Responding to Red Flags

- The sky is not falling
- Red Flags are warning signs and require some level of inquiry and investigation
- Red Flags should be reasonably investigated before action is taken
- Red Flags do not necessarily mean the end of a business opportunity
Managing Corruption Risk: “Red Flags” are not violations

- Notice of a potential issue requiring follow-up
- Eliminate, or mitigate and manage to reduce risk
- Remediate or otherwise address
- Intelligent, risk-based assessment
- Business decision
  - What is your risk tolerance?
Managing Corruption Risk

If no evidence of a violation, risk can usually be managed:

- Narrowly defined performance obligations
- Restrictions on assignment rights or ability to delegate duties to third parties
- Audit rights
- Cash controls
- Anti-corruption compliance representations and warranties – including termination rights for breach
- Anti-corruption compliance certifications
- Require itemized invoices
Managing Corruption Risk

- Monitor invoices
  - Review expenses and commission payments
  - Ask questions about service or handling charges
- Training programs for foreign business partners
  - Require certificate of completion as written record of training
- Require that business partners seek approval for any gifts, meals, or entertainment associated with business development activities and/or involving government officials
- Require that business partners seek approval before making campaign contributions or other donations to government officials, governments, or their charities
- Require business partners to open a dedicated account with trusted international bank with branch in Russia
Managing Corruption Risk

- **Perform periodic and/or remedial risk assessments**
  - **Who?** Internal compliance personnel, auditors, outside counsel, compliance experts
  - **How?** Scope and work plan will vary based on need
    - Target known problem areas – hit the likely suspects first
    - Review policies, procedures, and communications regarding same
    - Targeted interviews with key personnel internally and with business partner
    - Transaction sampling
Managing Corruption Risk: Successor Liability

Under the FCPA

- Undiscovered pre-acquisition bribery can be inherited by successor entity: imposing liability for knowingly purchasing or investing in circumstances where there is corrupt activity by the counterparty
- Successor entity also liable for addressing bribery risk identified in due diligence which post dates date of closure of acquisition
Managing Corruption Risk: Successor Liability

- Pre-acquisition due diligence a critical factor in DOJ charging decisions related to merger activity
- U.S. enforcement authorities expect maximum possible pre-acquisition diligence
  - Demonstrate risk-based, intelligent efforts to detect and resolve corruption
- SEC and DOJ will expect post-close organization to be in full compliance with FCPA regardless of prior state of compliance
Managing Corruption Risk: Successor Liability

- Acquirer and target should consider the effect anti-bribery scrutiny will have on respective businesses
- Business risk of bringing target into compliance
- Develop a plan and tailor due diligence to transaction-specific risks
  - Who will lead—buyer or seller?
Managing Corruption Risk: Successor Liability

Due diligence is essentially the same as with other business partners

- Identify areas of potential risk—
  - Industry, countries of operation, government customers/contacts
- Assess controls environment—
  - Employee training
  - Audit environment
  - Practices, policies and procedures regarding entertainment of, gifts to, and travel for government officials
  - Facilitation payments
- Process for retention and use of third-party intermediaries
- Vet third-party intermediaries—
  - Review contracts
  - Analyze payments
- Analyze books and records—
  - Fair and accurate representation of expenditures and transactions
  - No materiality lens
New developments regarding compliance in Russia

Effects of increased enforcement and focus on third parties:

• US and multinational companies operating in Russia are demanding more extensive anti-bribery compliance programs from Russian counter-parties

• Russian companies are now implementing standard compliance programs including training, preparing Codes of Conduct and internal procedures and enforcement mechanisms in order to be able to compete for contracts with US and multinational companies

Result may be more effective and widespread than Russian enforcement authorities are able to generate at this time
Compliance is new to Russia

• Developing notion within the context of the Russian market where companies gradually transform from being “compliance-curious” to “compliance-focused”
  ✓ Pressure from existing or potential business partners

• As a term, is not provided in the law, with the exception of
  ✓ Financial regulations (internal controls)
  ✓ Indirect references in the Criminal Code and Code on administrative violations
  ✓ No court decisions on point

• Example: Code on administrative violations – Article 2.1.(2)
  ✓ “A company is subject to administrative liability once it is shown that it had an opportunity to follow the norms […], but had not taken all the necessary steps to remain compliant”
FCPA compliance implementation issues & concerns

• Anti-monopoly concerns

• What is (-un) lawful under Russian written laws and regulations

• Labor regulations

• Personal data protection

• Attorney-client privilege, work product doctrine

• Mutual Legal Assistance Treaty

• Other miscellaneous practical aspects
Anti-monopoly concerns: summary

- **Novo Nordisk** enforcement settlement by RF Federal Anti-monopoly Service (2011)
  - Alleging that NN using FCPA third party due diligence program abuses dominant position on the Russian pharmaceutical market

- Developing practice for companies with dominant market position to design and implement commercial policies for dealing with commercial partners (resellers, distributors)
  - Incorporating (among other things) selection criteria, based on FCPA due diligence

- It is expected that new amendments to be introduced to the Federal Russian Law “On Protection of Competition” shortly will provide the necessity to publish the commercial policies of the companies.
Anti-monopoly concerns: commercial policy & reputational risks

• Reputational risks are acceptable as a criterion for choosing whether or not to work with a commercial partner, on a condition that determination is based on:
  ✓ The information provided by the commercial partner
  ✓ The information gathered from official enforcement decisions

• Other requirements:
  ✓ Reputation-based criterion must apply equally to all commercial partners
  ✓ Must be sufficiently defined with a clear, transparent and uniform application process
  ✓ Must be accompanied by a clear and transparent decision making process (who, when & how)
What is lawful under written laws & regulations

• RF Civil Code permits gifts to Russian state official of no more than RUR 3,000 (approximately USD 100) in value

• However, there are exceptions under separate federal laws (complete prohibitions)
  ✓ Army personnel
  ✓ Access-to-doctors rules under the new Federal Law N323-FZ

• Watch for: conflict of interest checks when hiring former public officials or when inviting public officials to events
Labor law issues

• Need to fix work duties and obligations within local normative acts

• Disciplining an employee must be in accordance with the Russian labor regulations
  ✔ Warning procedures
  ✔ Firing a general director is different from firing a regular employee

• There are no specific whistle-blower protection mechanisms
Data privacy

• Federal Law On Personal Data N152-FZ has been adopted in 2006
  ✓ Enforcement, court practice are slow to develop

• Personal consent requirement
  ✓ For processing
  ✓ For transfer to third parties
  ✓ For transnational transfer

• Written consent form
  ✓ Ought to include data subject’s personal details and signature
  ✓ Detail instances of processing and transfer
Attorney-client privilege

• Difference between (a) an *advocate* and (b) a *lawyer qualified for practice* in Russia

✓ For *advocates* – privileged is any information or communications between an advocate and his client, if they are produced in the course of the provision of legal assistance by the advocate to the client; an advocate cannot be questioned on the information he has gained in the course of carrying out his professional duties

✓ For *qualified lawyers* – not protected from disclosure; must disclose any information requested by an authorized regulatory or investigative state body; the requirement may extend to communications between the lawyer and his / her client held at the client’s premises
Other practical aspects

• Termination of existing relations based on reputational risks such as ongoing investigations and unofficial information?
  ✓ Be creative in contract drafting

• Conducting due diligence on subcontractor level

• Commercial policy is not a formality
  ✓ Cannot create special exceptions that are not in the document
  ✓ Living document, updated to reflect the reality

• Management support with adequate resources

• Employees involved tend to view compliance as implied criticism and may be reluctant to assist

• Adequate roll-out and presentation to commercial partners