



Ethical Codes in Russia

Paul Melling

September 30 2009

Baker & McKenzie International is a Swiss Verein with member law firms around the world. In accordance with the common terminology used in professional service organizations, reference to a “partner” means a person who is a partner, or equivalent, in such a law firm. Similarly, reference to an “office” means an office of any such law firm. 7439495

CIS Countries: Transparency International Ranking in 2008

- 180 countries surveyed
- Russia 147 (together with Syria, Kenya and Bangladesh)
- Ukraine 134
- Belarus 151
- Kazakhstan 146
- Uzbekistan 166

The Challenge for Multinationals: the Square Peg and the Round Hole

- The square peg: multinational company, its ethical business practices and strong compliance oriented corporate culture
- The round hole: Russia, its business practices and non-compliance oriented business culture
- How to be successful in the Russian business environment without straying from its way of doing business – can it be done?

The Challenge for Russian Companies: How to Build Trust

- Demonstrating commitment to compliance will win business in Russia and grow domestic revenues
- “Demonstrating commitment” means demonstrating understanding of legal obligations imposed upon multinational company and cooperating in ensuring compliance with same
- Your actions can give rise to liability for your trading partner in its home country

Threats to Compliance: Non-Compliance Culture

- Russian business culture is built around “taking shortcuts” and “cheating the system”
- Most commonly heard phrase – “that’s just how things are done in Russia”
- Reluctance to re-examine business structures that carry non-compliance risks because such structures have delivered results
- Problems of form over substance

Threats to Compliance: Personnel

- Unwillingness to challenge authority
- Unaccountable leadership
- “Silos” created – information and duties
- No whistleblower culture

Russian Anti-Corruption Legislation

- Criminal Code – prohibits bribery of “public officials” and commercial bribery
- Civil Code – prohibits gifts to civil servants with value exceeding 3000 rubles
- Civil service legislation – prohibits civil servants from receiving any benefits (cash or in kind) in connection with performance of their duties

Bribery

- Not just cash under the table – any form of economic benefit
- Criminal Code prohibits bribery of managers of commercial and other organizations
- “Other organizations” can include private companies, state owned companies and non-profit organizations
- Typical example: payment of a “commission” to a manager of a company for giving business

Russian “civil servants”

- Three components: state civil service (*gosudarstvennaya grazhdanskaya sluzhba*), military service (*voennaya sluzhba*) and law enforcement service (*pravookhranitel'naya sluzhba*)
- State civil service may be federal and regional
- Person is a “civil servant” if (1) he/she occupies a position entered into federal or regional registers of civil servants maintained by federal or regional authorities and (2) receives his/her salary from state budget

Russian civil servants – how can I identify one?

- Most employees of state owned enterprises are not civil servants
- Hard cases are the “hidden” civil servants e.g. hospital medical director who is also adviser to local healthcare authority
- If in any doubt – ask!

Russian civil service legislation

- Civil servants prohibited from receiving any compensation other than salary in connection with performance of their duties
- “Other compensation” can include gifts, loans, payment for entertainment, vacation, travel expenses
- Only safe policy – no such compensation of any kind

Russian civil servants – hard cases

- Gifts to civil servants at New Year, birthdays, International Women's Day
- Invitations to lunch and dinner – corporate hospitality
- Bearing travel expenses to attend conferences and symposia

New Anti-Corruption Legislation

- Three interconnected federal laws introduced in January 2009
- Main effect was to harmonise existing laws
- Raised the value of a permissible gift to 3000 roubles (from 500 roubles)
- Increased criminal penalties for commercial bribery
- Introduced new offence under the Administrative Code – “Unlawful Compensation on behalf of a Legal Entity”: penalty of three times the amount paid

Consequences in Russia of getting it wrong

- Extensive diversion of management time supplying evidence for authorities' investigation of your trading partners, leading to loss of business
- Loss of reputation, leading to loss of business
- Possible criminal liability under Russian law for key executives
- Damage to relationship with Customs and tax authorities

Competition law – a new focus

- Law prohibits agreements and practices that may lead to price fixing, market sharing on the basis of territory or impeding access to the market
- Certain restrictions apply irrespective of market share
- Fines of up to 15% of revenue derived from sales of those products in respect of which violation occurred during the calendar year preceding the infringement

Competition Law – Danger Areas

- Fixing distributor resale prices
- Undertakings not to sell competing products
- Participation in trade associations

United Kingdom – the Mabey & Johnson case

- British bridge construction company last week fined £3.5 million for bribery of foreign government officials
- First ever conviction of a UK company for overseas corruption by the UK Serious Fraud Office
- First US style plea bargaining negotiations
- This follows the £5.25 million fine imposed in January 2009 by the UK FSA on the US insurance broker AON for overseas corrupt activity

UK: Prevention of Corruption Act 1906

- The main offence: corruptly giving or agreeing to give any consideration to any agent as an inducement or reward for doing or forbearing to do any act or show favour or disfavour to any person in relation to his principal's affairs
- In 2001 the statute was amended so that now it is irrelevant if the principal's business is conducted outside the UK and the agent's actions are outside the UK
- Irrelevant if the actions in question were legal under the laws of the country in which they took place

UK: Proceeds of Crime Act 2002

- Criminal offence to participate in an “arrangement” which you know or suspect “facilitates...the acquisition retention use or control of criminal property”
- Covers any involvement by a UK person or company in a transaction whereby Russian taxes/customs duties are evaded
- “Suspect” – if you consider there is a possibility which is more than fanciful that relevant facts exist – you cannot wilfully close your eyes to the truth

UK: Draft Bribery Bill Corporate Offences

- Negligent failure by a company to prevent bribes being offered on behalf of that organisation
- Directors who consent at the commission of bribery may be charged with the principal offence

FCPA Anti-Bribery Provisions

The FCPA prohibits “issuers” (U.S. or foreign) and domestic concerns (and their officers, directors, employees, agents, or shareholders) from corruptly offering, authorizing, or making payments to foreign officials, foreign political parties or their officials, or candidates for public office for the purpose of obtaining or retaining business for or with, or directing business to, any company.

Accounting Issues under the FCPA

- **Books and records**
Issuers are required to make and keep detailed books, records, and accounts that fairly and accurately reflect transactions and dispositions of assets.
- **Internal accounting controls**
Issuers must devise and maintain internal accounting controls to ensure that financial records and accounts are accurate for external reporting, that access to assets is permitted only in accordance with management instructions, and that the books are audited at reasonable intervals.
- **Sarbanes Oxley Requirements**
Disclosure of deficiencies in internal controls and fraud, audit committee oversight and increased legal scrutiny all triggered by improper payments.

Enforcement of the Foreign Corrupt Practices Act

- The interplay of FCPA anti-bribery and accounting provisions in the hands of law enforcement: bribes are usually masked by false records which implicate internal controls
- Related legislation: money laundering, fraud and related theories

Adverse Consequences of Violations

- Substantial criminal and civil penalties for companies and individuals
- Potential disclosure to the SEC (and the DOJ) in compliance with the Sarbanes-Oxley Act
- Risk of domestic enforcement actions
- Adverse publicity
- Protracted, costly investigations
- Diversion of management resources
- Impediment to raising money
- Debarment from government contracts

Recent FCPA Actions Targeting Non-U.S. Companies

- **Siemens** – DOJ and SEC settled case against Siemens for improper payments in Russia and other countries with fines and penalties totaling \$800 million; German authorities have fined Siemens over \$1.3 billion; investigation and compliance costs total over \$2 billion; investigation continues in 12 other countries
- **ABB** – SEC filed a civil complaint against the Swiss parent company, shares of which are traded in the United States. DOJ brought criminal charges against U.S. and U.K. subsidiaries of the Swiss parent. The parent settled by paying a civil fine of \$10.5 million and pre-judgment interest and disgorgement of profits totaling \$5,915,405; and by agreeing to hire an independent monitor to review its system of internal controls.
- **Syncor** – DOJ brought criminal charges against a Taiwanese subsidiary of a U.S. corporation. SEC brought a civil enforcement action against the U.S. parent. The subsidiary pled guilty to the FCPA violations and paid a fine of \$2 million.
- **Diagnostic Products Corporation** – DOJ brought criminal charges against a Chinese subsidiary of a U.S. corporation. SEC brought a civil enforcement action against the U.S. parent. The subsidiary pled guilty and agreed to pay a criminal penalty of \$2 million.

Recent FCPA Actions Targeting Non-U.S. Persons

- **John Samson, John G. A. Munro, Ian N. Campbell** – SEC filed a civil complaint against these U.K. citizens and former employees of ABB's non-U.S. subsidiaries in Nigeria and the U.K. charging them with violations of the anti-bribery provisions of the FCPA. Each employee settled and consented to pay a civil fine in the various amounts (\$40,000-\$50,000); and Samson was also ordered to pay \$64,675 in disgorgement and prejudgment interest.
- **Hans Bodmer** – a Swiss citizen, was charged with a conspiracy to commit FCPA and money laundering violations arising out of payments he made on behalf of U.S. entities to government officials in Azerbaijan.

Trends in FCPA Enforcement

- Many more cases reflecting U.S. government law enforcement priority
- Encourage corporate cooperation through voluntary disclosure
- More cooperation with companies in conducting investigations
- Greater cooperation among law enforcement agencies in the United States and overseas
- Wide range of conduct being charged
- Larger penalties and focus on individual responsibility
- Use of independent monitors to oversee compliance after resolution of case

Problem Areas in Russia That May Implicate the FCPA

- The broad definition of government officials for FCPA purposes
- Offshore payments
- “Black cash”
- “Designated” service providers
- Requests for charitable donations and contributions to social projects
- Use of intermediaries – both offshore and onshore

Key Challenge: Intermediaries

- Includes distributors, resellers, agents, marketing support services
- Sham intermediaries
- Misuse of legitimate intermediaries
- Multiple layers
- Hidden ownership

Due Diligence Issues - Intermediaries

- Who owns it? How readily does it disclose its shareholders?
- Who are its senior executives?
- Do its shareholders or executives have a criminal record?
- What is the reputation of the intermediary, its shareholders and management? Internet check? References obtained? Private investigators?

Due Diligence Issues - Intermediaries

- Does it have an infrastructure consistent with the obligations it is taking on? How many employees? Where are its locations?
- What is the amount of commission or compensation?
- Are margins and discounts consistent with market?
- Is the amount of commission consistent with the services being provided
- What evidence will be produced as to the services actually provided in return for compensation?

Due Diligence Issues - Intermediaries

- How and to where and to whom are we making payments? If by wire transfer, to what bank account – is it an account in Russia or overseas?
- Are all payments to be made to the intermediary's account or are payments to be made to the account of a third company?
- From whom and from where are we receiving payments?
- How and to whom is delivery to be made?
- Will we be using reputable freight forwarders?
- Does the transaction documentation accurately reflect what is actually happening?

Due Diligence Issues - Intermediaries

- Has all contractual documentation been submitted for legal review to ensure adequate and sufficient compliance obligations
- Has the distributor been offered compliance training for its key personnel?
- If so, what was its response?

Solving the Intermediary Problem

- Effective, risk-oriented due diligence that is periodically updated
- Training that focuses on particular risks
- Oversight and accountability, including obtaining evidence of services performed, assessing value and overseeing payment, delivery and other critical terms

Keys to Successful Ethical Code in Russia

- Top management commitment
- Compliance culture
- Accountability and communication
- Consistent enforcement
- Regular training and follow-through
- Constant updates to program

Compliance Plan of Action Tailored for Russia

- Do not forget the additional requirements of Russian law
- Personnel as the most important “internal control”
- Enhanced internal audit function
- Regular and consistent evaluation of risk as business develops