ANTI-CORRUPTION ENFORCEMENT

Foreign Anti-Corruption Compliance: Director and Officer Obligations and Considerations

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As recently as 1986, Canadian companies could deduct foreign bribery or "grease" payments as business expenses when reporting their income. This official recognition of bribery as a legitimate business expense has been supplanted in Canada and elsewhere by legislation expressly prohibiting the payment of bribes or inducements to foreign public officials. However, although the *Corruption of Foreign Public Officials Act*[1] was passed in Canada in 1998, it was not until recently, in light of criticism by the OECD and aggressive enforcement by the U.S. of its own anti-corruption legislation, that Canada has taken significant steps towards enforcing these rules. With breathtaking fines and onerous settlement terms being imposed in the U.S., Canadian authorities have also recently put anti-corruption on the radar for directors and senior management of Canadian companies that do business outside Canada.

It is increasingly clear that directors and officers cannot afford to ignore or take a passive approach to anti-corruption compliance, but will be obligated as part of their governance mandate to take an active role in establishing and monitoring compliance regimes. This article provides an overview of the risks and responsibilities facing corporate governors as a result of the new enforcement environment in Canada and elsewhere.

[1] S.C. 1998, c. 34 ("CFPOA" or the "Act").

Background

In 2008, the Canadian government organized the dedicated International Anti-Corruption Unit ("IACU") within the RCMP, which is comprised of two teams, one located in Ottawa and the other in Calgary. Two high-profile prosecutions followed the formation of the IACU, against Niko Resources Ltd. and Griffiths Energy International Inc.

Niko Resources

In 2011, Niko Resources, an oil and gas company located in Calgary, pled guilty under the CFPOA to bribing a public official in Bangladesh. Niko had provided the Energy Minister of Bangladesh with a $190,000 vehicle for use and personal trips in an attempt to influence the Minister during a compensation assessment relating to damage caused by a Niko project. Niko received a fine of $9.5 million and a three-year probation order. The company was also required to implement a comprehensive compliance program. This was the first conviction under the CFPOA since the 2005 conviction of Hydro Kleen Systems Inc., which resulted in a fine of only $25,000.

Griffiths Energy

The Griffiths Energy case involved the first Canadian company known to have voluntarily disclosed its wrongdoing under the CFPOA.

In 2011, Griffiths announced that it had formed a special committee to investigate certain consulting agreements between the company and corporations controlled by a foreign public official for the Republic of Chad and his wife. In January 2013, Griffiths was charged under the CFPOA and admitted to paying a $2 million bribe to the wife of Chad's ambassador and providing an opportunity to purchase approximately 4 million founders' shares in Griffiths. The Griffiths' plea bargain resulted in a fine of $10.35 million.

Charges Against Individuals

With respect to individuals charged under the CFPOA, in May 2010, the RCMP charged Nazir Karigar with allegedly making a payment to an Indian government official to influence the execution of a multi-million dollar contract. The IACU is also presently

involved in the investigation of Montreal-based SNC-Lavalin Group Inc. In April 2012, the RCMP laid charges under the CFPOA against two former employees of SNC-Lavalin (Ramesh Shah and Mohammad Ismail) in relation to the awarding of a contract related to the PADMA Multipurpose Bridge in Bangladesh.

Ongoing Investigations and Legislative Changes

The federal government has stated publicly that the RCMP is pursuing upwards of 35 other foreign corrupt practices investigations against both companies and individuals.

Very recently, Canada has extended the reach and sharpened the teeth of the CFPOA by making several significant amendments to the Act. These amendments, which took effect on June 18, 2013, have:

- expanded the CFPOA's jurisdiction to include acts of bribery, wherever committed, if committed by Canadian citizens, permanent residents present in Canada, Canadian corporations or other entities created under the laws of Canada or a province (otherwise known as "nationality jurisdiction");
- created a new offence related to the manipulation or falsification of accounting records to conceal bribery ("books and records" offence);
- increased the maximum term of imprisonment for individuals under the Act from 5 years to 14 years;
- expanded the offence of bribing a foreign public official to include not-for-profit activities;
- prescribed the eventual prohibition of "facilitation payments" (payments to a public official to expedite a routine governmental act that is part of the official's duties, and not to obtain or retain business or any other undue advantage) at a future date to be set by the Governor in Council; and
- conferred exclusive enforcement authority with respect to the CFPOA to the RCMP.

Offences Under the CFPOA

The CFPOA prohibits giving or offering to give a benefit of any kind to a foreign public official, or to any other person for the benefit of the foreign public official, where the ultimate purpose is to obtain or retain a business advantage. "Benefits" are not limited to cash, but may include entertainment, travel, services, employment of relatives and so on. The Act is applicable both to individuals and corporations, whether they are acting directly or through an agent or third party. Importantly, and as demonstrated in the Griffiths Energy case, the offence does not require that a business advantage was actually obtained in exchange for the conferred benefit.

A payment that might otherwise constitute an offence under the CFPOA will not attract liability if it was technically lawful (not simply customary) under the particular laws of the foreign country, constituted a "reasonable promotional expense," or was a "facilitation payment" (until the provision against such payments comes into force).

The CFPOA's books and records offences are a series of specific prohibitions relating to the falsification of books and records for the purpose of bribing a foreign government official or of hiding bribery. These include maintaining off-books accounts, failing to record or inaccurately recording transactions, and recording non-existent expenses.

Offences under the CFPOA are indictable offences and are not subject to limitation periods.

Who Is at Risk?

Any Canadian company operating abroad and interacting with foreign public officials (for example, government approvals or procurement agreements/joint ventures with state-owned entities) is at risk of violating the CFPOA. Companies that regularly use local third party agents and/or operate in countries ranking highly on the Corruption Perception Index (as published by anti-corruption watchdog Transparency International) should exercise particular diligence. Typically, the energy, mining, and construction/infrastructure industries are at the greatest risk for violations given that local governmental approvals are normally required to conduct business wherever they operate. That being said, companies

in all industries are wise to evaluate their specific circumstances and determine their level of exposure.

It is important to understand that what passes for common practice in particular areas of the world may very well be prohibited by the CFPOA. A company may find itself offside Canadian law not just through a calculated series of clandestine transactions that are aimed at influencing a government decision-maker, but also as a result of a "shakedown" by a public official or by a third-party agent who claims that payments or favours are simply the common currency of business in a particular jurisdiction. Liability under the CFPOA will arise equally whether the Canadian company voluntarily offers an illicit benefit or responds reluctantly or naively to a demand for one.

Criminal Liability

A Canadian individual or company committing an offence under the CFPOA (including through a foreign subsidiary) will be subject to criminal penalties including unlimited fines and, for individuals, up to 14 years in prison.

Although Canada has indicted individuals in two cases (in the technology and construction sectors as noted above), the criminal liability of directors and officers *per se* under the CFPOA has yet to be tested, and the legislation itself provides little assistance in determining when or if criminal sanctions will be imposed on individual directors who do not personally commit a breach. Notably, conspiracy and counseling to commit an offence and being an accessory after the fact all attract criminal liability under the CFPOA. Likewise, sections 21(1)(*b*) and (*c*) of the Criminal Code[2] (aiding and abetting) apply to persons whose involvement in a federal offence is incidental but helpful to the activities of the principal perpetrator, which may be the corporation. These provisions could apply to conduct by directors and officers who further the offences committed by the corporation or by another person within the corporation. Similarly, there is authority to suggest that willful blindness – defined roughly as "closing one's eyes to the truth" – by directors to offences by a corporation or its employees may trigger criminal liability.

Financial Loss and Civil Liability

The losses that may be visited upon corporations as a result of anti-corruption enforcement action are multifarious and appear to be mounting steadily. Loss in share value is a well-known result of a corrupt practices investigation or charge, with the associated potential for reputational damage given the public attention that is invariably drawn to failures of corporate social responsibility. Convictions under anti-corruption legislation are also grounds for debarment from government procurement opportunities in many countries including Canada, and from World Bank or other Multilateral Development Bank funded projects. The costs of an internal investigation can also be crippling; Avon Products Inc. announced in 2010 that the cost of its internal investigation of breaches of U.S. anti-corruption legislation (the *Foreign Corrupt Practices Act of 1977*[3]) would rise to $200 million by 2011 (not including the costs of implementing new compliance measures). This was dwarfed by the costs incurred by Siemens AG, which estimated in 2012 that its legal and accounting advisors alone billed 1.5 million hours of service in the company's anti-corruption investigation and defence.

Given the success of private litigants in competition law, with class actions following hard on the heels of prosecutions, public companies that disclose and/or are prosecuted for anti-corruption offences may also face potential civil liability that may be more significant financially than the sizable fines imposed by criminal authorities. While there is no statutory cause of action under the CFPOA, the class action bar in Canada has already become attuned to the possibility that CFPOA offences may provide grounds for statutory claims under Part XXIII.1 of the Ontario *Securities Act*[4] against both companies and their officers and directors.

In the high-profile case of SNC-Lavalin, the Ontario and Quebec Superior courts granted leave to shareholders to commence secondary market liability actions under the

[2] R.S.C. 1985, c. C-46.

[3] 15 U.S.C. §§ 78dd-1, *et seq*. ("FCPA").

[4] R.S.O. 1990, c. S.5.

respective provincial securities acts, and certified class actions against SNC-Lavalin and a number of its directors and officers personally. The plaintiffs allege, among other things, that the company's disclosure documents contained material misrepresentations regarding the adequacy of and compliance with internal anti-corruption controls, with the result that the price of SNC-Lavalin's securities was inflated. The plaintiffs also allege that corrupt practices contrary to the CFPOA were systemic within SNC-Lavalin and were carried out with the knowledge of senior management, including members of the Office of the President and SNC-Lavalin's inside directors. The claims exceed $1 billion.

The SNC-Lavalin shareholders also initially made claims in common law negligence and shareholder oppression against individual officers and directors, which were dropped in exchange for an agreement by SNC-Lavalin to consent to certification of the *Securities Act* action. While the validity of these claims remains to be seen and is outside the scope of this article, even the potential cost of successfully defending a civil action constitutes an incentive to attend to anti-corruption compliance.

What Boards and Senior Management Need to Do

Oversight by directors and senior management is a critical element of a company's anti-corruption compliance efforts; their duties in this respect arise from statute, jurisprudence, the principles of corporate social responsibility and business best practices. The liability of the company and its individual governors may depend largely on the procedures implemented and processes followed by those governors in reaching their compliance decisions.

Director and Officer Compliance Obligations

Anti-corruption compliance falls squarely within the corporate governance mandate of corporate boards of directors and senior management. Without a clear and visible commitment "at the top" to monitoring compliance, a corporation is at significantly higher risk of running afoul of anti-corruption legislation. As noted, the CFPOA criminal provisions apply to directors and officers of corporations personally, and the non-criminal repercussions of CFPOA investigations and convictions – including civil liability – may exceed even the costs imposed by regulatory authorities.

It is therefore critical that boards and senior management of companies that operate internationally take steps to assess the risk of corrupt practices and to ensure that the corporation has appropriate measures in place to mitigate or eliminate such risk.

As a general matter, officers and directors are required to exercise the level of care, diligence and skill that a reasonably prudent person would exercise. They are required to act honestly, in good faith and in the best interests of the corporation. It is well-established that in support of this diligence, directors must remain informed about the corporation's activities and must ensure the lawfulness of the articles and the purpose of the corporation. In the anti-corruption context, boards and senior management must therefore be mindful of the corruption risk landscape on which the company operates and must actively implement appropriate compliance protocols.

The probation order issued by the Alberta Court of Queen's Bench against Niko Resources, which was drafted in consultation with U.S. enforcement authorities, demonstrates at least one Canadian court's acceptance that responsibility for compliance with the CFPOA is within the scope of a board's governance obligations. The Court ordered that all directors, officers and employees of Niko must receive training in relation to the anti-corruption program, complete with annual recertification. Further, the order required that one or more senior corporate executives of Niko must be responsible for implementation and oversight of the company's anti-corruption program, and must report directly to the Board of Directors or an appropriate committee of the Board.

The Delaware case *In re Caremark Int'l Inc. Derivative Litigation*[5] is often cited as characterizing directors' duty of oversight with respect to a corporation's regulatory compliance. *Caremark* held that a board should establish an information and reporting system "reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to

[5] 698 A.2d 959 (Del. Ch. 1996).

allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance."

That having been said, both *Caremark* and subsequent jurisprudence have held that pursuant to the business judgment rule, directors will face liability only for "sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists."

The Court in *Caremark* went on to define a multi-factor test to establish that directors had breached their duty of care, namely:

- the directors knew or should have known that violations of the law were occurring;
- the directors took no steps in a good faith effort to prevent or remedy the situation; and
- such failure proximately resulted in the losses complained of (though this last element may be thought to constitute an affirmative defence).

Corporate governors are well-advised not to court the lower threshold of "sustained or systematic failure to exercise oversight." To protect the companies they oversee, and in the process to protect themselves, directors and senior management should ensure that their corporations deploy adequate and effective internal controls to comply with anti-corruption legislation. Such internal controls will require closer attention to the extent that the company operates overseas or uses overseas agents that are outside the direct supervision of domestic management, and to the extent that the company operates in jurisdictions where bribery of public officials is common or even expected.

A compliance program serves at least two purposes: (i) as a prophylactic measure against corrupt practices (advertent or inadvertent) by a company, its employees and agents; and (ii) in the event any such practices come to light, to attempt to insulate the company and its management from civil and criminal liability by putting in place a system of due diligence whereby the company can demonstrate its *bona fide* efforts to prevent such occurrences.

In general, compliance regimes should include the following core elements:

1. conspicuous buy-in and compliance at the board and senior management level;
2. a robust anti-bribery risk assessment of the company's operations as a whole, and specific review of projects or proposals involving business with other countries;
3. guidelines with respect to, among other things, facilitation payments, financial controls and records, gifts and hospitality, the engagement of third parties or agents, mergers and acquisitions due diligence, and investigation protocols;
4. a review of relationships, including governing legal agreements, with all business partners to establish and document compliance with anti-bribery rules – this includes, for example, requiring specific provisions in agency agreements to ensure that third party representatives understand and comply with these requirements;
5. appointment of authoritative officers who are responsible and accountable for anti-bribery compliance;
6. regular communication and education and training programs for employees and executives;
7. a compliance manual available to all employees that clearly articulates the necessary requirements and due diligence for compliance with anti-bribery laws and sets out appropriate discipline for non-compliance;
8. processes for internal and external reporting of potential violations, and protections against reprisals for whistleblowers;
9. a documentation regime for all compliance initiatives, activities and training; and
10. monitoring by the board and senior management, including:
    a. regular and comprehensive audits to assess and confirm compliance levels and program effectiveness;
    b. periodic risk assessments and regular reports made directly to the Board or senior management; and

c. regular review of legislation and benchmarking with corporate peers.

Every reasonable effort should be made to provide the company's compliance officer(s) or committee with the authority and budget needed to be effective, including the authority to retain counsel and conduct investigations where necessary. He or she should have a reporting line directly to the board of directors or relevant committee. Compliance-related duties and responsibilities should be clearly communicated at all levels of the organization to ensure accountability.

With respect to compliance costs, 180 largely multinational companies responded to a recent survey by LRN Corporation in the U.S. and reported spending approximately $55 per employee on anti-corruption compliance programs in 2012. The cost to particular companies can vary greatly depending on the comprehensiveness of the compliance regime and the level of risk associated with the company's sphere of operations. As a practical matter, not every Canadian company operating overseas will require a top of the line anti-corruption program. Determining what is appropriate in a particular circumstance requires careful consideration of the level of risk, the appetite for risk, and the company's ability to manage the risk.

Due Diligence in Corporate Transactions

In the case of corporate transactions, anti-corruption compliance is an increasingly important element of the due diligence process, and a prior conviction or the absence of effective compliance procedures may be seen by a potential acquirer or merger partner as importing an unacceptable risk. Notably, when faced with charges under the CFPOA, Griffiths Energy decided to withdraw its initial public offering and to write off approximately $1.8 million in pre-IPO expenses. In the U.S. under the FCPA, General Electric Company agreed to pay $23.4 million to the U.S. Securities and Exchange Commission to settle charges arising from subsidiaries that were alleged to have committed FCPA violations prior to their acquisition by GE.

Within the transactional framework, directors and senior management need to evaluate the risks posed by potential CFPOA violations while remaining mindful that the purpose of the exercise is to determine risk, as opposed to exposing violations. Much of this can be accomplished effectively and quickly by way of questionnaires and interviews used in conjunction with normal financial due diligence. Depending on the level and nature of the risk, identified issues can often be managed within the transaction.

The due diligence exercise should take account, at minimum, of the nature of the industry, the level of contact with foreign officials and state entities, the use of agents and other third parties to facilitate operations, the countries in which the target operates (including subsidiaries), the existence of anti-corruption policies/program/controls, and the use of commission sales and commission rates in foreign countries.

Voluntary Disclosure

Even the most comprehensive anti-corruption program cannot guarantee that a CFPOA violation will not occur. In the event that a potential violation is identified, the board will need to tread cautiously when investigating the occurrence, using internal resources and outside counsel appropriately. If a violation is confirmed, the board will ultimately need to determine if and when it is in the company's interest to self-report the incident to the RCMP. For public issuers, the decision may, of course, ultimately be determined by the need to comply with securities reporting requirements.

Canada does not yet have a formal system to incentivize early voluntary reporting of non-compliance, but common sense, fairness and off-the-record comments by federal officials strongly suggest that voluntary disclosure is viewed favourably. If the decision to self-report is made, Crown prosecutors have indicated informally that companies should be prepared with an evidentiary package that will be useful for the purposes of proceedings against an offending individual. This raises important considerations with respect to the safeguards offered to the offending individual during the investigatory stage. For example, questioning the offending individual on the record and with counsel present might provide more utility for prosecutors, but it could prejudice the investigator's ability to obtain forthright information in the investigation. Further, it might not be in the company's

interest to create a paper record of the interview. A comprehensive review of such investigatory considerations is beyond the scope of this article.

Recently, questions have been raised in the U.S. as to whether there is actually a benefit to self-reporting foreign corruption offences. In particular, recent reviews have suggested that the fines and penalties imposed in self-reported cases in the U.S. have had less to do with the fact that the incident was self-reported, and more to do with the fact that the incidents reported were relatively minor in nature. In Canada, it is worth noting that the Niko matter was not voluntarily disclosed, and resulted in a fine of $9.5 million. Griffiths Energy did voluntarily disclose and received a fine of $10.3 million. Again, while two examples are insufficient to discern any meaningful pattern, ultimately, there is considerable prosecutorial discretion at play, and making a decision about when and how to voluntarily disclose a CFPOA violation should be made on an informed and careful basis.

Global Compliance

The anti-corruption compliance landscape is increasingly complex. Apart from the high-profile, long-armed U.S. legislation, which U.S. authorities have suggested can be broadly applied against any company whose securities trade on U.S. exchanges or, for that matter, in respect of any violation that has even a limited connection to the U.S. (for example, associated e-mails routing through U.S. servers), the U.K. *Bribery Act 2010*[6] takes an even more aggressive stance against bribery, not just of foreign public officials but against private bribery overseas. The U.K. Act does, however, provide for a "due diligence" defence not available in Canada. Canadian companies with footprints in either of these jurisdictions may well be subject to these different regimes, not to mention the increasing number of anti-corruption regulations being enacted in other countries in one form or another. As a result, many companies are choosing to implement anti-corruption programs on a global basis to ensure that they are compliant in every applicable jurisdiction.

An example of the complicated interplay among the approaches of different jurisdictions can be seen in the recent amendments to the CFPOA that prescribe the eventual elimination of the exception for "facilitation payments." These payments, which may be part of the everyday cost of doing business in certain jurisdictions, are not prohibited by the U.S. FCPA. That having been said, most U.S. corporations have policies that strongly discourage or outright prohibit reliance on this exception, in light of communications from U.S. enforcement authorities that have discouraged this practice.

Assessing and mitigating the risk of global non-compliance falls within the obligations of boards and senior management in conjunction with experienced in-house or regulatory counsel. Engaging advisors who have a direct presence or at least an association or "boots on the ground" in the applicable jurisdiction(s) can be an asset that provides added protection and keeps companies apprised of local developments that could impact the level of risk.

Summary

Anti-corruption enforcement is in its early stages in Canada, and corporate governors and their legal counsel are constrained to read the tea leaves of the few prosecutions and limited guidance provided by regulatory authorities in determining their responsibilities under the legislation. Fundamentally, there is no standard compliance regime that will work for every company, and expert advice may be required to assist the board and officers with the discharge of their obligations. It is apparent, however, that directors and senior management cannot hide from potential foreign corruption liability. In order to protect their companies, and in doing so themselves, directors and senior management must carefully analyze the risk environment and implement policies and procedures that appropriately address the risks faced by their companies.

[6] *Bribery Act 2010* (c. 23).