MOSCOW RULES
Russian dispute resolution reviewed

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Change to consumer justice

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What arbitration business needs today?

Impact of the Internet and electronic communications for business development (legal aspects)

On-Line Dispute Resolution Service. The experience of Foreign Institutions

Consideration of disputes by On-Line arbitration under the RAA rules

Invited speakers:

Mikhail Galperin, Head of the economic legislation department, Russian Ministry of Justice

Vladimir Lisin, Chairman, NLMK

Michael McIlwrath, Associate General Counsel – Litigation for General Electric Oil & Gas

Mark Appel, Senior Vice President of ICDR

Ruslan Ibragimov, Vice President, Corporate and Legal Matters, Member of the Executive Board, MTS

Vladimir Khvalei - RAA Chairman; Partner Baker & Mckenzie

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Arbitration in Russia:

NEW SOLUTIONS FOR BUSINESS

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time & change

This issue of *CDR* comes at a time of change, as **Edward Machin** departs as editor. Edward's excellence as a writer, undoubted editorial ability, and interest in all aspects of disputes – especially arbitration – mark him out as a legal journalist. As he moves on to a legal career, we at *CDR* wish him well for the future.

Edward taught me much, as did his predecessors, **Ben Lewis** and **Fraser Allan**, in covering change in the disputes market. I look forward to working with our contributors and readers in covering such change in the future and the challenge to clients it represents.

Change and challenge are both present in Russia's relationship with the legal landscape. Recent events in Ukraine have accentuated the need for businesses to re-evaluate Russian relationships. Likewise, law firms have been swift to offer advice on the effective risk management of Russian disputes, both now and in the future.

Both clients and counsel face an uncertain future, given the volatile nature of civil conflict in Ukraine. While the impact of sanctions remains hard to predict, this issue assesses some possible outcomes (page 27), and surveys the support for arbitration given across Russia and the CIS (page 18), while also looking at how Russia has sought to reform its dispute resolution regime (page 31).

How effectively Russia will compete with other centres as a jurisdiction of choice remains an open question, and one to which careful clients will seek an answer sooner, rather than later.

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RUSSIA AND THE CIS

Steven Finizio and **Kenneth Beale** of **WilmerHale** survey international arbitration in the Commonwealth of Independent States; London's continued lure for Russian parties; **Fredrik Svensson** and **Fredrik Ringquist** of **Mannheimer Swartling** consider the applicable arbitration law of Russian-related contracts; assessing reforms to Russia's dispute resolution laws; CIS claims beyond the headlines; Russian disputes – the offshore angle

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ANTI-BRIBERY

Gönenç Gürkaynak, **Olgu Kama** and **Burcu Ergün** of **ELIG** examine the scope of US anti-bribery legislation and its application to transactions in emerging countries

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Gönenç Gürkaynak, **Olgu Kama** and **Burcu Ergün** of **ELIG, Attorneys-at-Law** examine the scope of US anti-bribery legislation and its application to transactions in emerging countries

Recent Securities and Exchange Commission ("SEC") and Department of Justice ("DOJ") enforcement actions have demonstrated that payments made through third parties are among the most frequently suspected breaches of the US Foreign Corrupt Practices Act ("FCPA").

Back in 1977, when the FCPA was promulgated, the US Congress envisaged that companies operating businesses in foreign countries could attempt to use their lack of actual knowledge as a defensive shield, in case their operations in foreign countries were found to be corrupt.

Therefore, the FCPA has held companies responsible to a different standard of knowledge than actual knowledge alone, thus avoiding the possible gap in accountability. Without this standard of knowledge, companies could have stipulated that they had no idea how corrupt a deal was, because the company did not have an established branch in a country where alleged bribery had arisen, and/or their distributors were the primary source who conducted business dealings.

Companies could allege they cannot be held accountable due to the corrupt acts of their consultants, and the joint ventures they formed, agents, distributors, etc. As long as they placed someone between the actual knowledge of corruption and themselves, affected companies could argue that they would be safe from criminal indictment.

According to the FCPA, any person who knows that all or a part of a thing of value will be offered, given or promised to any foreign official, directly or indirectly with corrupt purposes within the scope of his/her business, can be held accountable for their actions.

In order to compensate for the possible accountability gap explained above, the knowledge standard under the FCPA goes beyond 'actual knowledge'. In fact, as per sections 78dd-1(f) (2) of the FCPA, the term 'knowing' is defined to include two options:

(i) a person is aware that the other person is engaging in prohibited conduct, that corrupt circumstances exist or the corrupt result is substantially certain to occur; or
(ii) a person has a *firm belief* that corrupt circumstances exist or the corrupt result is substantially certain to occur. ▸

Accordingly, even if a person does not have 'actual knowledge' of a prohibited action occurring, their awareness of a high probability of occurrence of such action is enough to deem that they 'knew' of the prohibited action and therefore, breached the FCPA.

The fact that engaging in corruption is how ordinary business is conducted in a certain jurisdiction will not relieve companies or employees of liability.

Similarly, the fact that corrupt actions are not generally prosecuted in the foreign jurisdiction of their operations should not be a mitigating factor either, as the possibility or otherwise of such foreign prosecution is irrelevant to FCPA investigations.

To that end, companies who retain third parties in their foreign business engagements should carry out thorough due diligence on these third parties and the foreign jurisdictions they are active in. This way, they will not have ignored any red flags due to a lack of possible awareness that they may have breached the FCPA.

Retainer agreements should contain anti-corruption undertakings as well as clauses which entitle…the termination of the agreement in case [of] corrupt practices

Third party due diligence

As part of a company's FCPA compliance programme, companies are advised to conduct due diligence regarding their business partners and the foreign jurisdictions they are active in.

The first step of such due diligence would be to determine the qualifications of a retained third party. For example, if the third party was retained as a consultant for the company's oil business, but has no previous experience in the said sector and they are known for their good relations with the government officials, this constitutes a serious red flag for the retaining company.

Another due diligence step would be to investigate the reputation of third parties. Companies should avoid third parties who are notorious for their questionable business methods.

Following such vetting, companies should evaluate the terms of their relationship with commercial third parties. Their first task should be to assess whether the company needs a business partner to realise the relevant transaction.

Retaining a third party who does not provide any added value to the business of the company is a red flag. To that end, the services a third party will provide to the company should be explicitly set out in the retainer agreement.

In addition, payment terms are also important in terms of third party due diligence. Significant red flags regarding payment terms would be making payments to an offshore account. In general, any terms which are not common to the industry of the business transaction would be a red flag.

Finally, subsequent to following up on the above-mentioned two steps, companies should periodically check if third parties are actually discharging their duties as set out in the retainer agreement.

To that end, retainer agreements should contain anti-corruption undertakings as well as clauses which entitle the termination of the agreement in case a third party engages in corrupt practices. In order to communicate the seriousness with which corrupt behaviour is treated, the principal company could provide third parties with anti-corruption training, where the jurisdiction of operation requires it.

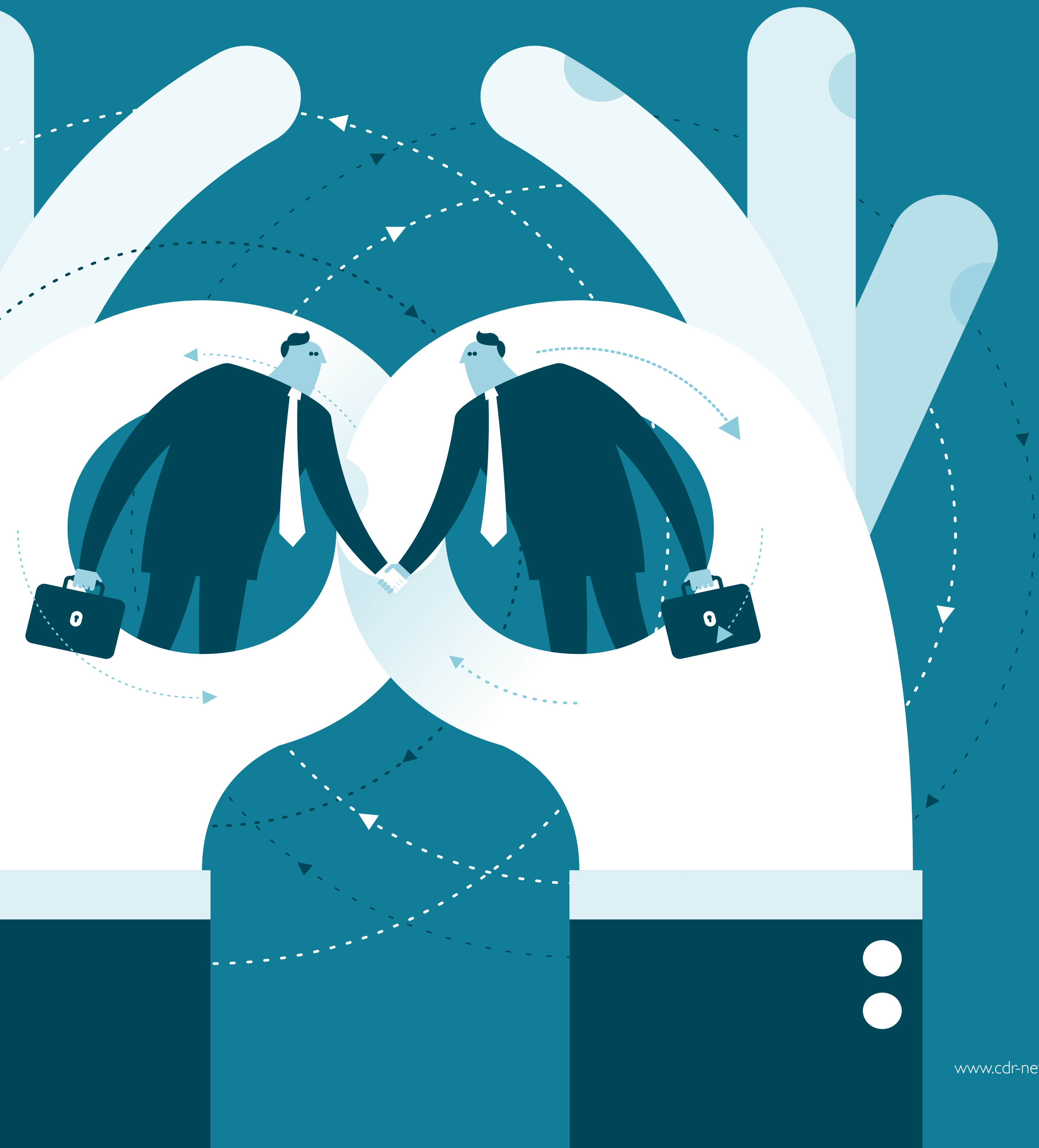
US v Kozeny, et al

The most prominent case on the knowledge requirement is *US v Kozeny* (2009) where the defendant **Frederic Bourke** was sentenced to: (i) one year and one day in prison; (ii) three years of probation; and (iii) a fine of USD 1 million due to FCPA violations, on 10 July 2009.

According to the facts of the case, both Bourke and a Czech investor named Victor Kozeny were among the partners of a consortium which sought to benefit from the privatisation of the Azerbaijani state-owned oil company SOCAR.

Bourke had invested USD 8 million on behalf of his relatives and friends to a company named **Oily Rock**, controlled by Kozeny. Through Oily Rock, Azerbaijani state officials were offered significant financial inducements ▸

The strict knowledge requirements of the FCPA mean companies cannot assert they did not know corrupt practices were taking place



two thirds of the vouchers bought by the company to participate in the privatisation (under the Azerbaijani privatisation system, one had to purchase government vouchers so as to participate), and two thirds of Kozeny's profits in case the privatisation was awarded to the consortium.

Even though during the trial process Bourke alleged that he too was a victim of Kozeny's corrupt deals and he was not aware of Kozeny's actions, the court did not accept this 'I-did-not-know' defence.

The court held that Bourke was liable under the FCPA since: (i) he was aware that Kozeny, who was Bourke's friend and neighbour, was nicknamed "the Pirate of Prague" due to his dealings with government officials; (ii) he knew that the jurisdiction in which the transactions were realised was prone to corruption; and (iii) Bourke had even established companies to shield himself from FCPA liability.

In other words, the court held that Bourke had remained wilfully blind to the fact his business partner was bribing government officials. After all, he was sufficiently aware that Kozeny's engagement in the aforementioned corrupt behaviour was a high possibility in a corruption-prone jurisdiction such as Azerbaijan. Therefore, he was liable. Bourke's subsequent appeal to the US Court of Appeals was unsuccessful.

Kozeny demonstrates that, when it comes to FCPA enforcement, the authorities do not tolerate a head-in-the-sand approach. This renders third party due diligence ever-more important.

Transactions in emerging countries

It is a fact that not every jurisdiction, e.g. emerging countries, enforces its anti-corruption legislation as rigorously as the US. While anti-corruption legislation is becoming more alike across jurisdictions as time passes, it may take time before a new understanding and intolerance of corruption as promoted by new legislation permeates through to some local cultures.

Some jurisdictions are prone to corruption while others are not. For example, in some emerging countries, gift giving, hosting or extravagant entertainment expenses might be a part of the business culture.

Additionally, it may be possible that anti-corruption laws are seldom enforced in these jurisdictions.

From the outside, it may seem like bribery and corruption are part of the usual processes of business. Since there is little or no enforcement of the law, companies and individuals may feel like they are safe from criminal penalties.

However, as noted previously, the DOJ and SEC do not require the jurisdiction in which the alleged corrupt practice actually occurred to investigate the alleged corrupt act, in order to pursue the investigation themselves.

There are many examples of enforcement actions where persons engaged in corrupt acts were held liable under the FCPA, even though the acts were not illegal within the jurisdiction of the corrupt act.

Accordingly, persons who fall within the scope of the FCPA's reach should be aware that their actions anywhere in the world could be subject to enforcement actions in the US.

Given the strict knowledge requirements of the FCPA, companies cannot assert that they did not know corrupt practices were taking place in the presence of red flags, as described above.

The *Kozeny* case above demonstrates that factors such as being aware that a jurisdiction is prone to corruption, or being aware of red flags that could lead to potential FCPA liability, will lead to criminal liability, unless sufficient mechanisms to prevent corruption are put in place.

Therefore, those falling within the scope of the FCPA enforcement should be diligent while retaining third parties or engaging in business transactions in emerging markets. ■

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