UNDERSTANDING AND MITIGATING YOUR THIRD PARTY CORRUPTION RISK UNDER CANADA'S CORRUPTION OF FOREIGN PUBLIC OFFICIALS ACT

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1. Introduction

The use of third party agents in international operations or business development, whether consultants, sales representatives, customs brokers, contractors or distributors, is often unavoidable. This may be because the retention of a local agent is a requirement of foreign law, because of cultural or linguistic barriers, or because of practical or logistical realities. However, engaging third party agents can be fraught with uncertainty and this is one of the most significant areas of anti-corruption risk facing Canadian companies. The following is an overview of (i) the potential liability of Canadian companies for the acts of third party agents under the *Corruption of Foreign Public Officials Act* (CFPOA), and (ii) risk mitigation strategies available to Canadian companies to address this exposure.

2. The CFPOA, the Criminal Code and Indirect Corrupt Acts

Subsection 3(1) of the CFPOA provides that "[e]very person commits an offence who, in order to obtain or retain an advantage in the course of business, directly *or indirectly* gives, offers or agrees to give or offer a loan, reward, advantage or benefit of any kind to a foreign public official…" (emphasis added).

Importantly, the use of the phrase "direct or indirect" captures payments or other benefits provided through a third party, including third party agents. Individuals and entities may therefore be liable under the CFPOA for illicit payments or promises extended on their behalf by an agent, consultant or other representative to a foreign public official or to any other person for the official's benefit if the individual or entity either knew or was 'wilfully blind' to the fact that the illicit payment or promise would likely be provided.

This is also reflected in the corporate liability provisions of the Criminal Code. Under section 22.2, a company will be considered to be party to an offence where a senior officer "knowing that a representative of the organization is or is about to be a party to the offence, does not take all reasonable measures to stop them from being a party to the offence. The Criminal Code defines "representative" broadly to mean "a director, partner, employee, member, agent or contractor of the organization"

3. *R v. Briscoe* and the Doctrine of 'Wilful Blindness'

Assuming that the vast majority of Canadian companies will not readily initiate or participate in third party activities contrary to the CFPOA, most often the question is at what point an organization may incur liability as a result of the conduct of its agents or representatives even

where the organization does not explicitly direct such behavior. This necessitates a close examination of the doctrine of 'wilful blindness', the principle pursuant to which persons can be held criminally liable under Canadian law for actions taken by others where the person had near knowledge of the intended activity but deliberately avoided further inquiry in order to claim ignorance.

In *R. v. Sault Ste. Marie*,[1] the Supreme Court of Canada set out the *mens rea* requirement for criminal culpability where no threshold is specified within the relevant legislation, as is the case with the CFPOA. The Court stated:

> Where the offence is criminal, the Crown must establish a mental element, namely, that the accused who committed the prohibited act did so intentionally or recklessly, with knowledge of the facts constituting the offence, or with wilful blindness toward them.[2]

In this regard, the scope and substance of the 'wilful blindness' doctrine was recently outlined by the Alberta Court of Appeal in *R. v. Briscoe*[3] and the Supreme Court of Canada in *R. v. Briscoe*.[4] At issue in that case was whether wilful blindness could be used to determine whether a person who was present during the planning and execution of a murder had the requisite knowledge and intent to be convicted of the same crime.

The Alberta Court of Appeal held that the doctrine of wilful blindness "is well established in Canadian law."[5] Referring to the ruling of the Supreme Court of Canada in *R. v. Sansregret*,[6] the Court of Appeal summarized the doctrine as follows:

> [W]ilful blindness arises where a person who has become aware of the need for some inquiry declines to make the inquiry because he does not wish to know the truth. He would prefer to remain ignorant. The culpability… in wilful blindness… is justified by the accused's fault in deliberately failing to inquire when he knows there is reason for inquiry.[7]

The Court of Appeal explained that wilful blindness "is not premised on what a reasonable person would have done, but requires a finding that the accused, with actual suspicion, deliberately refrained from making inquiries because he or she did not want his or her suspicions confirmed."[8]

The Supreme Court upheld the decision of the Alberta Court of Appeal, and in so doing emphasized that the doctrine of wilful blindness "imputes knowledge to an accused whose suspicion is aroused to the point where he or she sees the need for further inquiries, but deliberately chooses not to make those inquiries… [it] involves an affirmative answer to the question: Did the accused shut his eyes because he knew or strongly suspected that looking would fix him with knowledge?"[9]

4. The CFPOA, Third Party Agents and Risk Mitigation

What are the lessons from *R v. Briscoe* for Canadian companies seeking to mitigate their exposure to liability under the CFPOA in connection with the engagement of foreign agents or consultants?

(a) The Importance of Pre-Engagement Due Diligence

Comprehensive due diligence of all foreign agents is paramount. Culpability pursuant to the doctrine of wilful blindness is anchored in the conscious decision to refrain from inquiries and investigations where suspicion of impropriety or potential impropriety has been aroused. Stated differently, it flows directly from the deliberate refusal to actively pursue additional knowledge and information when one is troubled by or fearful of the revelations such additional knowledge or information may entail. Therefore, in order to avoid criminal liability under the CFPOA for actions undertaken by a third party, Canadian companies and their representatives should carefully diligence all agents under consideration for engagement where there is the slightest concern that foreign corrupt practices could come into play.

Appropriate due diligence will include, at the very least, close consideration of the qualifications, credentials, resources, reputation and past experience of the prospective agent, as well as all past and present affiliations of the agent. A number of inquiries should be made. Has the agent performed similar services in the past and, if so, who for? What is the reputation of the agent and all such previous clients and have any of such individuals or entities ever been accused of or connected to any improper dealings of any kind? Does the agent have the requisite qualifications, credentials, resources and experience to perform the services offered? Are the proposed fees to be charged by the agent commensurate with the services to be provided? Are they comparable to fees being charged by agents of similar qualification in the same market and industry sector? Who are the shareholders or principals of the agent? Is the agent transparent in its operations, management and capital structure? Has the agent ever worked in government or for a government agency in the subject jurisdiction or any related jurisdiction? Does the agent have any ties to government, whether direct or indirect, and whether by family or casual relation or otherwise?

(b) Consider Engaging Third Party Due Diligence Agents

Depending on the circumstances, some or all of the questions canvassed above may be difficult for a company to answer with certainty. Where this is the case, companies should consider retaining the services of independent third party due diligence agents. Such agents can perform a number of inquiries a company or its counsel may not be ideally positioned to efficiently conduct. First, they may offer proficiency in the local language of the foreign jurisdiction allowing them to consult sources and references otherwise inaccessible to the company. This includes not only the ability to review information only available in local languages but also the ability to personally consult references and other sources relevant to the past experience, credentials and reputation of the agent. Secondly, they may have ready access to certain relevant watch lists, corporate registries or litigation records that a company or legal counsel might not. This includes government watch lists of persons involved in potential illegal activity, including persons suspected of engaging in corrupt practices, money laundering, terrorism and other international crime. This also includes ‘politically exposed persons’ databases intended to catalogue companies, personnel and other individuals connected to or affiliated with governments, government agencies and state-owned entities. Lastly, such agents may be in a

position to readily conduct in-person interviews with a prospective agent as well as in-person visits to the agent's offices to confirm relevant representations made by the agent, including claims regarding resources, personnel and past experience.

(c) Take a Risk-Based Approach to Due Diligence of Agents

The appropriate scope and degree of due diligence of an agent will be informed by the particular circumstances of a company as well as the particular circumstances of the agent. Corruption is more pervasive in certain regions than in others. Similarly, the "industrial sector" of a company or a particular project should also be a chief consideration. Generally speaking, resource sectors, including oil and gas and mining, and in particular the resource sectors of developing countries, are perceived as acutely fraught with corrupt practices (and are thus a main concern of anti-corruption authorities and enforcement policies). Another important potential red flag to monitor is the degree to which doing business in the subject industry sector is dependent on the receipt of government licences and permits, as well as the degree of government oversight and inspection, including but not limited to customs and immigration clearing. The same is the case where a company routinely makes sales to or performs services for government, government agencies or state-owned entities. Put simply, the greater degree of government involvement and interaction in the industry sector, the greater opportunity there will be for corrupt public practices, whether initiated by a government official or by a third party agent.

(d) Consider Red Flags Raised by a Prospective or Current Third Party Agent

Companies should carefully consider possible red flags specific to an individual agent. Again, a number of questions should be asked. Does the agent reside in the country in which the services are to be provided? Is the agent incorporated in a tax haven? Does the agent refuse to disclose its complete ownership, capital structure or other reasonably requested information? Is there reason to suspect that the agent has a silent partner? Does the agent regularly engage contractors or subcontractors in performing its services? Have such subcontractors been readily disclosed? Does the agent recommend the involvement of third parties who contribute no discernible value? Does the agent wish to reserve the right to assign its rights or obligations under the agent agreement to third parties? Are the agent's financial books and records professionally prepared and transparent? Does the agent request the preparation of any unusual financial documentation? Do all wire transfers record the identity of both the sender and recipient? Does the agent demand an unusually high commission or a large up-front payment? Does the agent require that payments be made in cash or to a bank in a foreign country unrelated to the transaction? Does the agent require that political or charitable donations be made by the company? Has the agent been recommended to the company by a foreign government official? What is the agent's apparent familiarity with anti-corruption laws and anti-corruption policies and procedures, including sworn compliance certificates? Does the agent resist cooperating in due diligence procedures or providing written representations, warranties, covenants or audit or termination rights related to anti-corruption law and compliance?

(e) Abort Agent Engagements where an Unacceptable Level of Corruption Risk is Identified

The due diligence of agents will not in and of itself provide immunity from liability under the CFPOA: one must of course also abort any engagement of a third party agent in respect of which unacceptable corruption risk has been identified so that it cannot in any manner be argued that the company stood by or acquiesced to any corrupt practices engaged in by the agent.

But just when is this threshold crossed, i.e. what constitutes sufficient evidence to reasonably presume that an agent will or may engage in corrupt practices? There is no simple answer to this question. In the *United States v. Kozeny*, a case involving corrupt payments made through a third party agent to government officials in Azerbaijan, the Court highlighted that the defendant (i) was aware of the high level of corruption in Azerbaijan generally, (ii) knew of the agent's reputation for previous criminal activity, (iii) had deliberately engineered a corporate structure intended to evade anti-corruption liability, and (iv) had deliberately avoided conducting due diligence into his suspicions regarding corrupt practices by his associates.[10] This is a considerable amount of concerning facts. Indeed, the Court stated that this same evidence could also be used to infer that the defendant actually knew about the crimes. Not all potential agent engagements will present such blatant 'deal breakers', and where this is the case businesses will need to apply prudent judgement, erring on the side of caution. Where specific concerns are raised, these must be exhaustively diligenced. And where questions still remain following such an exhaustive exercise, the wisdom of the proposed engagement should be seriously reconsidered.

(f) Include Appropriate Protections in Agent Contracts

Where a company does proceed to engage a third party agent in respect of overseas operations this should always be done pursuant to a comprehensive agent agreement which includes fulsome anti-corruption representations, warranties, covenants and related rights.

In particular, all agency or consultant agreements involving foreign jurisdictions should include, at minimum, (i) a precise description of the services to be performed by the agent, (ii) a precise description of the time frame of the engagement of the agent, (iii) representations and warranties by the agent disclaiming any affiliation to any foreign public officials, (iv) covenants by the agent to comply with all applicable law (including anti-corruption laws) and to timely inform the agent of any changes in the agent's circumstances which would render its representations and warranties inaccurate or untrue, (v) covenants by the agent not to engage subcontractors without the prior express written consent of the company, (vi) covenants by the agent to certify, on an annual or other basis, the agent's compliance with anti-corruption laws, (vii) undertakings by the agent to keep detailed financial books and records recording, in particular, all distributions and disbursements of funds made by the agent, (viii) audit rights in favour the company granting it access to the books and records of the agent to confirm compliance with anti-corruptions laws, (ix) indemnities in respect of breaches by the agent of its

representations, warranties or covenants under the agreement, and (x) rights allowing the company to immediately terminate the agent's engagement where suspected non-compliance with anti-corruption laws is identified.

(g) Continue to Monitor Agents Over the Course of their Engagement

Matters do not end with a fulsome agent agreement, however. Companies should also be careful to continue their diligence of agents going forward over the entire course of the engagement through appropriate monitoring and the exercise of contractual access and audit rights.

Some examples of enforcement proceedings under the U.S. *Foreign Corrupt Practices Act* provide cautionary tales. In *Oil States International, Inc.*,[11] for example, Oil States' Venezuelan subsidiary hired a local consultant to interface with PDVSA on its behalf who later became involved in 'kickback' scheme with certain PDVSA employees. The ploy was discovered by an internal investigation by U.S. management of the subsidiary into unexplained narrowing profit margins and the agent's engagement was terminated. Although the SEC accepted that there was "no evidence that [the subsidiary's] or Oil States' employees in the United States were aware of or sanctioned the improper payments", it also highlighted that (i) Oil States had not investigated the background of the agent, (ii) Oil States had not provided any formal education to the agent regarding the requirements of the FCPA, and (iii) the agent agreement failed to address compliance with U.S. law, including the FCPA. In *SEC v. Bobby Benton*,[12] on the other hand, a customs agent engaged by Pride International, Inc.'s Mexican subsidiary took it upon himself to independently orchestrate a bribe of approximately $15,000 to ensure the timely export of a drilling rig from the country. The scheme was discovered when the agent submitted invoices to the subsidiary seeking payment for 'extra work' performed during the export process. Mr. Benton, a Vice President of Pride who discovered the scheme but subsequently failed to bring it to the attention of the company's management, legal department or auditors, was personally charged with violating the anti-bribery provisions of the *Securities Exchange Act* and fined USD$40,000.00.[13]

Summary

While wilful blindness is arguably a difficult standard for criminal prosecutors to satisfy, companies should never continue a suspect third-party agent engagement in reliance on such a premise. Comprehensive due diligence prior to the retention of an agent as well as continuing due diligence and monitoring post-retention should be the norm and any engagement in respect of which potential corruption concerns are identified should be immediately investigated, and where appropriate, terminated. Furthermore, the fact that corporate and individual criminal liability for the acts of third party agents has been uncommon in Canada to date does not change this analysis. Canadian companies are operating in a new high risk environment when it comes to anti-corruption compliance and mitigation of third party agent risk should be a critical component of your compliance strategy.

[1] [1978] 2 SCR 1299.

[2] Ibid., at 1309.

[3] 2008 ABCA 327 (CanLII).

[4] [2010] 1 SCR 411.

[5] Ibid., at para. 16.

[6] [1985] 1 SCR 570.

[7] Supra note 3, at para. 16.

[8] Supra note 3, at para. 21.

[9] Supra note 4, at para. 21.

[10] *United States v. Kozeny*, No. 09-4704, 2011 WL 6184494 .

[11] http://www.sec.gov/litigation/admin/2006/34-53732.pdf.

[12] http://www.sec.gov/litigation/complaints/2009/comp21335.pdf.

[13] http://www.sec.gov/litigation/litreleases/2009/lr21335.htm; http://www.sec.gov/litigation/litreleases/2010/lr21726.htm.