



Fighting Corporate Fraud

Nationwide Russian Survey
2012-2013 Report



Dear colleagues!

Russian Union of Industrialists and Entrepreneurs is happy to bring to your attention the results of the Nationwide Survey “Practice of Fighting the Corporate Fraud”, which is the product of cooperation between the Russian Union of Industrialists and Entrepreneurs and VEGAS LEX law firm.

Issues of corporate fraud and corruption along with imperfections of Russian laws and law enforcement practice are, in our opinion, some of the key factors of suppressing home business growth and positive competition development.

The work completed with the work product based on surveying over 100 companies does not only demonstrate illustratively the current status of the problem, but contains practical recommendations as well with respect to the measures enabling to reduce potential risks of corporate abusive practices and to work more efficiently on restoration of violated rights and recovery of lost assets.

Let me express appreciation to all the companies that took part in the Survey.

On the basis of the data collected further to expertise summary, the organizers of the Survey have also elaborated suggestions for reforming Russian laws in the sphere of fighting corporate fraud that are intended to improve business environment on a national scale and protect the interests of honest businessmen.

President Of the Russian Union of Industrialists and Entrepreneurs
Alexander Shokhin



Dear friends!

We would like to bring to your attention the results of the Nationwide Survey “Practice of Fighting the Corporate Fraud”, conducted jointly by the Russian Union of Industrialists and Entrepreneurs and VEGAS LEX law firm.

Any fact of corporate fraud does damage to the company affecting all principal areas of business, its internal and external profile, and often has deferred adverse effect, sometimes of unpredictable scale. In our opinion, the most effective method of fighting corporate fraud is to create a system of monitoring, control, managers’ abuse protection and responsibility, and measures aimed at corporate fraud detection, investigation and prevention.

Having set a goal in 2012 to obtain the most complete and impartial data related to corporate fraud environment in Russia, we surveyed and interviewed over one hundred respondents through a special web portal www.stopcorporatocrime.ru, over 60 per cent of which reported such crimes in their companies.

In addition to statistics collection, we made a point straightway to elaborate efficient tools for eliminating negative effect of corporate fraud, abusive and corruptive practices.

In this booklet you can familiarize yourself with the results of the research performed and obtain practical recommendations related to development of legal instruments for preventing corporate fraud.

In my turn, I would like to thank one and all who took part in our Survey.

Managing Partner at VEGAS LEX
Alexander Sitnikov

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SURVEY DESCRIPTION

The key mission of the Nationwide Survey conducted by VEGAS LEX law firm under the auspices of the Russian Union of Industrialists and Entrepreneurs is improving the methods of fighting the corporate fraud¹ in the Russian Federation and elaborating suggestions for updating Russian laws.

The Survey organizers defined as key tasks the following issues:

- exploring the current status of the problem of corporate fraud in Russian companies;
- detecting the most dangerous kinds of corporate fraud;
- defining efficient practices of fighting corporate fraud and methods to restore infringed rights of the companies and repair the damages;
- elaborating efficient instruments for preventing and relieving the consequences of the corporate fraud.

The Survey is designed for the following respondents:

- business owners;
- members of the board of directors;
- senior executives (general, financial, HR directors and other);
- managers and specialists of economic security, internal audit and other relevant departments.

Being aware of the fact that the corporate fraud rate is generally high, while the businessmen do not give due consideration to this phenomenon, the Survey organizers focused on practical aspects of crime investigation, holding liable the guilty parties, forming the body of evidence and the methods of recovery of the damages inflicted.

The report reflects the opinion of representatives of 127 companies that participated in our work. Web site <http://www.stopcorporatedecrime.ru> designed for this specific purpose allowed the respondents within the period from November 2012 up to August 2013 to answer 35 questions of the inquiry in any convenient way: online, by offline questioning or individual interview.

Consequently, the figures were analyzed both for 2011 – 2012 and first half of the year 2013. The organizers ensured confidentiality of the information obtained during the Survey as well as anonymity for the respondents who opted for it when filling the inquiry.

Summarizing the results of the survey performed, the experts have worked out practical recommendations and suggestions for improving the laws of the RF, key provisions of which are also described in this report.

¹For the purposes of the Survey, the “corporate fraud” is understood to be any acts of the employees or owners of the Company related to abuse of confidence for personal advantage and to the detriment of the Company, such as any forms of assets misappropriation and any acts of corruption.



MAIN CONCLUSIONS

1. Corporate fraud constitutes a grave threat to the Russian companies. 60 per cent of participants of the Survey acknowledge signs / facts of corporate crimes to be detected.

2. The trend of corporate fraud in Russia remains almost steady for the period of 2011 – 2013. However, it is probably that it will grow in future, for instance, in case of aggravating crisis development in the national economy.

3. Corporate fraud results in the broad range of adverse consequences, sometimes even crucial:

- considerable financial loss (16 per cent of respondents point out that the damages exceed 1 million US dollar, while the maximum amount of the damages named by the participants of the Survey equals to 1 billion US dollar);
- damage to the corporate brand;
- retardation of business development;
- loss of business contacts with partners;
- dismissal of employees and collapse in confidence among the workforce.

4. Owners and senior executives of the companies do not always give due consideration to corporate fraud. Attitude of these persons towards the problem is formed under the influence of the following factors:

- stage of business development;
- corporate culture level;
- existence of the company’s long-term strategy;
- size of the business;
- focus on the foreign market / foreign partners;
- company’s business scope;
- amount of the incidents previously detected and the extent of damage, etc.

5. With the view to risks of corporate fraud and extent of potential losses, the following business processes are the most sensitive:

- implementing investment projects;
- capital construction;
- any procurement activities (services, works and goods);
- financial operations;
- sale of end products;
- logistics and transportations, etc.

6. The gravest crimes in the companies are committed by senior executives vested with confidence on the part of the directorate and often showing high performance. Sometimes criminal schemes involve partners and competitors of the companies.

7. The most common kinds of corporate fraud are commercial bribery (kickback), various forms of misappropriation of assets as well as using corporate property for personal advantage.

8. Business is currently underestimating the threat of confidential information leakage and cyber-crimes.

We believe it is related to the complicity of recording the leakage and distribution of the proprietary information, difficulty to prove cause and effect connection between such acts and the damages incurred and to referring these issues to the limited authorities of the relevant corporate departments (IT, security).

9. Fighting corporate fraud is a key task of the businesses. Solving this problem will make it possible not only to improve efficiency and reduce costs of the companies, but to reduce corruption background on a nationwide scale as well.

First and foremost, this task requires the appropriate treatment of the owners and senior executives of the companies.

In addition to direct implementing, it is necessary to maintain on a regular basis various proactive and reactive measures and to involve in these processes not only departments of internal audit, but HR experts, lawyers, independent auditors and other specialists as well.

10. Detecting facts / signs of internal fraud creates no problem for the relevant corporate departments.

Business generally shows trend towards more severe penalties for guilty persons (reporting to law enforcement agencies, dismissal, taking compensatory legal actions).

11. In the context of reactive response to the cases of corporate fraud, the main bottlenecks are:

- lack of unified procedure for cooperation of all corporate functional unit, forcing the companies to operate in "manual mode", that impairs the effectiveness of further measures;
- investigation process of the incidents;
- procedures for reparation of damages and recovery of assets.

12. It is possible to enhance efficiency of the processes most significant for the businesses, such as recovery of assets and reparation of losses, through use of several additional instruments that are hardly used by the companies by the moment.

For instance:

- providing hotline enabling to inform the company 24/7 of any signs / facts of corporate crimes;
- implementing policy of confidentiality and security guarantees for the persons having informed the company of the relevant incidents;

- establishing commercial confidentiality;
- managing corporate data flows;
- conducting independent (!) external anti-corruption audit of key business processes;
- conducting legal expert anti-corruption examination and due diligence of corporate procedures and documents;
- conducting independent attorney's (!) investigations that will make it possible to improve considerably the efficiency of proof and evidence, as well as ensure in many cases real compensation of damages and recovery of the title to the lost assets;
- involving on timely basis experts in international law when any risks are revealed of siphoning the assets off beyond the borders of the Russian Federation;
- taking immediate legal measures with respect to striped assets related to tracing and protecting these assets;
- engaging experts in the sphere of cyber-crime investigation.

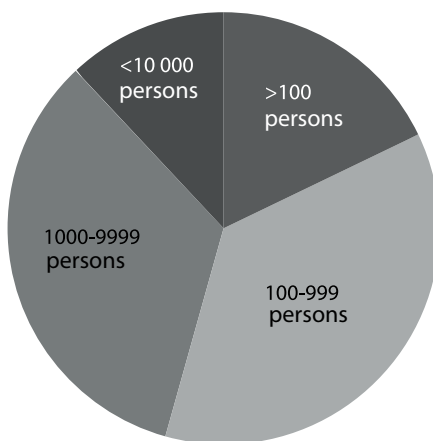
ANALYTICS

1. SURVEY RESPONDENT INFORMATION

127 companies took part in the Survey, of which 13 are the foreign investment enterprises.

Major (over 10,000 people) and medium-sized (over 1,000 people) companies aggregated to 46 per cent of respondents (Chart 1).

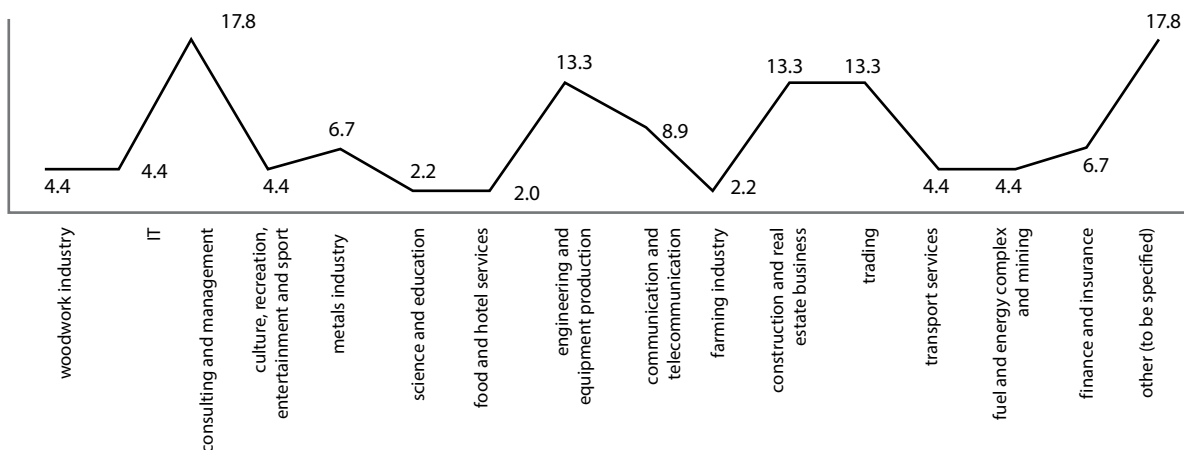
Chart 1. Average number of employees of the responding companies



With regard to the sector profile (Chart 2) companies in the sphere of consulting and other sectors non-specified in the general list were the ones most actively involved.

Construction, trading and engineering enterprises were all second ranked (8 – 14 per cent of respondents).

Chart 2. Business sector of the responding companies



The respondents of Central, Southern, Northwestern and Privolzhkiy Federal Districts took the most active part in the Survey.

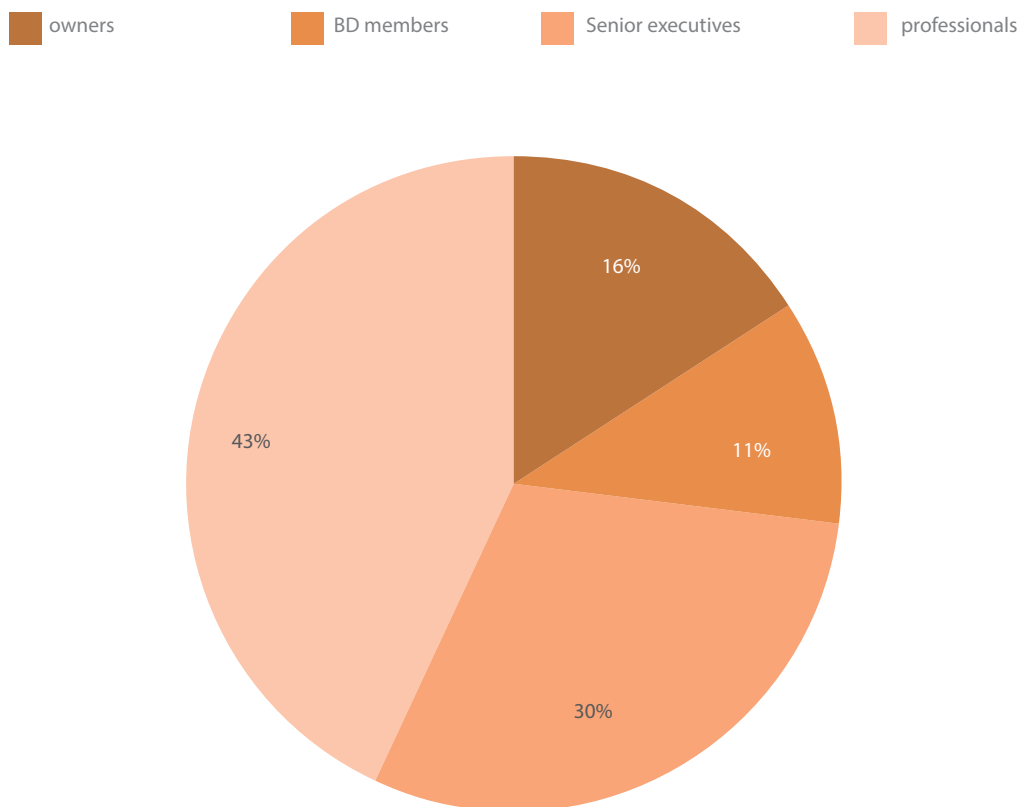
In our opinion, the wide range of responding companies constitutes an illustrative evidence of the high concern for the problem under study on the part of representatives of nearly all the spheres of business.

Status of the direct participants in the Study includes business owners, senior executives (general, financial, HR director, deputy general director for legal issues etc.), members of the board of directors, managers (professionals) of the relevant divisions and departments (economic security department, internal audit and compliance department, legal department) (Chart 3).

Most respondents (57 per cent) involved in the Survey have been continuously employed by the companies: 32 per cent – over three years, 25 per cent – over ten years. The percentage of the participants of the Survey with the record of work for the company from one to three years amounted to 27 per cent.

Therefore, we believe that the data obtained during the Survey and the conclusions deduced are based on a rather representative selection, while the information provided by the respondents is backed by the substantial real-life experience and certain loyalty to the companies represented.

Chart 3. Status of the respondents



2. CORPORATE FRAUD:
CURRENT STATUS, EFFECT, TYPES, ACTORS

40 per cent of respondents attach high value to the problem of corporate fraud (Chart 4). At the same time, 30 per cent of the interviewed consider this phenomenon to be insignificant or essentially absent (2 per cent). It is important to note, that relevant professionals (representing economic security, compliance, internal audit and HR departments) traditionally lay special emphasis on the problem of corporate fraud, while owners of business and members of the boards of directors attribute less importance to this phenomenon (Chart 5).

According to the experts, such attitude is indicative of the following facts:

- underestimating business risks related to various kinds of corporate fraud and their effect, financial and non-monetary (see Charts 7 and 8);
- lack of trust in efficiency of measures on fighting corporate fraud;
- perception acts of corruption in business as “normal business practice”;
- tendency to using reactive measures of fighting internal abusive practices.

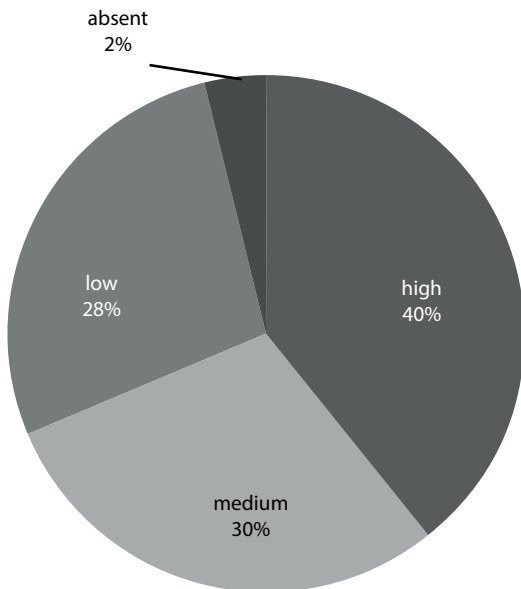


Chart 4. What is the importance level of the problem of corporate crime for your company?

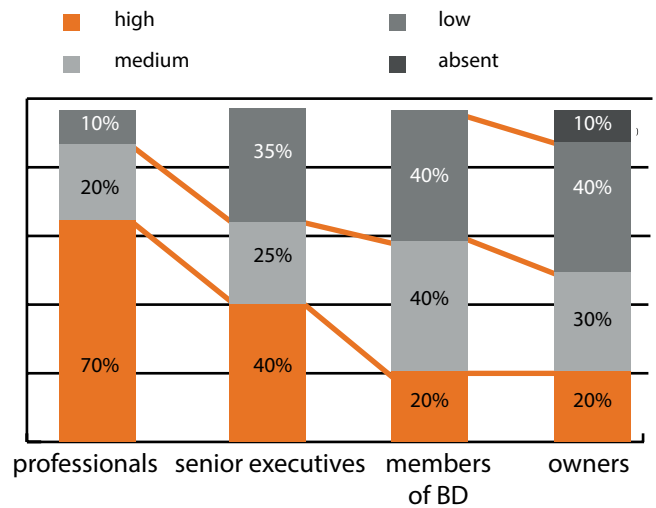


Chart 5. Significance of the problem of corporate fraud with regard to respondent’s level

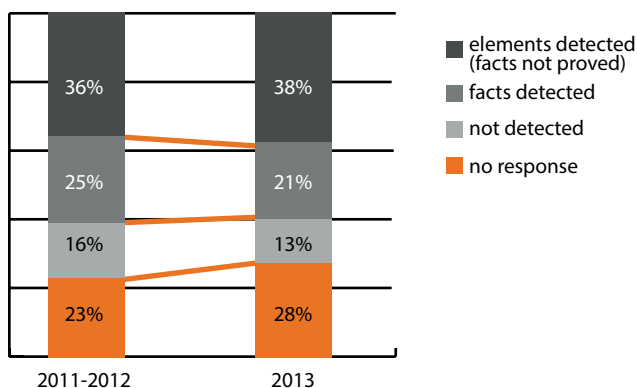
During evaluation of the data obtained and, primarily, individual interviews with the respondents, the experts selected a range of factors having major influence on forming the attitude of owners and senior executives of the companies to the problem of corporate fraud as a matter of principle. Such factors include:

- company’s business scope (industrial production and engineering, capital construction, trading, communication and telecommunication, finance and insurance are exposed to greater risks);
- having long-term business development strategy (including plans of diversification, increasing market share, attracting strategic and/or financial investors, IPO, planning M&A transactions, etc.);
- stage of business development;
- size of the business (larger companies tend to attach greater importance to the problem);
- focus on the foreign market (foreign partners);
- amount of the corporate crimes previously detected and the extent of damage inflicted;
- corporate culture level.

A total of approximately 60 per cent of the respondents reported that they detected facts / elements of corporate fraud in 2011 – 2012. It should be noted that, irrespective of fewer respondents having provided information for 2013, we can state nearly permanent trend of detecting fraud in companies (Chart 6). According to the experts, it is quite expectable. Steadiness of figures at the beginning of 2013 is caused by relative tranquility in economy, absence of crisis signs and violent currency fluctuations, predictable inflation.

On average, companies detect 5–7 events of abuse annually. Maximum amount of the facts revealed that was specified by the participants of the Survey is 27.

Chart 6. Detecting corporate fraud



Considerable losses incurred by the Russian companies due to internal crimes are also illustrative of the scale of the matter explored. 16 per cent of the respondents to this question specified that the amount of damages inflicted by corporate fraud exceeded 1 million USD. 18 per cent evaluate material losses at the rate of 100,000 to 1,000,000 USD (Chart 7).

63.2 per cent of respondents named loss of profits as adverse effect of corporate fraud besides direct material loss.

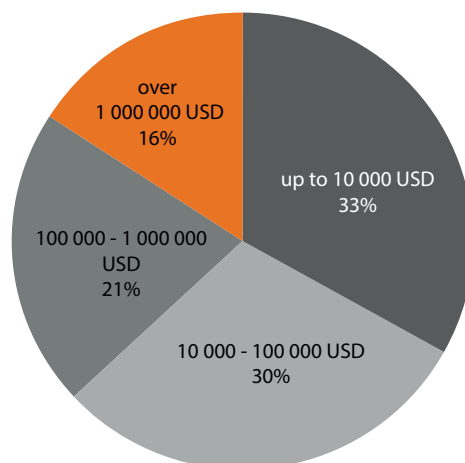


Chart 7. Extent of loss

It is important to note that, according to the figures indicated by the respondents, the maximum extent of loss inflicted due to corporate fraud committed by senior executives exceeded 1 billion US dollar.

Thus, we can state that most Russian companies suffer from corporate fraud, this phenomenon not declining. What is more, statistics and facts of comparable research imply growth in strength of corporate fraud in case of crisis development in the economy, which is entirely possible in the Russian Federation in 2014 – 2015. Extent of direct financial damage and loss of profits caused by such abusive practices are quite impressive, so effective companies show serious attitude to this problem.

Businesses with good reason point out various adverse non-monetary consequences of corporate crime. According to 46 per cent of respondents, facts of such crimes are directly associated to the risk of detriment to market reputation of the company. In addition to it, participants indicate the following adverse consequences (Chart 8).

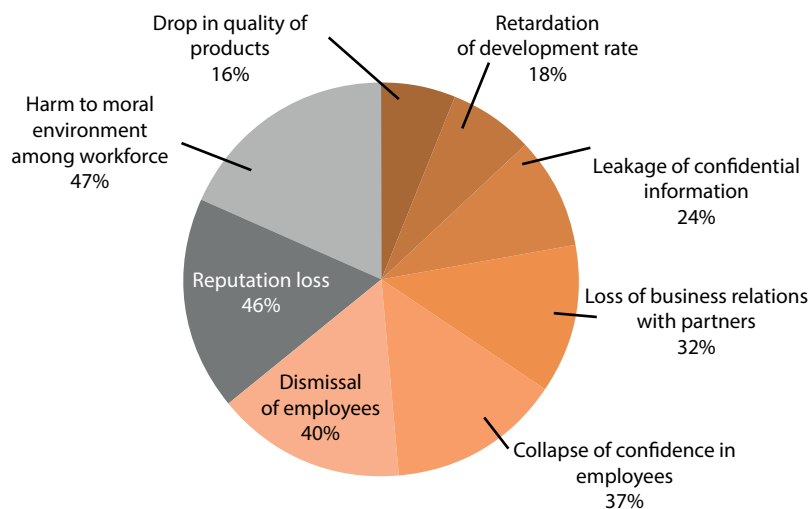
In this context, it is rather paradoxical that 60 per cent of respondents underestimate the significance of the problem of corporate corruption (see Chart 4).

According to the experts, it is due to the fact that corruption practices run extremely deep and stable in society and are perceived by the vast majority as long-standing and inevitable attribute of Russian reality.

During interview² of representatives of the companies, the experts determined business processes that are most sensitive with the view to risk of corporate fraud and extent of losses incurred. The prioritized list of such business processes is given below:

- implementing investment projects;
- capital construction;
- any procurement activities (services, works and goods);
- financial operations;
- sale of end products;
- logistics and transportations;
- cash transactions;
- charity.

Chart 8. Detecting corporate fraud



²This question was not included into the questionnaire of the Survey. Respondents interviewed total to 47.



Commercial bribery (kickback) constitutes the method of corporate fraud that is prevailing in the contemporary Russian reality (74 per cent of respondents) (Chart 9).

This phenomenon is now so large-scaled due to a range of reasons, such as image of “normal business practice”, adaptability in almost any business process, complicity of detecting, recording and proving the fact of crime, connivance of directorate, opportunities of “kickback practices” actually at any work level, from senior executives up to minor employees of sales, procurement and other departments.

Experts are particularly concerned about reduced attention of the businesses to confidential information leakages and cyber-crimes (12 per cent and 13 per cent correspondingly). Experts believe the named risks are crucially underestimated.

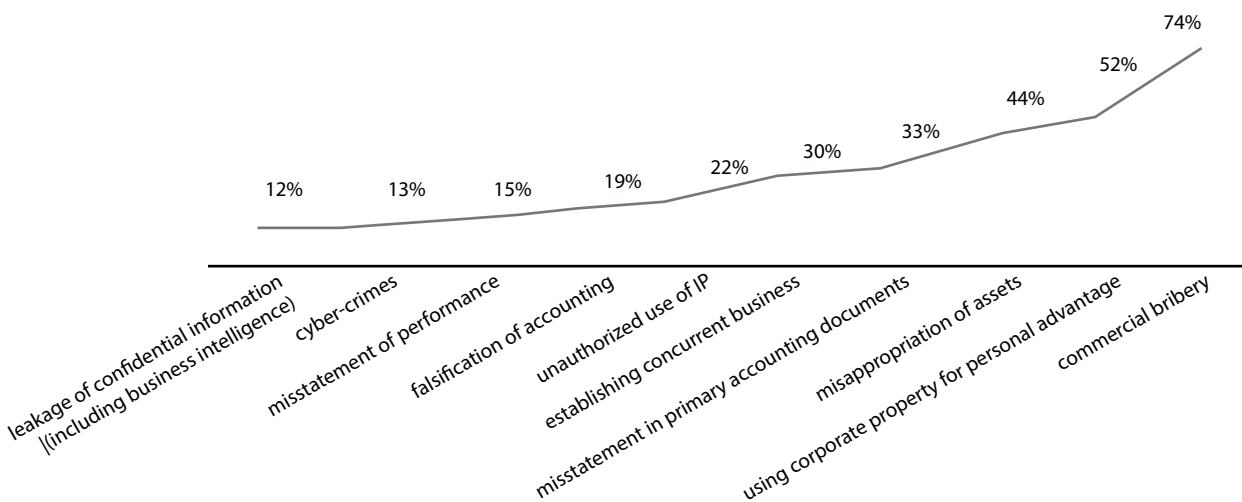
It is related to the fact that a lot of respondents do not focus on such intangible kind (information, IT), referring them to the authority of the relevant departments, such as IT, HR, legal department, economic security department and others. Additional latency factors are: complicity of recording the leakage and distribution

of the proprietary information, difficulties in proving cause and effect connection between information leakage and the damages incurred, total imperfection of computer security sphere, etc.

The results of the Survey predictably demonstrated that the largest losses and the most significant non-monetary adverse effect are caused by fraudulent acts committed by senior executives of the companies (Chart 10). The respondents pointed out that partners (!) and competitors are involved in criminal schemes, being contingent upon participation of these parties in “kickback schemes”, according to the expert opinion.

It should be noticed that mid-level and junior employees demonstrate the most wide-scale crimes, however the extent of abusive practices typical for these categories is rather insignificant.

Chart 9. Methods of corporate fraud



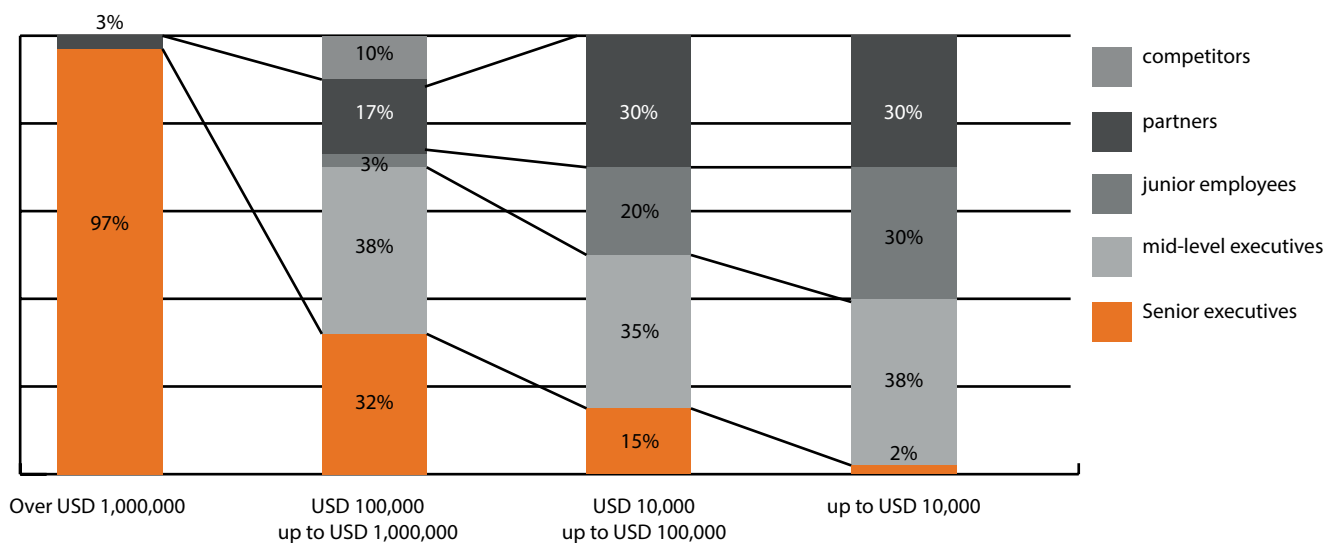
53 per cent of respondents stated that there are frequently several persons involved in committing corporate abusive acts. Average figures are as follows:

- senior executives – 2 persons;
- mid-level executives – 3 persons;
- junior employees – 8 persons.

During interviews, several participants of the Survey mentioned the following features common for “typical” corporate fraudsters³:

- top or mid-level executive;
- high degree of confidence on the part of directorate;
- high performance;
- working term in the company exceeding three years;
- higher education / degree.

Chart 10. Correlation between the extent of loss and corporate fraudsters



³This question was not included into the questionnaire of the Survey. Respondents interviewed total to 40.

3. FIGHTING CORPORATE FRAUD, LIABILITY, ASSET RECOVERY

Vast majority of companies use traditional institutes of control as the measures of fighting internal fraud. So, economic security department stands first on the list (75 per cent) followed by internal audit department (67.3 per cent), while background check upon entry into employment makes the top three (54.7 per cent) (Chart 11). Experts welcome the fact that a range of companies (first of all, large businesses) apply a package of proactive measures for fighting corporate crime.

However, only 23 per cent of respondents perform regular monitoring and estimate efficiency of measures of fighting corporate fraud, while 37 per cent do not exercise such audit at all (for more details see Chart 12).

Such statistics can be illustrative of formal approach of the business owners and corporate directorate to the implemented instruments of control. Moreover, purely implementing or conducting incidental measures of fighting corporate fraud is not sufficient. These mechanisms require constant attention on the part of senior executives and maintenance by the whole range of relevant corporate departments, such as HR, IT, legal department, internal audit, economic security department and others.

With regard to detecting facts of corporate fraud, it should be noted that the respondents deem contribution of the economic security department to be the most effective instrument in this sphere (35 per cent of respondents to this question). It is quite logical, having in mind traditional character of such corporate bodies and smaller popularity of other mechanisms (help line, compliance department, anti-corruption policies, processing control and monitoring, etc.). In 21 per cent of cases such facts come to notice occasionally (Chart 13).

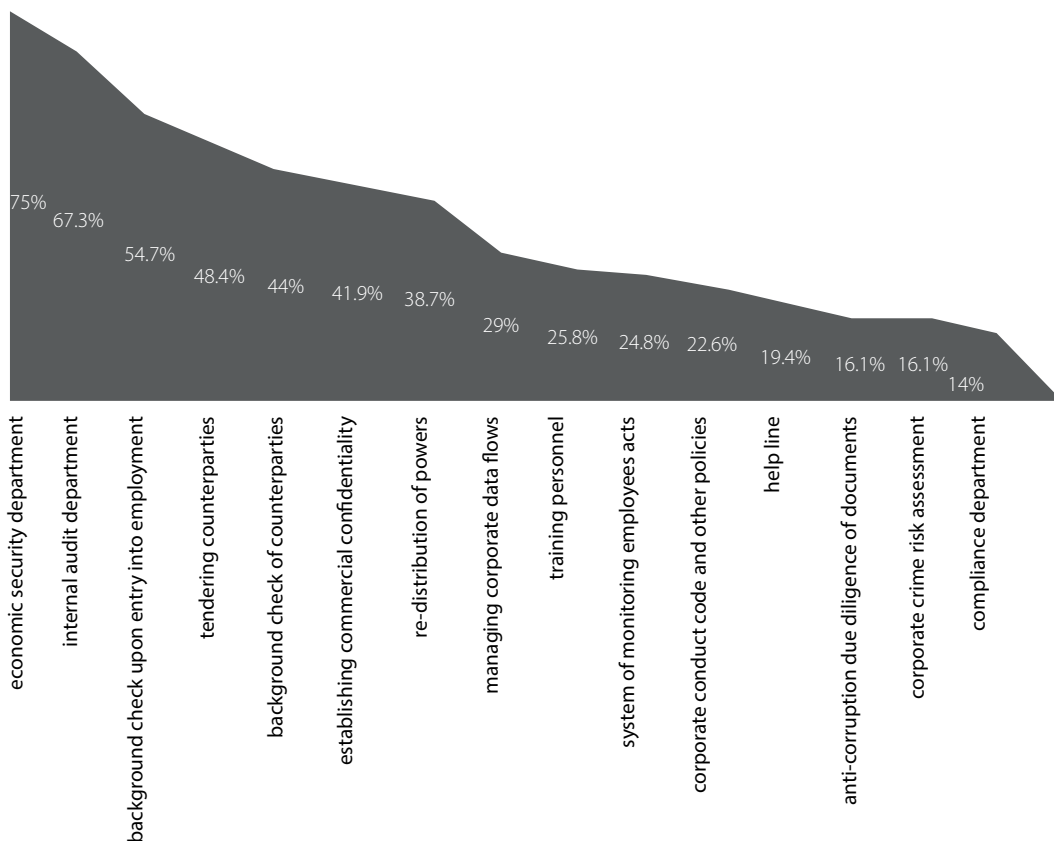


Chart 11. Measures of fighting corporate crime

Chart 12. Estimating efficiency of measures of fighting corporate crime

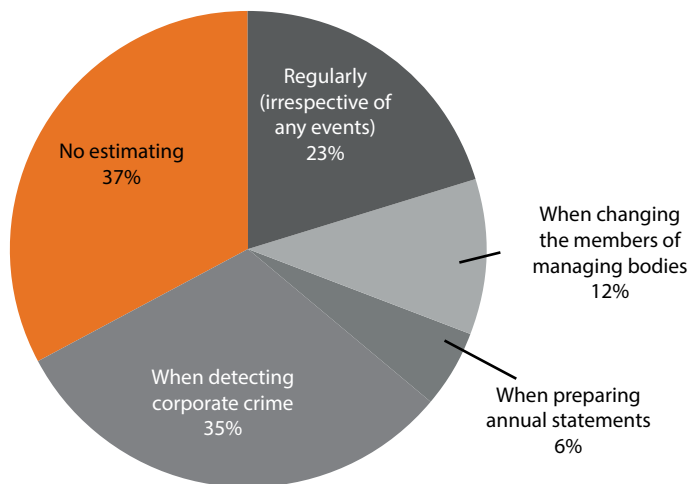
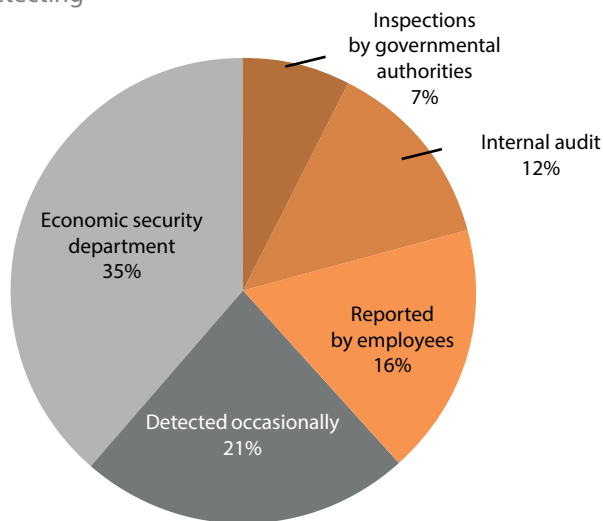


Chart 13. Methods of detecting



Special emphasis should be given to the fact that prevailing majority of companies (97 per cent) have no unified procedure for response of the corporate functional departments in case of detecting corporate fraud.

It means that every single time the company is operated in “manual mode”, which is proven by practice to reduce considerably the efficiency of further measures. The fact that over half of respondents (58 per cent) speak of the company’s readiness to disclose the fact of corporate fraud to public constitutes a positive trend.

Firstly, it is done for the purposes of forming adequate corporate culture antagonistic to internal abusive practices and preventing potential detriment to reputation. 19 per cent of the participants of the Survey having responded to this question mentioned that carrying out a “show trial” would be reasonable in order to prevent similar incidents in future. However, 42 per cent of respondents still believe that cases of corporate crimes should not be disclosed to public.

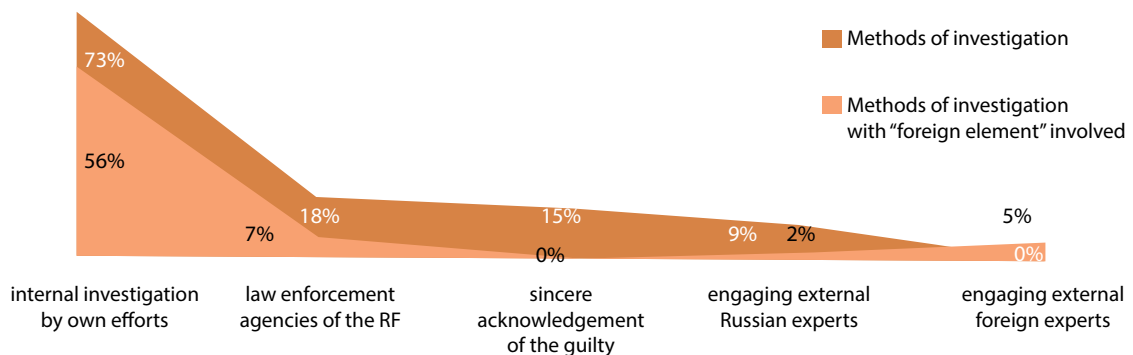
It is without doubt the choice of each specific company, which is frequently determined both by internal corporate culture and the nature of the crime detected. In the context of fighting internal fraud, such choice is important only with respect to preventing repeated crime.

Russian companies prefer to conduct investigation of detected facts of fraud by their own efforts (72 per cent of respondents to this question) (Chart 14).

This trend is quite expectable for the experts and is determined by a range of factors, including the obstacles faced by the business in course of investigating “commercial crime” (for more detail see below) and non-willingness to disclose facts to the public.

Moreover, the wish to “manage it on one’s own” is more common for small and medium-sized companies, which constituted the majority of participants to the Survey. Things are changing if there is any “foreign element”, for example, in case when one of the parties involved in the scheme is a foreign partner / competitor of the company or when the assets are being siphoned out in foreign jurisdictions. In this case, companies are more eager to engage external specialists in order to compensate for the lack of specific expertise.

Chart 14. Methods of investigation

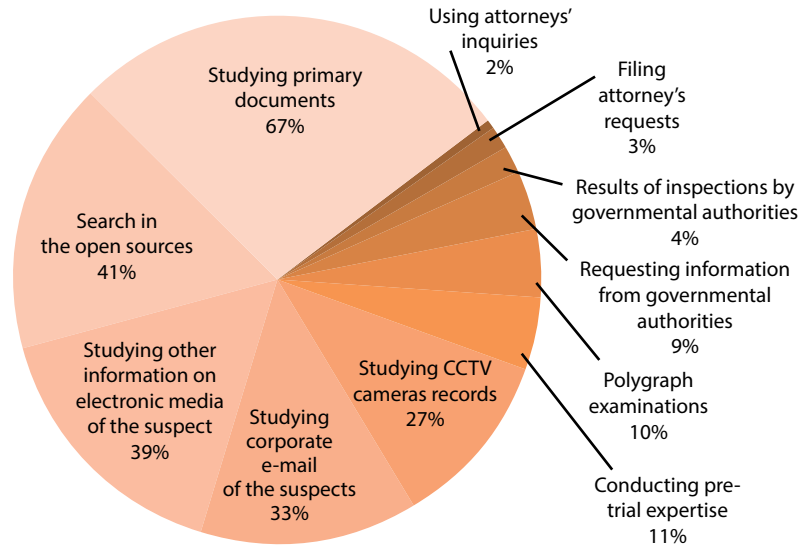


The matter of instruments used during investigation for collecting evidence (Chart 15) is of certain practical interest for the experts. Experts believe that at present internal corporate specialists are not effective enough in using some available methods of collecting and forming proper body of evidence, such as attorney’s inquiries, attorney’s investigations (the facts of which, by the way, are protected by client-attorney privilege), notarization of witness testimony, production of computer

expertise and others. These methods can increase considerably the efficiency of internal investigations and enable to obtain nearly completed body of evidence for further institution of criminal or administrative proceedings and/or bringing appropriate actions within civil proceedings against guilty persons.



Chart 15. Instruments of collecting evidence



It is noteworthy that only three respondents mentioned that they initiated attorney's investigations of the detected facts of corporate abuses. The participants specified the efficiency of the said methods with respect to protection of confidential information (client-attorney privilege), recording and legalization of evidence.

Participants to the Survey mention for good reason the difficulties they face during investigation of such crimes. The main ones are the following:

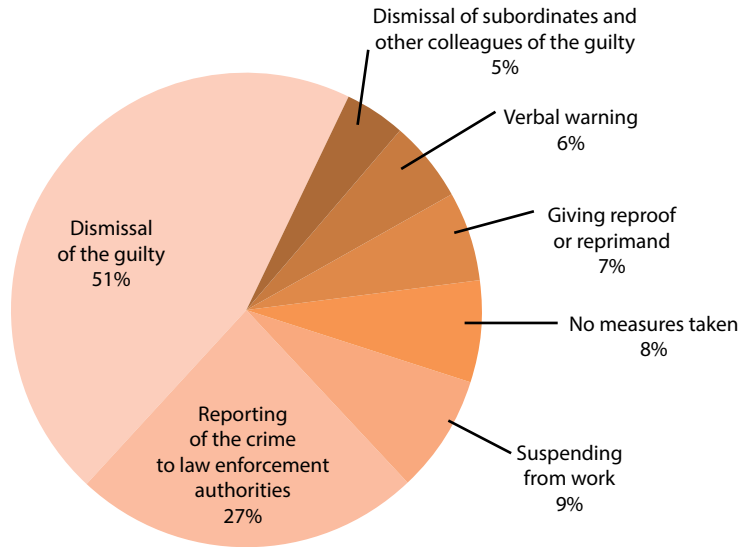
- impossibility to collect, record and/or legalize the evidence (45 per cent);
- inactivity of law enforcement authorities during investigation (41 per cent);
- dynamic counteraction by the suspects (38 per cent);
- unreasonable delays in considering the applications by law enforcement authorities (31 per cent);

- recriminatory internal suspicions with respect to being involved in the crime (30 per cent);
- unreasonable refusal to institute criminal proceedings (27 per cent);
- misclassification of the crime by the law enforcement authorities (19 per cent).

Dismissal is mostly often used as liability against guilty persons. Some respondents pointed out, that immediate surroundings of the guilty colleague are dismissed as well. Of course, such dismissals are exercised by agreement of the parties and upon payment of agreed compensation.

8 per cent of the respondents to this block of questions do not hold guilty persons liable at all, which, according to the experts opinion, constitutes a grave violation of core principles of fighting corporate fraud leading to material adverse effect with regard to creating and maintaining effective corporate culture, forming the sense of impunity and all-permissiveness among the personnel (Chart 16).

Chart 16. Liabilities



Below are a few words about the most popular measures of indemnification and efficiency of such measures.

Over 60 per cent use negotiations as the instrument. Just over half of respondents hold guilty persons financially liable, among them 39 per cent address to court with the corresponding lawsuits (Chart 17).

Our respondents specify that the measures taken are effective only to a certain degree, particularly, with regard to direct loss (44 per cent of the respondents to the relevant questions of the questionnaire) (Chart 18).

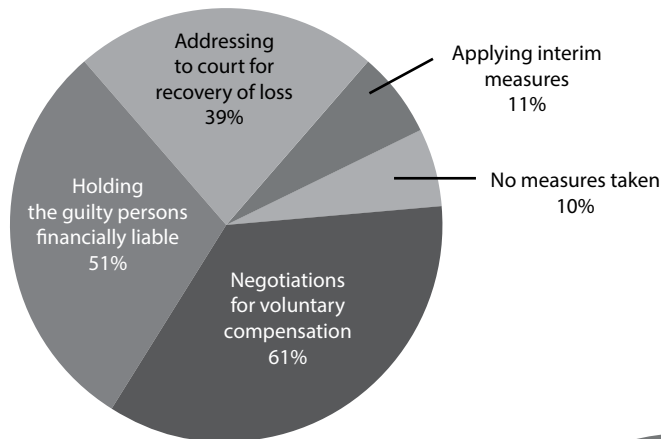


Chart 17. Measures of indemnification

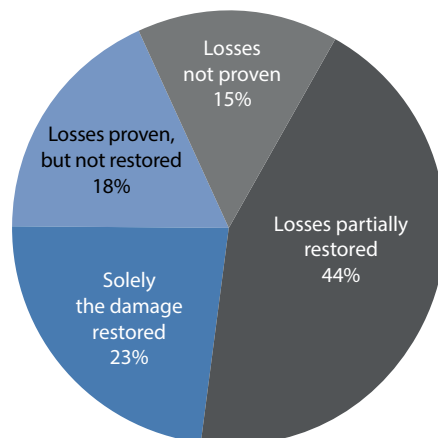


Chart 18. Efficiency of the measures of indemnification

Disserting upon the reasons for poor efficiency of the implemented measures of indemnification, the participants to the Survey mentioned a number of obstacles faced in reality, including the:

- evaluation of the losses inflicted (39 per cent);
- failure to locate the assets siphoned out (23 per cent);
- having no competent specialists in the proper area on the staff (28 per cent);
- failure to determine the scheme of stripping assets (11 per cent).

In course of research of the problem of misappropriated assets recovery, the experts should note that nearly half of respondents having faced fraud provided replies to this group of questions.

General trend appears to be negative:

assets recovery along with the issue of indemnification constitutes a “bottleneck” of the entire set of measures of fighting corporate fraud.

Share of successful cases is not too large and falls below 1/3. At that, most participants mention considerable expenses of the company (managerial, time, financial and other) aimed at recovery of impaired rights and interests of the business.

Speaking of the misappropriated assets that were successfully located, it should be noted that most of them remain within the borders of the Russian Federation, which is confirmed by 61 per cent of respondents to this question. First and foremost, it obviously refers to most physical assets (buildings/structures, equipment, goods, etc.).

According to the respondents, assets are being siphoned out into foreign jurisdictions in nearly 20 per cent of cases; however, we believe this figure to be substantially understated.

This is due to several factors, such as difficulty to determine the actual location of assets, excessive complicacy of contemporary fraudulent schemes, failure to record great number of facts of cyber-crimes and abuse in the sphere of confidential information leakage.

Several respondents name the following groups of persons to obtain, as a general rule, the title to the assets fraudulently converted:

- employees of the company, their relatives, friends or persons otherwise connected to them (over 50 per cent);
- Russian and foreign partners of the company;
- representatives of governmental authorities;
- Russian and foreign competitors of the company.

Being aware of risks and material complexity of the procedure for reparation of damages and recovery of assets, a few companies opt not to take any steps to that effect and stop half-way. The selection of key arguments for such tactics is given below (Chart 19).

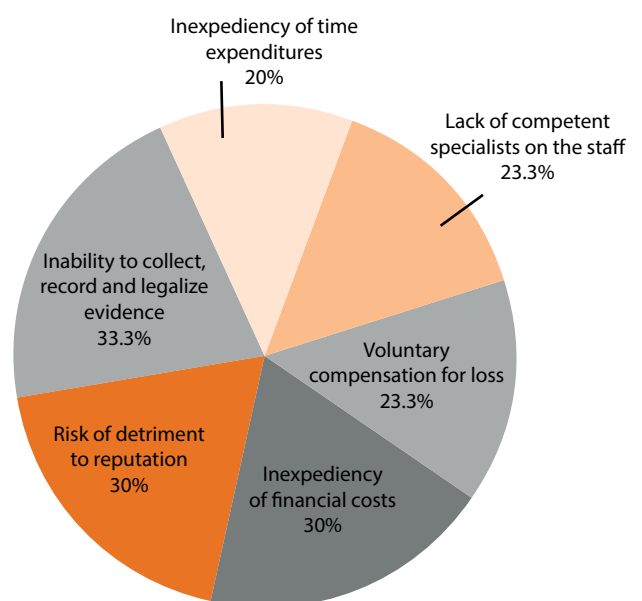


Chart 19. Reasons for waiving active measures of indemnification and assets recovery

The response of the participants to the question related to the measures taken by the company for minimizing potential reputation loss generated particular interest of the organizers of the Survey (Chart 20).

The respondents’ replies demonstrated both the measures having positive effect in future and the ones comprising the future risks in the context of preventing new facts of corporate fraud.

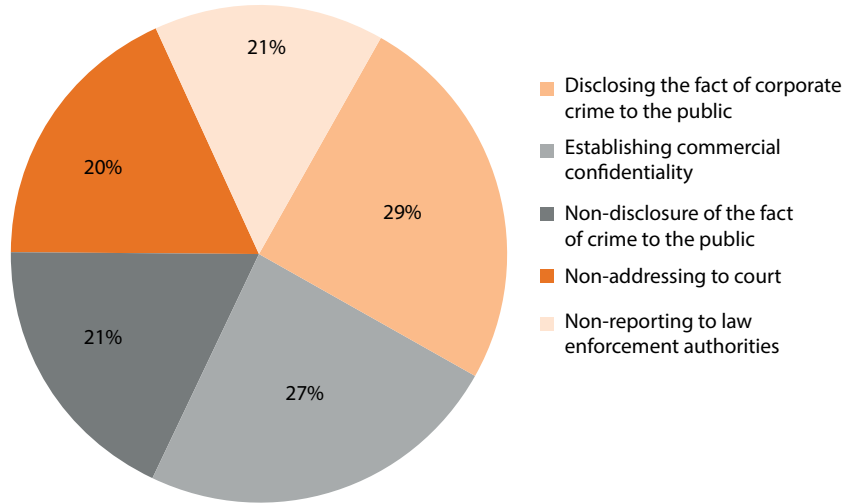


Chart 20. Minimization of risks of detriment to reputation

Further to detecting the incidents of corporate fraud, vast majority of the respondents tends to take the following measures to avoid (minimize) the cases of repeated wrongdoings:

- resolved upon introducing or upgrading the system of fighting corporate fraud (44 per cent);
- resolved upon conducting unscheduled checks/inspections (40 per cent);
- a corporate department established to fight corporate crime (21 per cent);
- a “show trial” initiated against the guilty persons (23 per cent).



SUGGESTIONS FOR IMPROVING LAWS

For the purposes of protecting key interests of the businesses, such as trade turnover sustainability and growth of capital, we believe that the trend of improving the Russian laws should meet the following basic criteria:

- (a) developing legal instruments for corporate fraud prevention;
- (b) implementing the international rules and standards for combating corporate fraud generally accepted by developed legal systems;
- (c) detailing the procedures and mechanisms of compensation for losses incurred by corporate fraud.

1. CIVIL LAW

(a) Absence in the Russian civil law of the rules ensuring real recovery of the assets lost due to corporate fraud often renders impossible the compensation for the losses, even though partial, while the fraudsters use the greater part of the asset stripping schemes.

(b) The law does not regulate by means of the special rules any consequences in civil law of commercial bribery⁴, including the issues of validity of the transactions made in effect of the bribery and responsibility of the parties involved.

In such cases it is possible to apply general rules of the Civil Code of the RF (articles 15, 168, 169, 179 and 1064)

if only they are interpreted broadly by the courts. In practical terms, it is not always efficient and besides raises additional difficulties in course of restoration of the rights of the companies affected.

Lack of the corresponding detailed provisions is a prerequisite for using courts in order to legalize obligations emerging as the result of commercial bribery along with the consequences of such obligations.

(c) It is reasonable, for the purposes of compliance of the Russian national law to the provisions of the Council of Europe Civil Law Convention on Corruption of 27 January 1999⁵ and other international rules, to consider the question of implementing the provisions that would contemplate the following:

1) concept of “piercing the corporate veil” in case of inflicting damages in effect of the corporate fraud;

2) the transaction by means of which the commercial bribery is committed being null and void⁶ (for instance, agency, consultancy or loan agreement, whereunder the commercial bribes are actually transferred);

⁴Article 204 of the Criminal Code of the RF “Bribery in a profit-making organization is the illegal transfer of money, securities, or any other assets to a person who discharges the managerial functions in a profit-making or any other organization, and likewise the unlawful rendering of property-related services to him for the commission of actions (inaction) in the interests of the giver, in connection with the official position held by this person”.

⁵For the Russian Federation the said Convention entered into force on 1 February 2007. Russia ratified the Convention by the Federal Law of 25.07.2006 # 125-FZ “On ratification of the Criminal Law Convention on Corruption”.

⁶See paragraph 1 article 8 of the Council of Europe Civil Law Convention on Corruption.

3) invalidating the transaction concluded in effect of the commercial bribery (or the particular provisions thereof like the price overcharged due to commercial bribery), specifically, upon demand of the companies on behalf of which such transactions were concluded⁷, or the right of the party to the contract, which was not aware that it was concluded under the influence of commercial bribery, to terminate such contract unilaterally;

4) consequences of invalidity of the transaction made in effect of the commercial bribery, including the following:

- opportunity to apply retroactively to restitution in case of performance of such contract, particular or complete;
- exclusion of unilateral restitution with respect for such transactions⁸;
- prohibition of restitution of commercial bribes.

5) full compensation for the losses inflicted due to commercial bribery (including the loss of profits) by the party that committed or authorized commercial bribery or failed to take adequate measures to prevent bribery⁹;

6) denial of relief for the person committed commercial bribery with respect to its rights under the contract concluded in effect of such bribery;

7) ability to compel to incorporate the anti-corruption reservation into the contract conclusion of which is obligatory for one of the parties thereto (article 445 of the Civil Code of the RF), as well as the right of the party obliged to conclude such contract to withdraw from conclusion of the deal due to lack of anti-corruption reservations, which should be exhaustively listed by the law;

8) recognition of the anti-corruption reservations established by law to be material conditions of governmental and municipal contracts¹⁰;

9) company having an internal system of preventing corporate fraud being recognized as a criterion for selecting participants in tenders for the right to conclude governmental and municipal contracts.

2. ANTI-MONOPOLY LAWS

It seems reasonable to refer corporate fraud to unfair competition practices¹¹ and empower anti-monopoly agencies to challenge the corresponding transactions.

3. LAWS FOR ADMINISTRATIVE OFFENCES

Article 19.28 of the Code of the RF on Administrative Offences, that allows for imposing multi-million liability on the company for corruption and commercial bribery, contains no criteria to define whether the person transferring the corruptive payment or bribes (corruptionist) was acting on behalf of the company, pursuing its interests or expressing its will.

Moreover, the corruptionist has a chance to avoid criminal liability if he reports the fact of commercial bribery or contributes to the investigation.

In its turn, the laws of the Russian Federation does not allow for excluding or mitigating the liability of the company, for instance, if it took efforts in order to prevent the act of commercial bribery / corruption. Therefore, it is presumed that the company is involved in the act of corruption, which creates the following adverse effect:

⁷See paragraph 2 article 8 of the Council of Europe Civil Law Convention on Corruption.

⁸Application of unilateral restitution is inadequate to the transactions aimed at inflicting harm upon third parties as well as in cases when the parties to the deal disposed of the estate that was not owned by them.

⁹Article 1 and paragraph 1 article 3 of the Council of Europe Civil Law Convention on Corruption.

¹⁰In compliance with clause (iii) section VI of the 1997 Recommendations of the Organization for Economic Co-operation and Development, supplementary to the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which Russia acceded to on 1 February 2012, the member states shall demand that the provisions on fighting corruption should be included into procurement contracts financed using the bilateral assistance funds.

¹¹Similar rule is contained in the Civil Code of Switzerland.

- (a) threat of intentional provocation of corruption / commercial bribery for the purposes of inflicting reputation and material damage on the company;
- (b) reduction of the businesses' motivation to reveal and investigate the facts of corporate fraud;
- (c) impairment of the rights of goodwill beneficiaries and employees of the company suffering unreasonably due to the corruptionist's acts.

In this context, it is reasonable to incorporate into the Code of the RF on Administrative Offences or other special laws the provisions regulating the following matters:

- (a) criteria for establishing the involvement of the companies in the acts of corruption;
- (b) differentiating the liability depending on the measures taken by the company in order to prevent, reveal and investigate the facts of corporate fraud¹²;
- (c) differentiating the liability of the company depending on the fact of extortion or solicitation.

4. CRIMINAL LAW

It is reasonable to criminalize the following acts:

- (a) promising or offering commercial bribes to any person exercising administrative functions in a commercial company¹³;
- (b) requesting commercial bribes by any person exercising administrative functions in a commercial company¹⁴;
- (c) commercial bribery committed by giving any material advantage (reducing rental charges, interest rate for using banking loans etc.); and
- (d) commercial bribery committed by giving non-material advantages (career progression, providing return service, supplying support in resolving any issue etc.).

Moreover, in order to improve the protection of the economic domain, it is recommended to create in the Russian criminal laws some special (establishing enhanced penal sanctions) events of such offences as fraud and inflicting property damage fraudulently or by abuse of trust, committed for the purposes of conversion of the company's assets or the powers of the corporate bodies.

Such qualifying element of commercial bribery as transfer of the payment in connection with the official position held by the payee should be excluded from the descriptive part of article 204 of the Criminal Code of the RF. It will allow to bring criminal action, for instance, with relation to bribing for providing insider information, collection, transfer and safekeeping of which is not referred to the corruptionist's direct authorities.

¹²Pursuant to clause (B) section V of the 1997 Recommendations of the Organization for Economic Co-operation and Development, the member states to the said Convention shall encourage elaboration and adopting of the appropriate corporate mechanisms of internal control, including the standards of behavior.

¹³Such liability is provided by article 7 of the Criminal Law Convention on Corruption (ETS No. 173) of 27 January 1999, ratified by the Russian Federation on 25 July 2006.

¹⁴Such liability is provided by article 8 of the Criminal Law Convention on Corruption (ETS No. 173) of 27 January 1999, ratified by the Russian Federation on 25 July 2006.

5. PROCEDURAL LAWS

For the purposes of improving work on detecting and investigating corporate fraud and recovery of lost assets, it is reasonable to incorporate into the Russian laws the rules that would provide the following:

- (a) empowering law enforcement authorities to conduct sting operations with respect to all elements of the cases of commercial bribery¹⁵;
- (b) ensuring security of persons having reported of the facts of corporate fraud and provided extensive assistance in the investigation¹⁶;
- (c) financial rewards for the persons helping to detect and suppress corporate fraud¹⁷;
- (d) recognizing the fact of initiating criminal proceedings with respect to corruption cases (inclusive of commercial bribery and others) to be a good and sufficient reason for applying interim relief measures upon

the lawsuit of the injured party in arbitration and civil litigation;

- (e) expanding in the laws on key attributes of the definitions of corruption offence and corruption crime¹⁸.

Special emphasis should be placed on reasonability of adopting at the regulatory level the unified recommendations, guidelines and standards for elaborating and implementing internal systems of fighting corporate fraud as well as incentives for businesses using such practices.

¹⁵It is allowed to conduct sting operation (transfer of bribes under control and detaining the offender red handed) solely for the purposes of detecting, preventing, suppressing and exposure of crimes of medium gravity, grave or grieves crime (part 3 article 8 of the Federal Law of 12 August 1995 No. 144-FZ “Concerning operational and investigative activities”). However, the main elements of commercial bribery do not fall under such category of crimes (articles 15 and 204 of the Civil Code of the RF).

¹⁶Introduction of such measures is provided by article 22 of the Criminal Law Convention on Corruption (ETS No. 173) of 27 January 1999, ratified by the Russian Federation on 25 July 2006. However, there is only general system of measures in Russia with regard to safety protection of the

parties to the criminal proceedings (see the Federal Law of 20 August 2004 No. 119-FZ “Concerning governmental protection of the victims, witnesses and other parties to the criminal proceedings”).

¹⁷For instance, there are such practices in China and USA.

¹⁸The law bill to make such amendments is currently pending in the State Duma of the RF (Law bill No. 371176-6 “On amending certain legislative acts of the Russian Federation with respect to improving anti-corruption measures”).

CONTACTS



MAXIM
GRIGORYEV

Head of the
Krasnodar Office

GRIGORYEV@VEGASLEX.RU



MIKHAIL
SAFAROV

Partner

SAFAROV@VEGASLEX.RU



KIRILL
TRUKHANOV

Head of Litigation Practice

TRUKHANOV@VEGASLEX.RU



ILYA
SHENGELIYA

Lawyer

SHENGELIYA@VEGASLEX.RU

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RECOMMENDATIONS & RECOGNITION:

- European Legal Experts 2013
- Best Lawyers 2012
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 - ▷ Restructuring and insolvency
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 - ▷ Project finance
- Chambers Europe 2013
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MOSCOW

Tel.: +7 (495) 933 0800
Fax: +7 (495) 933 0802
vegaslex@vegaslex.ru

VOLGOGRAD

Tel.: +7 (8442) 266 312/313/314/315
Fax: +7 (8442) 266 316
volgograd@vegaslex.ru

KRASNODAR

Tel.: +7 (861) 274 7408
Fax: +7 (861) 274 7409
krasnodar@vegaslex.ru