

## ***Sills Egsgard LLP Bulletin:***

# **Corporate Social Responsibility and Corruption: Fulfilling CSR goals without violating anti-corruption laws**

Corporate social responsibility (“CSR”) is increasingly important to successful business operations.<sup>1</sup> Yet CSR initiatives are often developed without attention to possible liability under anti-corruption laws. This bulletin addresses the changing approach to CSR, provides examples of CSR initiatives that both are and are not permissible under anti-corruption legislation, and suggests anti-corruption strategies for companies to use in the course of their CSR projects.

### **1. CSR: Times are Changing**

CSR once referred primarily to a company’s voluntary philanthropic projects, such as a donation to a local charity or the construction of a school. While these types of projects are still important, today the term CSR refers more broadly to a corporate responsibility to understand and address the various impacts a company’s operations may have on its stakeholders in the economic, social and environmental spheres, as well as their relationships in the workplace, the marketplace, the supply chain, the community and the public policy realm.

An example of this newer concept of CSR is set out in the widely endorsed *UN Guiding Principles on Business and Human Rights* (“Guiding Principles”). The Guiding Principles state that businesses have a responsibility to respect all internationally recognized human rights by avoiding infringement on the human rights of others, conducting due diligence to monitor rights impacts, and addressing adverse human rights impacts that may arise out of their operations.

### **2. CSR and Anti-Corruption Initiatives: What is the Relationship?**

CSR and anti-corruption initiatives are often approached differently both conceptually and within companies, yet they are linked. CSR considers the economic, social and environmental impacts of a company’s operations, and all of these spheres may be negatively affected by a company’s corrupt activities. Socially, corruption undermines the rule of law, the legitimacy of public office, and creates an obstacle to democracy. Economically, corruption depletes national wealth, leads to the misallocation of scarce resources, can hinder the development of fair market value structures, distort competition and deter investment. Environmentally, corruption can contribute to environmental degradation, the exploitation of natural resources, and insufficient regulation or enforcement to protect the environment.

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<sup>1</sup> For more information on this topic, please see our firm article, “The Risks Arising from Violation of CSR Norms: Litigation, Social License and Reputational Damage”, available online at: [http://www.lexmercantile.com/uploads/Final%20-%20Risks%20Arising%20from%20Violation%20of%20CSR%20Norms%20-%20%20%20Litigation%20Social%20Licence%20and%20Reputational%20Damage%20\(3\).pdf](http://www.lexmercantile.com/uploads/Final%20-%20Risks%20Arising%20from%20Violation%20of%20CSR%20Norms%20-%20%20%20Litigation%20Social%20Licence%20and%20Reputational%20Damage%20(3).pdf)

### **3. CSR: Presenting or Preventing Corruption Risk?**

Corruption risk varies depending on the CSR approach a company takes. Corruption risk ought to decrease when a company is using the newer concept of CSR embodied in the Guiding Principles. Best practices in anti-corruption compliance require policies, codes of conduct and due diligence processes to prevent and detect corruption, all of which are required by the Guiding Principles in respect of human rights. The steps required by the Guiding Principles can be integrated into a company's overall compliance processes, and can dovetail with existing anti-corruption policies, procedures and due diligence. This new "due diligence" approach to CSR, when followed, can provide additional feedback to help companies prevent, identify and remediate corruption.

In a project-based approach to CSR, companies need to remain vigilant about corruption. CSR projects are often designed to mitigate challenges in getting businesses up and running, particularly in developing countries. Not only must a number of approvals must be obtained from foreign officials in the regulatory area, but it is also often necessary to obtain more informal community approval or "social license" from affected local peoples for proposed projects. As a result, companies, particularly in the extractive sector, engage in activities such as investing in local infrastructure (improvement of roads, building of hospitals and schools, improvement of water systems), provision of training and support for local projects, charities and initiatives. Similarly, companies in the retail sector are encouraged to contribute to occupational health and safety initiatives in manufacturing countries, and pharmaceutical companies often donate projects or services to contribute to community health. Involvement in these initiatives is often beneficial to local groups, and practically essential in order to establish a business. Without precautions, however, these projects may expose a company to significant corruption risk, as illustrated in some of the cases described below.

### **4. CSR & Corruption: A look at some examples**

Authorities have considered CSR initiatives in the context of corruption in several publicized instances.

#### **a. Blackfire Exploration**

Blackfire Exploration Ltd. is a Calgary-based, privately owned junior company with operations in the southern Mexican state of Chiapas. In July 2011, the RCMP executed a search warrant at Blackfire's Calgary offices, alleging Blackfire paid \$20,000 into a local mayor's personal bank account to "keep the peace and prevent local members of the community from taking up arms against the mine." According to the RCMP, when the mayor's requests became more exorbitant and sleazy, including demands for airline tickets and prostitution, the company complained to the Mexican government that they were being subject to extortion.

Blackfire, in a 2011 statement, stated that it never knowingly paid bribes to anyone, and that it was under the impression that the money transferred to the mayor was for the benefit of the citizens of the local small town, destined for its fair and other public works. Blackfire said that when it learned the funds were possibly being used for other purposes it took immediate steps to stop the payments. The mayor subsequently stopped supporting the mine, and protestors took over the site. Ultimately three men, including a Blackfire employee, were arrested for the shooting death of a local anti-mining activist.

While charges have not been laid in the Blackfire case, it provides a Canadian example of the need for controls to be in place when making payments relating to CSR. In this instance Blackfire stated it believed the money paid to the mayor was to benefit the local community. However, there were apparently no systems in place to track how the funds were actually spent after being directed to the mayor. The company was therefore exposed to liability for bribery. The company also apparently failed to obtain “social license” from that spending, as it appears that the money benefitted only the corrupt mayor and was not effective in addressing any local community concerns.

#### **b. FCPA settlements relating to CSR payments**

Given the more aggressive enforcement of the U.S. *Foreign Corrupt Practices Act* (“FCPA”), CSR-related corrupt payments have more often been considered in the United States. The principles from those cases are nevertheless relevant to the Canadian context, given the similar bribery prohibition under the Canadian *Corruption of Foreign Public Officials Act* (“CFPOA”).<sup>2</sup>

In the U.S. there have been at least two FCPA settlements relating to CSR initiatives. The SEC alleged that in between 1999-2002, Schering-Plough paid \$76,000 to a castle restoration charity to influence the purchase of Schering-Plough’s products in Poland. The head and founder of the charity was a Polish official who had the authority to approve the purchase of the products. The charity was *bona fide*, and there was no allegation that the contributions were personally taken by the official. The U.S. regulators nevertheless viewed the contributions as payments made in exchange for assistance, noting that the foreign official had a special interest in the success of the Polish castle restoration charity. The regulators also found it significant that nearly all of Schering-Plough’s donation budget was used by the donations, the donations were structured to allow the Schering-Plough subsidiary to exceed its authorized limits for donations, no other recipient received multiple donations from the company, and that the donations were not accurately reflected in the company’s books and records. Schering-Plough was charged with violations of internal controls and books and records provisions of the FCPA and ultimately paid a \$500,000 penalty.<sup>3</sup> The regulators obviously took a broad view of what constitutes a “benefit” to a public official. Companies need to carefully consider who will benefit from their CSR projects, in order to avoid liability.

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<sup>2</sup> Both the CFPOA and the FCPA are based on the requirements of the OECD Convention on Combatting Bribery of Foreign Public Officials. The CFPOA provides, “**3.** (1) Every 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 or to any person for the benefit of a foreign public official (a) as consideration for an act or omission by the official in connection with the performance of the official’s duties or functions; or (b) to induce the official to use his or her position to influence any acts or decisions of the foreign state or public international organization for which the official performs duties or functions.” Similarly, the FCPA prohibits an “offer, gift, promise to give, or authorization of the giving of anything of value” to, among others, any foreign official, any foreign political party or any candidate for foreign political office for the purpose of influencing that person or entity into using their influence to secure improper advantage. *Foreign Corrupt Practices Act*, 15 U.S.C., effective December 19, 1977, ss 78dd-1, 78dd-2 and 78dd-3.

<sup>3</sup> Litigation Release No. 18740, SEC v. Schering-Plough Corp., No. 04-0945, June 9, 2004. Similarly, in 2012, the SEC charged Eli Lilly for \$39,000 in contributions to the same charity, making similar allegations to those made against Schering-Plough: Litigation Release No. 22576, SEC v. Eli Lilly and Co., No. 1:12-cv-02045, Dec. 20, 2012, available at <http://www.sec.gov/litigation/litreleases/2012/lr22576.htm>

**c. US Department of Justice review of CSR initiatives**

Several U.S. FCPA Opinion Procedure Releases<sup>4</sup> have dealt with instances where proposed CSR initiatives were considered in the context of corruption, providing guidance on how CSR initiatives might be structured in order to avoid corruption liability.

**i. Opinion Release 95-01**

In 1995, a U.S. company proposed to make a \$10 million contribution for construction of a medical facility in South Asia, to be made through a charitable organization made in the U.S., and to be passed afterward to a public company in the host country. The U.S. DOJ indicated that it would not take enforcement action in relation to the donation based on the following:

- All officers of the U.S. charity and foreign public company would be required to sign certifications confirming the funds would not be used in violation of the FCPA;
- The company represented that no individuals affiliated with the charity and recipient company would be affiliated with the foreign government; and
- The company indicated it would require audited financial reports from the U.S. charitable organization, accurately showing how the funds were used.<sup>5</sup>

**ii. Opinion Release 97-12**

In this case, a U.S.-based utility company proposed to donate \$100,000 toward the construction of a school in an Asian country. The donation was to be made directly to the government entity responsible for the construction and supply of the school. The company stated that:

- It would require written certification from the government that the funds would be used only for the school construction; and
- The government would agree to conditions to ensure the school would be built, staffed and appropriately used.

The DOJ approved the donation, based on the fact that the contribution was to be made directly to a government entity, and not to a foreign government official, and that thus the FCPA provisions did not seem to apply.<sup>6</sup>

**iii. Opinion Release 06-01**

In 2006, a U.S. company proposed to donate \$25,000 to a fund to incentivize customs officials to vigorously enforce anti-counterfeit laws in an African country. It was proposed that the reward be distributed by that country's government with the following safeguards in place:

- Funds were to be paid by electronic transfer to a government bank account;
- Written confirmation was to be obtained from the African state that the funds were received in the

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<sup>4</sup> Under the opinion procedure process, parties submit information to the U.S. Department of Justice ("DOJ"), after which the DOJ issues an opinion about whether the proposed conduct falls within its enforcement policy. The opinions are available online.

<sup>5</sup> Foreign Corrupt Practices Act Review, No. 95-01 (Dep't of Justice Jan 11, 1995)

<sup>6</sup> Foreign Corrupt Practices Act Review, No. 97-02 (Dep't of Justice, Nov. 5, 1997).

account;

- The U.S. company would not take part in choosing agents to receive the financial reward, but would use predetermined criteria to ensure the funds were used for the designated purpose and given only to eligible agents;
- The U.S. company would monitor the incentive program; and
- The African government would keep records relating to the funds for 5 years and would allow the U.S. company to access those records.

The DOJ allowed the proposed donation.<sup>7</sup>

#### **iv. Opinion Release 09-01**

In this case, a U.S. company sought to donate \$1.9 million worth of medical devices to the government of a foreign country. A foreign official asked the requesting company to donate sample devices because the government was not familiar with the devices. The U.S. company had controls in place to ensure the donated devices would be provided to eligible candidates via a predetermined, subsidized medical device program.

The DOJ allowed the donation in part due to the controls, and noted that there was no reason to believe that a foreign official personally would benefit from the donation. The DOJ also noticed that the donated products were to be given to the foreign government, not to specific foreign officials, therefore falling outside the scope of the FCPA.<sup>8</sup>

#### **v. Opinion Release 10-02**

In 2010, a U.S. based non-profit sought to grant \$1.42 million to a local microfinance institution in a Eurasian country. Local authorities required the grant as part of the non-profit's attempt to reorganize its local subsidiary into a local financial institution. The recipient microfinance institution was to be chosen from a short list of institutions provided by local regulators. The U.S. non-profit determined after due diligence that only one of the short-listed institutions appeared qualified to receive the funds, however a foreign official sat on the Board of that institution.

The DOJ endorsed the proposal, citing a number of onerous controls that the U.S. non-profit had put in place to ensure the granted funds were appropriately received and used, including:

- Retaining an independent monitor to audit the donated funds on an ongoing basis;
- The recipient was to institute an anti-corruption compliance program; and
- Staggered payment of grant funds

Local law also prohibited compensation of board members who were government officials. The DOJ concluded that based on prior due diligence and these controls, it would be unlikely that the payment would result in the corrupt giving of anything of value to public officials.

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<sup>7</sup> Foreign Corrupt Practices Act Review, No. 06-01 (Dep't of Justice, Oct. 16, 2006).

<sup>8</sup> Foreign Corrupt Practices Act Review, No. 09-01 (Dep't of Justice Aug. 3, 2009)

The cases discussed above provide some guidance in terms of the types of controls that a company ought to consider to protect against corruption when implementing CSR initiatives.

#### **5. What controls can be implemented to avoid corruption in the CSR context?**

To make sure that CSR projects remain corruption-free, due diligence and controls are essential. In addition to other anti-corruption compliance measures, these may include the following steps:

- Prepare internal guidelines on CSR spending, and ensure compliance with them so that CSR-related payments are not viewed as reactive or designed to influence specific official action;
- Ensure that CSR spending is never exchanged for official action or inaction;
- Exercise great caution if the payment is being made at the request of a foreign official. Consider:
  - is the foreign official associated with the recipient/beneficiary?
  - can the foreign official influence decisions regarding your business in that country?
- Undertake and document due diligence on the recipient to confirm:
  - That the recipient is a *bona fide* organization or charity;
  - That no individuals involved with the recipient are foreign officials or have a close connection to foreign officials;
  - If they are, ensure those individuals have no influence over decisions regarding your business in that country.
- Obtain a written agreement from the recipient:
  - Restricting the use of funds for agreed-upon stated purposes;
  - Requiring that the recipient provide audited financial statements throughout the term of the project;
  - Requiring certifications from the recipient regarding their compliance with anti-corruption laws and implementation of anti-corruption compliance measures;
  - Allowing for on-going monitoring and auditing of the recipient's use of funds and effectiveness of the project/program if appropriate;
  - Prohibiting compensation certain individuals.
- Arrange phased payments to the recipient contingent on meeting audited targets, or confirmation that recipient commitments are met before disbursement of funds.
- Ensure the CSR spending is performed transparently and properly booked in company records.

Our firm would be pleased to assist your company in developing your CSR and anti-corruption compliance strategies.

*Mark N. Sills*  
[msills@lexmercantile.com](mailto:msills@lexmercantile.com)

*Jennifer L. Egsgard*  
[jegsgard@lexmercantile.com](mailto:jegsgard@lexmercantile.com)

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