MANAGING FCPA ISSUES IN AN INTERNATIONAL ERA: TRENDS, CHALLENGES AND IMPLICATIONS ARISING FROM GLOBAL ANTICORRUPTION ENFORCEMENT ACTIONS

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INTRODUCTION

The past several years have witnessed an explosion of Foreign Corrupt Practices Act ("FCPA") enforcement actions brought by the Department of Justice ("DOJ") and the Securities and Exchange Commission ("SEC"). This trend is continuing unabated as aggressive U.S. enforcement is coupled with enhanced international cooperation arising from heightened international anti-bribery standards and active parallel investigations in foreign jurisdictions.[3] As a result, U.S. companies doing business abroad now face the greatest level of government resources to combat bribery since the passage of the FCPA more than 30 years ago.

Among the formidable challenges facing U.S. companies doing business abroad is determining whether their business operations have properly addressed corruption risks. The question is no longer whether, but how, a U.S. company, in the form of subsidiaries, branch offices or third party distributors, manages the FCPA risks engendered by its business operations.

Increased FCPA enforcement has significant consequences for U.S. companies and their officers and directors. A substantial percentage of recent deferred prosecution agreements ("DPA") involves violations of the FCPA. Many of these DPAs have resulted in the use of an independent monitor with wide latitude to review business operations and report its findings to the government.[4] The rise in FCPA cases have also resulted in unprecedented corporate fines,[5] and increased prosecution of individual corporate executives with attendant terms of imprisonment.[6]

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[3] The global investigations involving Siemens AG and Azko Nobel are illustrative. In December, 2008, Siemens, a German company, and three of its subsidiaries plead guilty to FCPA violations brought by DOJ and SEC. See DOJ News Release, No. 08-1105 and SEC Litigation Release, No. 20829 (December 15, 2008). In its press release, DOJ acknowledged the assistance of the Munich Public Prosecutor's Office, which also brought charges involving corrupt payments to foreign officials against Siemens. Id. As a result, the Siemens case is the first ever simultaneous resolution of domestic and foreign anticorruption charges. In settling its FCPA enforcement action against Azko Nobel, the government acknowledged the cooperation from the Dutch Public Prosecutor and even gave credit for fines to be paid by Azko Nobel to the Dutch authorities in a separate settlement agreement. See DOJ News Release, No. 07-1024 (December 20, 2007).

[4] For example, as part of settlement agreements with the SEC and DOJ, the following companies have all agreed to the appointment of monitors or consultants to companies to ensure FCPA compliance,: Siemens, Halliburton/KBR, AG, Ingersoll-Rand, York International, Paradigm BV, Baker Hughes, Vetco International, Schnitzer Steel, Statoil, ABB, Diagnostic Products Corporation, DPC (Tianjin) Ltd., InVision, Micrus, Monsanto, and Titan.

[5] Siemens agreed to pay $800 million in combined civil and criminal penalties to settle its case with the government. On February 11, 2008, Halliburton/KBR agreed to pay $579 million in combined criminal and civil penalties to settle its case with the government. In 2007, three subsidiaries of Vetco International agreed to pay $26 million, while Chevron agreed to pay $27 million to various enforcement bodies, in addition to a $3 million civil penalty.

[6]The recent increase in charges brought against individuals has generally followed settlements with cooperative corporations. The disclosures to the government which are attendant a corporation's cooperation make it far easier for the government to prepare a case against a corporate executive. Thus, Syncor and its subsidiary settled FCPA charges with the government in 2002 while the government thereafter filed charges against Syncor's former chairman, Monty Fu (see SEC v. Fu, No. 1:07-cv-01735 (D.D.C. Sept. 28, 2007)). In addition, on October 16, 2006, Schnitzer Steel agreed to a DPA with the government which thereafter filed charges against the former chairman and CEO of Schnitzer Steel (see SEC v. Philip, no. 07-cv-1836 (D. Ore. Dec 13, 2007). On September 24, 2008, an Alcatel executive, Christian Sapsizian, was sentenced to 30 months in jail in prison after pleading

The purpose of this overview is to identify key provisions of the FCPA and specific strategies to manage the FCPA risks associated with recent FCPA enforcement trends.

THE FCPA'S ANTIBRIBERY PROVISIONS

The FCPA criminalizes the bribery of a foreign official to secure business. In particular, the FCPA prohibits the payment, offer or authorization of payment of money or anything of value to a foreign official for purposes of influencing any act or decision or securing an improper advantage to obtain or retain business. See 15 U.S.C. § § 78dd-1 to -3.

The FCPA's antibribery provisions apply to: (1) "issuers" (any company, and its agents, with a class of securities registered with the SEC or required to file reports with the SEC) (2) "domestic concerns" (any company, and its agents, with a principal place of business in the U.S. or organized under U.S. law and any other U.S. citizen or resident alien); and (3) "other persons" (foreign persons acting within U.S. territory).

Business leaders surely recognize that the FCPA prohibits the suitcase of cash going to a foreign ministry official to secure a government contract. Yet, it may surprise many business executives to learn that the FCPA more broadly applies to an almost limitless, far less culpable, set of circumstances involving administrative and regulatory matters. To protect against FCPA liability, business leaders should have a firm understanding of the recent enforcement trends involving the following elements of the FCPA: "foreign official," "anything of value," and "obtain or retain business" and "any acts within the territory of the United States."

Foreign Official

Under the FCPA, a foreign official does not have to be an elected official or even someone appointed to a government ministry or agency. Individuals can be deemed "foreign officials" even though they are not considered foreign officials under local law.

The FCPA's definition of a public official is very broad. It includes "any officer or employee of a foreign government or any department agency, or instrumentality thereof . . . or any person acting in an official capacity for or on behalf of any such government or department, agency or instrumentality . . . ." 15 U.S.C. § § 78dd-1(f)(1) et seq. In other words, a person may also qualify as a public official by virtue of his employment with an "instrumentality' of government – a term which is neither defined by the FCPA itself or its legislative history. Once a foreign company is deemed an instrumentality of a foreign government, every employee of that company is a "foreign official" under the FCPA.

As a general matter, businesses must audit their internal operations for any interaction with the host governments and/or state-owned or state-controlled enterprises ("SOE"). An entity may become an "instrumentality" when the government holds the majority of the enterprise's subscribed capital, controls the majority of votes attaching to shares issued by the enterprise or can appoint a majority of the members of the enterprise's administrative or managerial body or supervisory board. An entity may also be deemed a state instrumentality if that entity performs a

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guilty to an FCPA violation arising out of 2.5 million in payments made to a Costa Rican official in order to obtain telecommunication contracts.

"public function." A public function may be inferred from preferential subsidies or other privileges which show that the entity is not functioning on a normal commercial basis.

Dangers involving work with SOE employees particularly exists for pharmaceutical and medical device companies who make payments to doctors employed by state-owned hospitals. In June 2008, after voluntarily disclosing and cooperating with government investigators, AGA entered into a 3-year deferred prosecution agreement with the DOJ and agreed to pay a $2 million criminal penalty in connection with improper payments made by AGA's Chinese distributor to physicians employed by Chinese government owned or controlled hospitals. See DOJ News Release, No. 08-491 (June 3, 2008). Diagnostic Products Corporation agreed to settle an FCPA enforcement action in connection with improper payments to physicians and laboratory personnel employed by government-owned hospitals in China. See DOJ News Release, No. 05-282 (May 20, 2005) and SEC Litigation Release No. 51724 (May 20, 2005). In another case, the SEC filed a settled civil injunctive action against Monty Fu, the founder and past chairman of Syncor International Corporation, in connection with improper payments made to doctors in state-owned hospitals in Taiwan. See SEC Litigation Release No. 20310 (September 28, 2007). As these cases illustrate, any company doing business in China must determine whether it is doing business with an SOE. See United States v. SSI International Far East Ltd., No. 3:06-cr-00398 (D Ore. 2006) (defendant company enters into DPA with DOJ for payments made to managers of government-owned steel mill in China).

A similar issue can arise where a company conducts business with someone who has both private and public duties. In that case, the company should:

- document that its contractual relationship with the individual is based on that individual's private capacity;
- confirm that there is a bona fide need for the services being provided;
- confirm that any payment under the contract is commensurate with fair market value; and
- document that the services were in fact provided.

Given the broad definition of "foreign official," every company should inquire whether its business partners are employed by an SOE or otherwise perform any public duties for a foreign country.

Anything of Value

FCPA liability does not simply require a suitcase filled with cash. While undefined by the FCPA and its legislative history, "anything of value" has been broadly construed to include political contributions, entertainment, travel, meals and lodging. It even includes intangible benefits, such as the enhanced prestige associated with a charitable contribution.

What qualifies as "anything of value" is malleable. FCPA liability is not triggered by some objective, threshold amount received by the foreign official. What determines whether "anything of value" has been offered or conferred is the personal valuation of the receiving official. For example, an ostensibly routine business trip to the United States to visit a factory may become

the trip of a lifetime to the foreign official if Las Vegas and Disneyworld are also on the itinerary.

The outer reaches of "anything of value" are highlighted in an enforcement action involving a charitable donation. In the Matter of Schering-Plough Corp., File No. 3-11517 (June 9, 2004), the U.S. government took the position that a donation to a bona fide charitable organization established to restore castles and other historic sites violated the FCPA. In that case, a Polish subsidiary made payments to a foundation whose founder became director of a government health fund. The donations constituted a thing of value to the official because they were subjectively valued by the official and provided him an intangible benefit of enhanced prestige. The Schering-Plough case shows that even payments to bona fide charities that do not pass directly or indirectly to a government official may violate the FCPA.

More routine expenses, like travel and lodging expenditures, may also violate the FCPA. In December 21, 2007, the SEC and DOJ filed and settled charges against Lucent Technologies, Inc, which spent over $10 million in travel, lodging, entertainment and related expenses for approximately 1,000 employees of a Chinese SOE from which Lucent was seeking business. See DOJ News Release, No. 07-1028 and SEC Litigation Release, No. 20414 (December 21, 2007). The trips were primarily for sight-seeing and leisure rather than business purposes and resulted in expenses being recorded as "factory inspections" in locations where no factory existed. Id.

The FCPA contains an affirmative defense for expenditures relating to the "promotion, demonstration, or explanation of products or services" or the "execution or performance of a contract." 15 U.S.C. § § 78dd-1(c)(2). However, a company must show that the expenses are "reasonable" and "bona fide" and "directly related" to a business purpose.

The Schering-Plough and Lucent cases alert business leaders to the fact that FCPA enforcement will subject a wide variety of business practices to review. To avail itself of an affirmative defense with respect to business expenditures, companies must ensure some control over the expenditure of funds to ensure that they relate to a legitimate business purpose.

Obtain or Retain Business

A common misperception of the FCPA is that improper payments must relate to securing government contracts. In fact, the FCPA is more broadly focused on payments that result in an improper advantage over competitors, regardless of whether a government contract is, in fact, in play. As a result, business leaders must know the administrative and regulatory practices of the foreign countries in which they do business.

United States v. Kay, 359 D.3d 738 (5th Cir. 2004) was the seminal decision which clarified the breadth of the FCPA's obtain or retain element. In Kay, the Court held that payments to lower corporate taxes and custom duties could violate the FCPA. In other words, the FCPA is not limited to securing government contracts.

Since the Kay decision, there have been several FCPA enforcement matters involving improper payments to obtain various foreign government licenses, permits and certifications. In July 2007, for example, Delta & Pine Land Company agreed to settle an FCPA enforcement action

for making approximately $43,000 in improper payments between 2001-2006 to officials of the Turkish Ministry of Agricultural and Rural Affairs in order to obtain various governmental reports and certifications needed to conduct its business in Turkey. See SEC Litigation Release No. 20214 (July 26, 2007). In February 2007, the Dow Chemical Company agreed to settle FCPA charges that it made approximately $200,000 in improper payments and gifts to officials in India who had discretionary authority in registering and inspecting company product for sale in India. See SEC Litigation Release No. 20000 (Feb. 13, 2007). In January 2005, Monsanto Company settled an FCPA enforcement action for its payment to a foreign environmental official in an effort to repeal certain environmental regulations. See SEC Litigation Release No. 50978 (Jan. 6, 2005).

Business executives must be aware of the FCPA risks associated with routine business activities such as exporting products into a foreign market. The following is a list of relevant questions:

- Does local law require the license, permit or certification?
- Is the company relying on a third party to obtain the various licenses, permits or certifications? If so, has there been due diligence to ensure compliance by that third party with the FCPA?
- Who is interacting with the foreign official to obtain the license, permit or certification? Are there any unusual reimbursement requests by that employee?
- Is the payment being made to the licensing agency or to the individual official? Is there an invoice and supporting documentation from the licensing agency?

Any Acts within the Territory of the United States

In 1998, several amendments empowered the Foreign Corrupt Practices Act to assert jurisdiction over foreign businesses and nationals. As a result, a foreign business or individual is subject to the Foreign Corrupt Practices Act if they cause, directly or through another, an act to further the corrupt payment to take place inside of the U. S.

Recently, the government has aggressively pursued FCPA liability against foreign persons and entities for their incidental use of U.S. bank accounts involving prohibited payments. In the Siemens and Halliburton/KBR cases, for example, the government charged foreign subsidiaries with FCPA violations based, in part, on U.S. dollar-based wire transfers between foreign bank accounts which cleared through correspondent accounts in the United States. The government made similar jurisdictional claims in a forfeiture action relating to Singapore funds associated with the Siemens case. See DOJ News Release, No. 09-020 (January 9, 2009).

The jurisdictional claims in the Siemens and Halliburton/KBR cases reflect an expansive interpretation of the territorial nexus required to prosecute non-U.S. persons under the FCPA. In particular, notwithstanding the absence of more traditional jurisdictional facts, including U.S.-based telephone calls, meetings or money transfers, the government may claim jurisdiction to prosecute foreign nationals or entities for FCPA liability based on a far more fleeting connection to U.S. territory.

IMPROPER PAYMENTS BY THIRD PARTIES

Another area of aggressive FCPA enforcement concerns improper payments by third parties. Business leaders can not shield their companies and themselves from FCPA liability by relying on foreign subsidiaries, agents and business partners. The FCPA has a very broad third party payment provision, which includes the making or authorization of improper payments indirectly through third parties while "knowing" that all or a portion of such money or thing of value will be passed on to any foreign official. See 15 U.S.C. § § 78dd-1(a)(3) et seq.

As a result, business executives must know how their products or services reach their end users in each foreign market. Does the business rely on any third parties, e.g., foreign distributors or some other agent, to assist in securing business? If so, business leaders must ensure that a vetting process is in place to protect against the FCPA violations of these third party intermediaries.

The Knowledge Standard

The government will impute knowledge to business leaders even if they do not have actual knowledge of an improper payment by a third party intermediary. In particular, the government will pursue FCPA liability if it finds "willful blindness" to any "red flags" that should reasonably alert a company's management to a "high probability" of an FCPA violation.

The government will likely construe a breakdown in internal controls as an effort to adopt a "head in the sand" approach to FCPA compliance. In an enforcement action against York International, several improper payments were made by a foreign subsidiary to third-party agents under circumstances that demonstrated that the company failed to conduct adequate due diligence to assure itself that payments were not being passed to SOE officials. See DOJ News Release, No. 07-783 (October 1, 2007).

In the Halliburton case, the SEC charged the company, in part, with a civil violation of the FCPA's antibribery provisions without alleging that Halliburton had any knowledge of the bribe payments at issue. Halliburton's liability was premised on its failure to conduct sufficient due diligence of the foreign agent who, while working on behalf of Halliburton's joint venture, had made the prohibited bribe payments. See Complaint, SEC v. Halliburton Co. and KBR, Inc., Civ. Action No. 4:09-399 (S.D. Tex.) (Feb. 11, 2009) at 31.

Vicarious Liability

The following enforcement actions highlight the broad application of the FCPA's third party payment provision, including liability for foreign subsidiaries, distributors and sales agents:

- On October 31, 2007, Ingersoll-Rand entered into a three year DPA with the DOJ based on improper payments made by Ingersoll-Rand's Italian and Irish wholly-owned subsidiaries foreign subsidiaries to the Iraqi government in connection with contracts under the United Nations Oil for Food program. See SEC v. Ingersoll-Rand Company Ltd. (No. 07-cv-1955) (D.D.C. 2007).

- On December 3, 2004, DOJ entered into a DPA with GE Invision, Inc. for FCPA violations arising from improper payments made by its distributors in China to

foreign officials to secure the sale of airport security screening machines. See DOJ News Release, No.04-780 (December 6, 2004).

Due Diligence and Red Flags

While a comprehensive review of due diligence is beyond the scope of this overview, it is imperative that business leaders conduct a risk assessment based on an informed understanding of that company's business strategy entering a foreign market. Third parties should be vetted according to the following two general criteria: (1) the nature and frequency of an intermediary's contact with a foreign official; and (2) the amount and type of an intermediary's compensation. Particular attention should be paid to intermediaries, like sales staff, who are paid on a purely commission basis.

Given that resources are limited, business leaders may employ a tiered approach to distinguish between high-risk and low-risk intermediaries. At a minimum, however, business leaders should consider whether:

- a business justification exists for entering into the relationship with the intermediary;
- a history of corruption exists in the country in question;
- the intermediary is a government official, is related to a government official, works for a company owned in part by a government official or is recommended by a government official;
- a fair market valuation exists for any service to be performed by an intermediary;
- the intermediary requests excessively high commissions, unusual discounts, mid stream, up-front or cash payments;
- the intermediary objects to anticorruption standards and representations, audit rights, and termination rights in the contract;
- the intermediary is not competent to perform the requested service, e.g., the intermediary lacks the necessary qualifications or resources;
- there is a lack of transparency in accounting and expense records or the intermediary has requested that the company prepare false invoices or any other type of false documents;
- the intermediary refuses to disclose owners, partners or principals;
- the intermediary uses shell or holding companies that obscure ownership without credible explanation; and
- there are press reports of improprieties concerning the intermediary.

FCPA'S EXPANSIVE BOOKS AND RECORDS PROVISIONS

Another area of aggressive FCPA enforcement involves the FCPA's books and records provisions. These provisions reinforce the government's expectations that companies will implement compliance programs and auditing procedures to deter and identify FCPA violations in their overseas operations.

The FCPA requires that issuers "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of

the issuer." See 15 U.S.C. § 78m(b)(2)(A). The FCPA also requires that issuers "devise and maintain a system of internal controls sufficient to provide reasonable assurances that transactions are executed in accordance with management's general or specific authorization." Id. at § 78m(b)(2)(B)(i).

The purpose of these provisions is to ensure that shareholders receive an accurate assessment of the company's expenditures by preventing the accounting fraud associated with improper payments. A company facing an FCPA enforcement action may, therefore, also be sued in a civil action under securities law by shareholders claiming to have purchased their shares at an inflated price and in derivative actions brought by shareholders to recover for alleged wrongdoing by officers and directors.

The FCPA's book and records provisions only apply to issuers and require no proof of a U.S. territorial nexus. Given the expansive reach of the FCPA accounting provisions, business leaders should recognize the increased risks of a parent company for the accounting practices of its foreign subsidiaries.

Strict Liability

A U.S. parent is liable for the accounting fraud of its foreign subsidiary whether or not the parent has knowledge of the accounting fraud. There is no *sciente*r requirement nor is there a materiality requirement.

For example, in its settlement with the government, Siemens acknowledged that it violated the FCPA's book and records provisions when it incorporated the books and records of several of its subsidiaries that participated in the United Nations Oil for Food Program into its own books and records. The subsidiaries falsely characterized kick-back payments to the Iraqi government as "commissions" on their books and records, which were later entered into the books and records of the parent.

The mere consolidation of a subsidiary's bogus entries into a parent's own books and records is sufficient to establish FCPA liability. Dow Chemical Co. settled a civil action with the SEC for allegedly violating the FCPA's books and records and internal control provisions. See SEC Litigation Release No. 20000 (February 13, 2007). Dow consented to pay a $325,000 civil penalty in connection with improper payments by one of its foreign subsidiaries to public officials in India. The improper payments were made through third party intermediaries of the foreign subsidiary and without the knowledge of the U.S. parent.

Increased Risks of Parent Company for Foreign Subsidiary's Books and Records and Internal Controls

The following high profile FCPA enforcement actions underscore the government's leverage to demand exorbitant fines from a U.S. parent for a breakdown in its financial and audit controls over a foreign subsidiary:

- On October 30, 2007, Ingersoll-Rand settled an SEC books and records enforcement action by agreeing to pay disgorgement of profits of $1,710,034 plus pre-judgment interest of $560,953, and a further civil penalty of $1,950,000 in

connection with improper payments by foreign subsidiaries to an Iraqi public official. See SEC Litigation Release No. 20353 (October 31,2007);

- On October 1, 2007, York International settled an SEC books and records enforcement action by agreeing to the disgorgement of $8,949,132 in profits, plus $1,083,478 in interest, and a $2,000,000 civil penalty in connection with improper payments made to an Iraqi public official by an intermediary of a foreign subsidiary. See SEC Litigation Release No. 20319 (October 1, 2007); and

- On April 26, 2007, Baker Hughes settled an enforcement action with the SEC and DOJ by agreeing to pay a record $44.1 million in connection with alleged bribery payments by its foreign operations in Kazakhstan, Nigeria, Indonesia, Uzbekistan, Russia and Angola. The SEC complaint alleged FCPA violations under circumstances that reflected a failure to implement sufficient internal controls to determine whether the payments were for legitimate services, whether the payments would be shared with government officials or whether these payments would be accurately recorded in Baker Hughes' books and records. See DOJ News Release, No.07-296 (April 26, 2007) and SEC v. Baker Hughes, 07-cv-1408 (SD TX. 007).

Each instance signifies the government's aggressive enforcement of the FCPA based on questionable accounting practices in the foreign operations of issuers subject to the FCPA. In each case, the inadequacy of the issuer's internal controls provided the government with an aggravating circumstance to enhance the penalties.

Importance of Internal Auditors

The expansive reach of the FCPA accounting provisions presents formidable challenges to businesses with non-U.S. operations. While the varied elements of an FCPA compliance regime are beyond the scope of this overview, business leaders must ensure that internal auditors are trained to identify the forensic evidence necessary to establish an FCPA violation in its foreign operations.

The role of compliance can not be limited to training for management or third party intermediaries. Nor can it be limited to periodic independent audits by outside counsel and auditors. The day-to-day gatekeepers overseeing a company's expenditures must also be trained in FCPA compliance.

To be more than a "paper program," FCPA compliance must focus on identifying the "at-risk" expenditures which could finance an improper payment. Towards that end, internal auditors should establish accounting controls for such items as charitable contributions, gifts and cash expenditures. Back-up documents must be retained along with a strong cash controls to minimize the presence and access to cash accounts. Financial personnel must maintain regular account reconciliations for petty cash. Moreover, transaction process controls should also identify the "who, what and why" of any gift or cash expenditure.

Financial and audit personnel should closely review the bona fides for any expense booked as a consulting, licensing or promotional payment to an intermediary. Personnel in business operations should look for the following red flags:

- payment requested in cash or to a numbered account or the account of a third party;
- payment requested in a country other than the intermediary's country of residence or the territory of the sales activity, and especially, if it is a country with little banking transparency;
- payment requested in advance or partial-payment immediately prior to a procurement decision;
- reimbursement requests for extraordinary, ill-defined or last minute expenses;
- payment request lacks supporting documentation; and
- payment request is excessive in light of past payments for similar services

CONCLUSION

In today's global marketplace, business leaders face a Herculean task of managing the FCPA risks in their foreign business operations. Notwithstanding this challenge, the government expects that a corporation will conduct the appropriate due diligence and implement the necessary internal controls to identify and remediate the danger of FCPA violations. Given the dramatic increase in FCPA enforcement against both companies and senior corporate executives, business leaders must educate themselves and their employees on the industry-specific FCPA risks attendant to their non-U.S. business operations.