Foreign Corrupt Practices Act and Compliance Strategies

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Why is FCPA compliance important?

1. U.S. Persons, U.S. Companies, Companies & their Foreign Subsidiaries are subject to PROVISIONS of Foreign Corrupt Practices Act of the United States (FCPA).
Who is subject?

- US Individuals (WW)
- US Companies
- Foreign branches of US Companies
- Foreign Subsidiaries of US Companies
- US Issuers (Companies whose securities are registered with SEC)
Why is FCPA compliance important for doing business in India?

2. Incidents of corruption are commonplace in India
Transparency International
Corruption Perceptions Index

- India ranked #84 on 2009 Index
- India scored 3.4 on scale of 0 – 10
  - 0 = highly corrupt
  - 10 = highly clean
- India = prime territory for FCPA violations
- Ranks below Serbia and above Malawi;
- Tied with El Salvador, Guatemala, Panama, and Thailand
Why is FCPA compliance important?

3. Penalties for FCPA Violations are significant and apply to individuals as well as companies.
Penalties for FCPA Violations

**Individuals:**
- **Civil Penalty:** Up to $100,000
- **Criminal Penalty:** Up to 5 years imprisonment & $250,000 fine
- Employers cannot indemnify employees who are fined

**Corporations:**
- **Civil Penalty:** Disgorgement of profits and a fine of up to $500,000
- **Criminal Penalty:** $2 million fine per violation or twice the benefit that the offender sought to obtain, disgorgement of profits, and possible debarment
4. Increasing FCPA Enforcement Activity

- There has been a recent explosion of enforcement activity by both the SEC and the DOJ.
  - 18 new enforcement actions by the DOJ
  - 10 new enforcement actions by the SEC
- There are approximately 100 other companies that currently have open FCPA investigations.
Increasing FCPA Enforcement Activity

- DOJ and SEC enforcement actions have nearly doubled since 2000
- SEC filings indicate more than 100 public companies have voluntarily disclosed FCPA-related issues in last two years
- Companies are paying significant fines
- Individuals are going to jail
- Companies operating in India have been, and will continue to be, impacted
Increasing FCPA Enforcement Activity

- The explosion in FCPA enforcement activity is best captured in the following chart, which shows how many actions were initiated in the past few years.

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U.S.’s FCPA

vs.

India’s Prevention of Corruption Act
PREVENTION OF CORRUPTION ACT

✓ Primary legislation dealing with corruption in India.

✓ Precludes Public Servant from taking gratification other than legal remuneration with respect to an Official Act

✓ Focuses on Bribe Takers as opposed to Bribe Givers

FCPA focuses on Bribe Giver
The Origins of the FCPA

- Enacted in 1977 in the wake of a series of investigations by the SEC which revealed that US companies operating abroad were making “questionable” payments, including payments to foreign government officials for the purpose of securing business.

  Initial Version prohibited all payments

- Revised in 1988 to eliminate “facilitating payments” from scope

- Recent cases exhibit expansion of payment types
Summary of FCPA

Foreign Corrupt Practices Act

No Payments to

Foreign Government Officials

to Obtain or Retain Business
FCPA Dissection

**Element #1:**
No Payments…

- Cash or Cash Equivalent
- Travel Expenses (1\textsuperscript{st} Class…)
- Entertainment & Hospitality
- Gifts
- Anything of any value…
FCPA & Payments

- Anything of value can be a bribe
  - Cash or cash equivalents
  - Tangible and intangible property
  - Promise of future payment or employment
  - Training or education
  - Entertainment

- The amount involved is irrelevant
- If a payment is requested by a foreign official, it likely has value to the official; thus a charitable contribution or a “good works” contribution purported to be for the benefit of the community may constitute a bribe if requested by a government official and made with corrupt intent
FCPA Dissection (cont’d)

Element #2: Foreign Government Official

- Officer of Foreign Government
- Employee of Foreign Government
- Foreign Political Party Official
- Candidate for Foreign Political Office
- Officers / Employees of Public International Organizations
- Anyone acting in an official foreign government capacity
Examples of Foreign Government Officials

Employees of any department or agency of the government

- Example: tax collectors / revenue agents / customs officials

Employees of government-sponsored commercial ventures and other government-owned business

- Example: national telecom carriers

Rank, level, or title is irrelevant

Issue = Ability to Influence Purchasing Decision
FCPA Dissection (cont’d)

Element #3: Obtain or Retain Business

- Gain improper advantage
- Influence business / buying decisions
- Induce foreign official in contract award determinations
- Successful award **not** required!
- Broadly Interpreted…

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Obtain or Retain Business

Broadly Interpreted -- Recent Trends:

- Influencing governmental impact study which resulted in specific contract award (cooking the books)

- Influencing license determination which resulted in contract award to specific US company…
FCPA Provisions on Bribes

- Bribe must be intended to assist the company in obtaining or retaining business
- Need not result in government business
- Need not be tied to a specific contract or project
Third Party Payments

Foreign Corrupt Practices Act also prohibits Third Party Payments made to “foreign government officials” via intermediaries and / or third parties if made with knowledge that all or a portion will go directly or indirectly to “foreign government official”
Third Party Payments

Third Parties include:

✓ Foreign Subsidiaries
✓ Agents
✓ Sales Representatives
✓ Distributors
✓ Consultants
✓ Lobbyists
Third Party Payments

Knowledge Standard for Payments by Third Party Payments is very broad and always evolving

- √ Conscious Disregard
- √ Willful Blindness
- √ Deliberate Ignorance
- √ US Company nexus
Third Party Payments

Knowledge Standard for Third Party Payments very broad (cont’d)

Fact Specific: US Company

• Issued wire transfer instructions
• Authorized funds transfer
• Authorized, directed, controlled and / or benefited from the activity in question
Third Party Payments

- FCPA prohibits direct payments as well as payments to or through a Third Party if it is known that all or a portion of the payment will be passed on to a foreign government official.

- “Knowledge” will be deemed to exist if:
  - a person has a firm belief that circumstances exist or
  - a result is substantially certain to occur

- Taking a “head in the sand” approach will result in a violation

- Facts and circumstance test
Third Party Payments

- In India, it is common for US companies to conduct business with and through local agents, consultants, partners or other intermediaries. Doing this requires extreme caution
  
  - Company must conduct due diligence to ensure that third parties will not make payments in violation of the FCPA
  
  - If an issue ever arises, government may contend that absence of due diligence demonstrates that company put its “head in the sand”
Third Party Due Diligence

- Document the Third Party’s:
  - Competence, Expertise, and Reputation
  - Relations With Government Officials through Family, Prior Employment or Political Activity
- Maintain Records of Due Diligence
- Make Inquiries Re: Third Party
  - Law Firms, Audit/Consulting Firms, US Embassy, Commerce/State Department, Private Investigators
Third Party Due Diligence

✓ Require:
  o FCPA Certifications
  o Contract Reps and Warranties

✓ Provide:
  o FCPA Policy Communication
  o Training

✓ Look for “Red Flags”
Third Party Due Diligence

Red Flags

- History of corruption in a country
- Third Party’s Reputation for corruption
- Family relationship between participants and government officials
- Unusual means of payment
- Size of the commission paid to the third party in relation to the services performed
- Third Party’s lack of qualifications to perform services
Red Flags – Cont’d

- Refusal to sign certifications or make FCPA representations
- Misrepresentations in connection with proposed transaction
- Requests for false or incomplete documentation
- Lack of transparency in financial records
- Lack of internal controls
Foreign Corrupt Practices Act

Affirmative Defense #1

Payment is a facilitating payment intended to “expedite” routine foreign government actions

Non-discretionary acts

Obtaining permits or licenses

Processing governmental papers, e.g., visas

Loading & unloading cargo
Facilitating Payment

- There is no violation of the FCPA if a payment qualifies as a facilitating, or grease, payment
  - Applies to expediting payments to low-level government officials
  - Payment must be to secure a “routine governmental action”
  - If official exercises discretion or payment results in advantage over competitors, it will not fall within the exception

- Demands for facilitating payments are common in India
  - US companies operating in India frequently face books and records issues with respect to facilitating payments
  - Facilitating payments must be accurately recorded as such in the company’s books and records
Foreign Corrupt Practices Act

Affirmative Defense #2

Payment is “expressly” legal in foreign country

Bona fide (actual) business expense

No Country has written law that permits bribery of government official
Affirmative Defenses

Reasonable and bona fide expenditures, such as travel and lodging, related to:

(i) the execution or performance of a contract with the government; or

(ii) the promotion or demonstration of products

Travel and lodging must be reasonable, not lavish
Affirmative Defenses

Limited entertainment is probably OK; Lavish entertainment is not

Examples:

Afternoon round of golf at New Delhi Golf Club is probably OK

One week trip to Saint Andrews is too much
Necessity is not a defense!

- It is not a defense to argue that competitors are making improper payments to government officials
- It is not a defense to argue that it is impossible to conduct business without paying government officials
Recent FCPA Actions Involving India

- **Dow Chemical**
  - Settled civil action with SEC in connection with payments made by fifth-tier Indian subsidiary

- **York International**
  - Paid civil and criminal fines in connection with payments made to officials of Indian Navy through third-party sales agent

- **Electronic Data Systems**
  - Consented to entry of an SEC cease-and-desist order relating to improper payments made by Indian subsidiary

- **Westinghouse Air Brake Tech Co.**
  - Paid about $675,000 and entered into a deferred prosecution agreement to resolve FCPA offenses caused by its Indian subsidiary; will also retain an independent compliance consultant.
Trends in FCPA Enforcement

1. Imposition of Large Penalties:

- **AGCO Corporation** (October 2009): **$20 million** fine related to UN Oil-for-Food program ($13.9 million in disgorgement of profits, $2 million in prejudgment interest, $1.6 million criminal fine and $2.4 million civil penalty)

- **Novo Nordisk A/S** (May 2009): **$18 million** ($9 million criminal fine, $4.3 million in disgorgement of profits, a $3.0 million civil penalty, and $1.7 million in pre-judgment interest)

- **Halliburton** (February 2009): **$579 million** – largest ever against a US company ($402 million criminal fine, $177 million in disgorgement of profits, and requirement to retain an independent compliance monitor for 3 years)
Trends in FCPA Enforcement

1. Imposition of Large Penalties (cont’d)

- **Fiat (December 2008):** $17.8 million in combined fines and penalties: $7 million criminal fine, $5.3 million in disgorgement of profits, a $3.6 million civil penalty, and $1.9 million in pre-judgment interest

- **Siemens (December 2008):** $800 million – largest ever FCPA enforcement action! Total criminal penalty of $450 million (a $448.5 million fine against Siemens and a $500,000 fine against each of three subsidiaries); $350 million in disgorgement and requirement to retain a compliance monitor for 4 years.
Trends in FCPA Enforcement

2. Expanding Scope of Enforcement:

- **Omega Advisors (July 2007):** Action against a hedge fund for investments made with knowledge of related unlawful payments
  - Several individuals were also indicted in connection with this scheme, including a Swiss lawyer who advised Omega and a foreign national who allegedly served as the agent of US investors.

- **Dow Chemical (February 2007):** Action against a parent company for payments made by a fifth-tier subsidiary without the parent’s knowledge

- **Statoil (October 2006):** Action against a foreign issuer
  - Alice Fisher, Assistant Attorney General, has stated: “The Department will not hesitate to enforce the FCPA against foreign-owned companies, just as it does against American companies. (October 16, 2006)

- **Schnitzer Steel (October 2006):** Unlawful conduct included improper recording of payments made to private individuals
Trends in FCPA Enforcement

3. Broad, Industry-Wide Investigations:

- More than two dozen companies have announced investigations related to kickbacks paid in connection with the UN Oil for Food Program. To date, the DOJ and SEC have entered into deferred prosecution or settlement agreements in eleven different cases, including those of Fiat (December 2008), AB Volvo (March 2008), and Chevron (November 2007).

- The Wall Street Journal reported on July 25, 2007 that the DOJ has requested information from nearly a dozen oil and oil services companies relating primarily to the Nigerian oil services business.

- Some DOJ officials have indicated during recent legal conferences that the pharmaceutical industry will be the focus of future FCPA scrutiny.
Trends in FCPA Enforcement

4. Emphasis on Individual Culpability

- The DOJ and SEC enforce the FCPA against both corporations and individuals.
- Charges have been brought against executives and mid-level employees.
- Since 1990, twice as many individuals have been prosecuted as corporations.
- Examples:
  - **ABB**: Regional Sales Manager for West Africa; Senior Vice President of Operations; Vice President of Finance; Former Vice President of Sales
  - **Faheem Salem**: Civilian Translator in Iraq
  - **InVision**: Senior Vice President for Sales and Marketing and Board Member
  - **Schnitzer Steel**: Executive Vice President of Sales
  - **Titan**: Titan’s Africa President
  - **Willbros Group**: Division Manager of Nigerian and Latin American Subsidiary Operations; General Manager of On-Shore Operations
  - **Syncor International Corp**: Chairman
Trends in FCPA Enforcement

Cooperation with Enforcement Agencies

Reduced penalties for Companies that Cooperate:


- Paradigm (September 2007): Entered into a non-prosecution agreement and paid a $1 million fine. The DOJ cited Paradigm’s prompt disclosure, cooperation, and implementation of remedial measures.
  
  - Alice Fisher, Assistant Attorney General, noted that “Paradigm’s actions in this matter, including voluntary disclosure and remedial efforts, are consistent with our view of responsible corporate conduct when FCPA violations are uncovered. Accordingly, the Department has resolved this case to permit the company to move forward on sound footing, governed by ethical business practices.” (September 24, 2007)

- Textron (August 2007): Entered into a non-prosecution agreement and paid a $1.15 million fine.
  
  - The DOJ agreed not to file charges “in recognition of Textron’s early discovery and reporting of the improper payments; Textron’s thorough review of those payments as well as its discovery and review of improper payments made in other countries, including India, Egypt, and the United Arab Emirates; and the company’s implementation of enhanced compliance policies and procedures.” (DOJ Press Release, August 23, 2007)
Other Trends in FCPA Enforcement

1. Agents and Third Party Services Companies
2. Increasing Parallel Investigations in Foreign Jurisdictions
3. Importance of Pre-Acquisition Due Diligence
   - Increased Self Reporting of Problems Found in Merger Due Diligence
Acquisition Due Diligence

To avoid successor liability for FCPA violations, extensive pre-acquisition due diligence is necessary.

- Evaluate the target’s compliance program, including internal controls.
- Evaluate particular risks associated with the target’s business, including its sales and marketing methods.
- Focus on the target’s operations in corrupt or developing nations.
- Evaluate the target’s control over subsidiaries, field offices, and agents.
- Conduct enhanced due diligence of any “red flags” that arise during the diligence process.
Successor Liability

- Under principles of successor liability, an acquirer can inherit the liability of an acquired subsidiary.
- US enforcement agencies are focusing on FCPA issues that arise in the context of mergers and acquisitions
  - Mark Mendelsohn, Deputy Chief of the Fraud Section at the DOJ recently noted that there has been a “heightened level of attention to FCPA risk in connection with M&A and foreign joint ventures.” (Sept. 27, 2007)
  - Alice Fisher, Assistant Attorney General, has stated: “I strongly encourage you and your clients to do thorough FCPA due diligence in transactions involving overseas companies.” (Oct. 16, 2006)
FCPA Compliance For Foreign Subs

Due Diligence Requirements

Investigate foreign reps & JV partners

✓ Ties to foreign government
✓ Reputation in general

Educate / train foreign subsidiaries Regarding FCPA
FCPA Training and Education

- Live Training Preferred
- Local Language
- Initial Training Upon Hiring/Acquisition
- Periodic Refresher Sessions
- Supplemental Distributions of Policy/Law Changes
FCPA Compliance Program

Monitoring

- Training Completion Certification
- Annual Compliance Certification
- Audit Testing of High-Risk Areas
- Internal/External Compliance Audits
- Confidential Reporting System
FCPA Compliance Procedures

Internal Controls

- Cash Handling Procedures
- Accounting and Financial Controls
- Recordkeeping Requirements
- Documentation Requirements
- Authorization Requirements
Applicable to Foreign Subs

Foreign Corrupt Practices Act

Due Diligence Requirements

✓ Implement procedural safeguards
✓ Pursue Contractual safeguards
✓ Check out “red flags”
Applicable to Foreign Subs

Foreign Corrupt Practices Act

Red Flags

✓ Unusual payment patterns
✓ Unusually high commissions
✓ Refusals to sign certifications regarding “no payments to officials"
Applicable to Foreign Subs

FCPA Compliance

If purchase order issued by foreign government entity:

✓ Check to make sure that there are no requests for “bribes” or “kick-backs”
Avoiding FCPA Liability: Due Diligence

- What kinds of transactions require FCPA due diligence?
  - Retention of third-party agents
  - Mergers/acquisitions/investments
  - Joint Ventures
- Identify the transaction giving rise to the risk
  - Example: A company wants to retain a third party agent to assist with filing documents necessary to qualify for Special Economic Zone status in Hyderabad
- Once risks are identified, carry out diligence procedures focused on the risk
  - Example: Attempt to interview potential third-party agent or others to discern agent’s qualifications and reputation
Avoiding FCPA Liability: Due Diligence

- The use of third-party sales agents or consultants is a common practice in India; conducting due diligence on those parties is critical.
- Red flags that should raise FCPA concerns include:
  - Agent is recommended by government official
  - Agent requests that payment be made in cash or to a bank account in a third country
  - Agent claims to have familial or close personal relationships to government officials
  - Agent refuses to provide information in response to due diligence requests or to sign certificate stating that he or she will not violate the FCPA
What If Misconduct is Alleged?

- **Allegation of misconduct**
  - Management may want to conduct an initial inquiry; if it appears there is something to the allegation, management will report to the board of directors or audit committee
  - Audit committee (or a specially-created independent committee) may conduct investigation
What If Misconduct is Alleged?

- **Allegation of misconduct (cont’d)**
  - If a violation occurred, company must take remedial action
    - Employee discipline
    - Adjustments to compliance program/controls
    - Additional training
    - Actions to be taken with respect to third parties, including severing relationships with any third parties involved in wrongdoing
    - Actions with respect to project/contract at issue; can the company continue to move forward on a potential deal?
What If Misconduct is Alleged?

- Allegation of misconduct (cont’d)
  - Does the company self report?
    - Timely and voluntary disclosure of wrongdoing and willingness to cooperate is a mitigating factor
    - If third parties, i.e., competitors or former employees, know of misconduct there is a risk that they will disclose
In conclusion…

- Take FCPA issues seriously
- Maintain a strong and comprehensive compliance program that keeps employees informed of what is and what is not allowed
- Know your employees
- Know the agent/partners with whom you are conducting business
- Know the entity in which you are investing or the company that you are acquiring
- If you have questions, contact Corporate Counsel