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Commentary

## QUIET ON THE SET! WHAT EVERY STUDIO AND PRODUCER NEED TO KNOW ABOUT THE FCPA

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Matthew Reinhard and James Tillen of Miller & Chevalier discuss how the Foreign Corrupt Practices Act could affect the movie industry, which often films overseas, and what studios and producers can do to prevent any improper payments to foreign officials.

Hollywood is poised to be hit by a blockbuster of epic proportions. And it does not involve the opening weekend grosses of summer blockbusters such as “Iron Man,” “Indiana Jones” or “Sex in the City.” Though the dollar figures could be just as large, this time the money may be flowing from Hollywood into the coffers of Uncle Sam, all due to the broadening enforcement net being cast by U.S. enforcement officials seeking to stamp out corruption abroad under the Foreign Corrupt Practices Act, 15 U.S.C. § 78dd-2.

Any major studios or producers intending to film on location outside the United States owe it to their investors to know, understand and comply with the FCPA, or they could find themselves involuntarily removed from the swank confines of Beverly Hills to the decidedly more downscale accommodations of Club Fed. Ignorance of this law could result in multimillion-dollar fines, disgorgement of profits and prison time.

### *The FCPA and Its Reach*

The Foreign Corrupt Practices Act became law in 1977, making it illegal for companies and individuals subject to U.S. jurisdiction to pay, or promise to pay, a foreign official to receive or keep business or to obtain any “improper advantage.” Importantly, payments need not be made directly, and payments made to foreign officials through intermediaries, such as third-party agents or “consultants,” can result in liability for the company or employee who hired the third party. Furthermore, a “payment” is not merely the exchange of cash; it may include the giving of “anything of value,” such as excessive entertainment and gifts, interests in business ventures, or in-kind contributions.

Similarly, the term “foreign official” is broadly construed to include not only elected and appointed officials working for a foreign government, but their families, as well as employees in government-owned or -controlled businesses, political parties, candidates for office, and officials of public international organizations. In heavily nationalized countries, such as China, where nearly all businesses are (to some degree) arms of the state, special care must be taken as employees who otherwise seem unconnected to government may nonetheless be considered foreign officials.

After nearly 20 years of enforcement stagnation, the Department of Justice and Securities and Exchange Commission ramped up enforcement of the FCPA in the 1990s. From two to three enforcement actions per year in the 1970s and 1980s, in 2007 the agencies brought 38 separate enforcement actions -- a new record.

While FCPA enforcement has long focused on global, multinational industries with long-term foreign operations, there are increasing signs that future enforcement actions will turn to other deep-pocketed industries that

operate abroad, including Hollywood and the movie industry.

### *Is Hollywood Next?*

In 2006 “Syriana” became the first major Hollywood production to mention the FCPA by name. While the plot of the movie revolved around a favorite FCPA target, the international oil industry, in recent years the government has made clear that any U.S. company operating abroad may be subject to FCPA scrutiny. Recent investigations have involved the agriculture and medical device industries, and there are increasing signs that Hollywood and the movie industry may be next.

Most notably, in December film and entertainment executive Gerald Green and his wife, Patricia, were arrested and charged with violating the FCPA. [FN1] Authorities alleged that the Greens conspired to bribe an official of the Thai government to win the management contract for the Bangkok International Film Festival. If convicted of all seven counts in the indictment, the Greens each face up to 35 years in prison. A trial is scheduled for Sept. 16 in the U.S. District Court for the Central District of California.

Similarly, a 2007 civil suit between novelist Clive Cussler and Crusader Entertainment over the filming of “Sahara,” which involved creative control of the script and post-production comments by the author, alleged that bribes totaling more than \$237,000 were made to expedite filming on location in Morocco. [FN2] The alleged bribes included payments to stop a river improvement project during filming, as well as \$23,000 for “political/mayoral support.”

It is not known whether these allegations are currently under investigation by the Justice Department or SEC, which can effectively keep their investigations secret until they are prepared to bring charges. Nonetheless, if the allegations in the complaint are true, the payments likely constitute violations of the FCPA and could result in individual and corporate criminal liability.

Some of the most authentic, most intriguing foreign locations to film also may be rife with corruption. From South America to Africa to the Far East, major Hollywood studios increasingly film on location in countries that have a long history of corruption and are less than transparent in business dealings. For example, 2007’s “The Bourne Ultimatum” (which grossed more than \$227 million) was filmed on location in Morocco, which is No. 72 (tied with six other countries) on Transparency International’s “corruption perceptions index.” [FN3] “Rambo III” was filmed on location in Thailand (TI Index No. 84) and Mexico (No. 72).

A number of films in this summer’s crop of potential blockbusters also have an international pedigree. “Wanted” was filmed on location in Hungary (No. 39) and the Czech Republic (No. 41). “The Chronicles of Narnia: Prince Caspian” was filmed in Poland (No. 61) and the Czech Republic. “Forbidden Kingdom” was filmed on location in China (No. 72). And “The Fall” takes the international prize, filmed in, among other countries, China, Brazil (No. 72), Namibia (No. 57), India (No. 72), Egypt (No. 105), Romania (No. 69) and Cambodia (No. 162).

Given tight filming schedules and colossal budgets for the largest films, there is understandably a temptation to throw money at any problems that may arise with local foreign officials to make the problems go away and allow filming to continue. Whether it is a park ranger insisting that filming is disrupting an endangered species and refusing to allow work to continue unless a payment is made, or a customs officer arguing that the camera equipment is subject to a special “import tax” (that must be paid in cash), or a local mayor demanding that his wife and children be hired as on-set “consultants” to ensure the locals do not “disrupt” filming, the possible occasions for corruption and graft during shoots on location are numerous.

FCPA dangers are not limited to filming on location. Post-production or CGI work outsourced overseas also may present opportunities for corrupt officials to seek improper payments. Similar consideration must be given to

contracts with foreign distributors to stop improper payments from being made to foreign officials to ensure the movie gets to the screen, to avoid censorship or even to pay “protection” money to avoid foreign piracy.

Not only does the FCPA have teeth with significant fine and prison penalties for offenders, but perhaps most importantly, potential penalties include the forfeiture of profits associated with the corrupt activity. With the massive revenue generated in Hollywood, the industry makes an appealing target for U.S. enforcement authorities. The thought that a \$100 bribe paid to the local constable in Cambodia to “allow” filming along a particular stretch of road could result in all profits from next year's must-see action blockbuster being forfeited to the government should give any studio or production company pause.

### ***It Only Takes One***

The movie industry should not take solace in the fact that the extent of FCPA enforcement to date is limited to the prosecution of the Greens. The Justice Department and SEC have a history of prying open an entire industry for investigation with the wedge of a single case. For example, in 2004 an oilfield services company and its subsidiary settled FCPA allegations with the U.S. government related to bribes paid to Nigerian officials. Under the agreement the subsidiary subsequently disclosed additional payments to Nigerian authorities and that it often used its customs broker as an intermediary for such payments. The disclosure resulted in another plea agreement by the subsidiary and, at the time, the largest fine in the history of the FCPA: \$26 million.

Having learned of the customs broker's role in facilitating the subsidiary's corrupt payments and armed with a better understanding of the industry and the Nigerian customs regime, the government then turned its attention to the custom broker's affairs and its customers. As a result, the Justice Department now is not only investigating the customs broker, but also at least 13 of its customers. Moreover, the current investigation is not limited to Nigeria, where the investigation began, but has expanded to include Saudi Arabia and Kazakhstan. Thus, what began as an investigation into a single company's operations in Nigeria has grown into a multinational investigation of at least 14 companies operating in a single industry.

Given the government's proven tactics of leveraging one investigation in an industry into several more, it simply is not safe to assume that the charges brought against the Greens are a one-off affair. Rather, if recent history is any guide, the government will use the knowledge gained in this investigation -- how the industry operates, who controls the flow of money, how accounts are kept and so on -- to launch other investigations into the movie industry's dealings abroad.

### ***Protecting the Investment***

Despite the dangers posed by the FCPA, with a thorough understanding of the law and a strong compliance program, studios and producers can operate effectively abroad and prevent improper payments from being made. Moreover, if improper payments are discovered, a swift and thorough investigation, followed by self-reporting the violation to enforcement authorities, may help a studio negotiate significantly reduced sanctions and fines.

Any payments made in the hypothetical scenarios discussed above could result in FCPA liability. So how can studios, producers and investors protect themselves? When it comes to the FCPA, knowledge truly is power. As a first step, in-house counsel must educate themselves on the contours of the law. With this understanding in hand, studios must develop a targeted and well-defined compliance program.

### ***Targeted Training***

It makes neither business nor financial sense to target every employee of a studio or production set for FCPA compliance training. As an initial step, in-house counsel, often working with human resources and/or internal

auditors, should identify employees most likely to encounter pressure to make corrupt payments and ensure that they receive appropriate training and instruction on the FCPA.

It is imperative to recognize that no position is “too small” for training; lower-level employees often are the first line of interaction with foreign officials, and they must be made aware of the policy prohibiting improper payments. Similarly, employees who make financial decisions, from the local petty-cash manager to upper-level accounting and control personnel, must be trained to spot inappropriate payments (or requests for such payments), whether from within the organization or on invoices from third parties.

### ***Strict Financial Controls***

As discussed, finance personnel must be sufficiently trained to spot and report suspect payments. Invoices from third-party consultants that contain line items for services rendered outside an agreed-upon contract or tariff, large “entertainment” expenses, or any requests for payment that lack sufficient receipts or documentation are especially suspect.

Similarly, strict controls must be instituted over local petty-cash or bank accounts to control access to such funds and ensure that all disbursements are adequately supported.

### ***Real-Time Guidance***

Given the intense deadlines inherent in filming on location, studios and producers should consider an on-set compliance manager who can quickly address issues as they arise and provide guidance. Such a person could be an employee with other responsibilities who has received enhanced compliance and FCPA training so he or she can provide immediate guidance or determine that an issue should be addressed with in-house counsel, internal auditor or controller.

### ***Vetting Third Parties***

Use of third-party contractors and consultants abroad is an area of particular scrutiny by enforcement authorities, given that they may be nothing but front companies used to funnel payments to officials. Similarly, contractors and consultants may be owned by foreign officials' friends and family members and may offer legitimate services but at highly inflated prices. Or studios may find that the hiring of such “consultants” is an unofficial prerequisite to obtain necessary government approvals or permits. Thus, strong controls must be in place to complete thorough due diligence on any local consultant or contractor hired on location.

### ***Clear Reporting Procedures***

Even with a “zero-tolerance” compliance program, strict financial controls and well-educated employees, it is still possible, even likely, depending on the location, that improper payments will be made in the course of filming abroad or in foreign post-production and distribution efforts. If a company detects or suspects an improper payment, its response can make the difference between multimillion-dollar fines and prison time on the one hand and a slap on the wrist on the other.

Current Justice Department policies favor companies that quickly address, investigate and report potential FCPA violations to enforcement authorities. Thus, it is imperative that studios establish clear lines of reporting of any potential violation on the set. In addition, an anonymous “tip line” may further encourage employees to report potential violations.

As unreasonable as it may seem, and despite the challenges that may be faced in implementing it, the key to any compliance program is ultimately insisting on a zero-tolerance policy for foreign bribes. The undocumented \$1,000 payment to the local official to allow filming on Main Street or to stop local construction projects until filming is complete may seem like nothing to studios and producers who have committed millions of dollars to a project and are loath to see production delayed while a local government official seeks to flex his muscles to line his own pockets.

While it certainly could be that the \$1,000 payment may never be detected or reported to the authorities, the question is whether the studio and producers are willing to wager every dime of profit (or if executives are willing to put their liberty at stake) that the payment will never be discovered. And, as the “Sahara” civil litigation demonstrates, creative conflicts unrelated to the alleged improper payments may lead to corrupt activity coming to light.

### ***Looking Forward***

The reach and breadth of the FCPA should not be taken lightly. The millions if not billions of dollars in fines and penalties that may be assessed, the stigma of criminal prosecution and liability, and the threat of incarceration for individuals should cause any company operating internationally to examine its operations.

The U.S. movie industry, given its global reach in both filming and distribution and its extremely deep pockets, makes for a very tempting enforcement target. That said, as with all legal hurdles, effective steps can be taken to minimize potential liability and still operate effectively -- and profitably -- abroad.

Through education and a robust compliance system, major studios and production companies can continue to shoot films in the world's most interesting and exotic locations and keep the audience hungry for more.

[FN1]. *United States v. Green*, No. 2:08-cr-00059-GW, *indictment unsealed* (C.D. Cal. Jan. 16, 2008).

[FN2]. *Cussler v. Crusader Entm't*, No. BC309114, *complaint filed* (Cal. Super. Ct., L.A. County Jan. 15, 2004).

[FN3]. The index is compiled annually by Transparency International, a global, nonpartisan non-governmental organization dedicated to fighting corruption and promoting transparency in government, business and the media. The annual index examines the perception of public sector corruption in 180 countries and territories.

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