ASPATORE SPECIAL REPORT

Increased Enforcement of the Foreign Corrupt Practices Act

Understanding the FCPA and Assisting Clients with Compliance Measures

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Feeling the Impact, Both Positive and Negative, of the FCPA

James G. Tillen
Coordinator, FCPA and Anti-Corruption Practice Group
Miller & Chevalier Chartered

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On its face, the Foreign Corrupt Practices Act (FCPA) has a simple purpose: prohibiting bribery of foreign officials. See Foreign Corrupt Practices Act (FCPA), Pub. L. No. 95-213, Title I, 91 Stat. 1494 (1977) (codified as amended at 15 U.S.C. §§ 78dd-1 et seq.). The U.S. government aggressively enforces the act against U.S. companies and individuals, as well as foreign companies and individuals that have a sufficient nexus to U.S. jurisdiction. Specifically, the FCPA applies to U.S. companies, citizens, and resident aliens for their actions anywhere in the world. For foreign companies and individuals, the entity must take an act "while in the territory" of the United States. See 15 U.S.C. § 78dd-3 (1998). The Department of Justice aggressively interprets the statutory language to apply to a foreign company or person if it causes, *directly or through agents*, an act in furtherance of the corrupt payment to take place within the territory of the United States. See U.S. Dep't of Justice, *Foreign Corrupt Practices Act Anti-bribery Provisions*, *available at* http://www.usdoj.gov/criminal/fraud/fcpa/dojdocb.htm.

In addition to prohibiting foreign bribery, the FCPA also requires issuers—U.S. and foreign companies registered on U.S. stock exchanges—to keep accurate books and records, and to implement internal accounting controls to ensure a company's funds are being used properly. See 15 U.S.C. § 78m(b) (2002). These provisions were designed to prevent companies from disguising bribes on their books and from creating off-book accounts to be used for bribes. These provisions are broad and have been used to punish issuers for inaccurate accounting entries and internal controls weaknesses unrelated to bribery.

Congress enacted the FCPA in 1977 in response to the Watergate scandal, when it was discovered that companies were using off-book accounts to make illegal campaign contributions. As a result, the SEC created a voluntary disclosure program for companies to report undisclosed payments to both domestic and foreign officials. More than 400 companies reported making such payments with amounts totaling over $300 million. The activity uncovered during the voluntary disclosure program led Congress to enact the FCPA with its two provisions: one to prohibit foreign bribery, and one to prohibit off-book slush funds that could be used to make these payments.

Challenges under the FCPA

Although the purpose of the FCPA is simple and most companies wish to avoid bribing officials, complying with the FCPA can be challenging for multinational companies. Challenges stem from the FCPA itself—the ambiguous nature of the statutory language, the relative lack of administrative guidance, and the small number of judicial opinions interpreting the statute—as well as the cultural norms of other countries. Two areas that reflect these challenges are the Act's vicarious liability provisions and the FCPA's treatment of gifts and hospitality for officials.

Vicarious Liability

The FCPA imposes liability if a company, or its officers or employees, gives, pays, promises, offers, or authorizes such payment when the company has knowledge that an improper payment has been or will be made by a third party. "Knowledge" is a defined term that sweeps more broadly than actual knowledge to include situations where "a person is aware of a high probability" of improper payments by a third party. 15 U.S.C. § 78dd-2(h)(3) (1998). According to the legislative history of this provision, the purpose of the standard is to prevent companies from adopting a "head in the sand" approach to the activities and identities of their foreign agents and business partners.

The vicarious liability provisions of the FCPA have ensnared dozens of companies and individuals. The recent conviction of Frederic Bourke, a well-known handbag mogul and co-founder of Dooney & Bourke, sheds light on how ignoring red flags of improper payments by a third party can be sufficient to establish liability. Mr. Bourke was charged with conspiracy to violate the FCPA in connection with his investment in a consortium attempting to gain an interest in the State Oil Company of the Azerbaijan Republic (SOCAR). Bourke and several other co-defendants were accused of participating in a plot to make payments to Azeri officials to promote the privatization of SOCAR and to permit the consortium an ownership interest in the newly privatized entity. The court allowed the government to introduce two types of evidence at trial to prove that Bourke "consciously avoided" knowledge of the consortium's bribes to Azeri officials: (1) background evidence relating to the corruption environment in Azerbaijan

at the time of Bourke's investment in SOCAR, and (2) evidence regarding the knowledge of the consortium's unlawful activities by individuals other than Bourke in order to impute to Bourke evidence of that knowledge. The admission of this evidence was critical to proving that Bourke was aware of the high probability that Azeri officials were being bribed and that he consciously and intentionally avoided confirming that fact. On July 6, 2009, after a six-week jury-trial in Manhattan federal court, Bourke was convicted on charges of conspiracy to violate the FCPA and making false statements to the Federal Bureau of Investigation (FBI). *United States v. Kozeny*, 638 F.Supp.2d 348 (S.D.N.Y. 2009).

Hospitality for Foreign Officials

Conflicts with cultural norms often arise in the area of hosting and hospitality—travel, lodging, meals, per diem, entertainment, and gifts for foreign officials. In many areas of the world, relationship building through these social events is common. Although many types of routine business promotion expenses do not meet all of the elements of an impermissible payment under the FCPA, and notwithstanding that the statute contains anaffirmative defense for "reasonable and bona fide" business expenses, the payment of hosting and hospitality expenses may be deemed not to be "reasonable and bona fide" or not directly related to the promotion, demonstration, or explanation of products or services, or not directly related to the execution or performance of a contract with a government entity.

An example of hospitality that crossed the line is the *Lucent* case from December 2007. According to the pleadings from the case, the company spent more than $10 million between 2000 and 2003 for approximately 1,000 Chinese foreign officials to take 315 trips to the United States and elsewhere. These trips were often characterized as "factory inspections" or "training" in Lucent's books and records, when, by 2001, Lucent actually no longer owned factories for its customers to tour. Instead, the trips were primarily sightseeing tours to places like Disneyland and typically lasted about two weeks, and cost as much as $55,000. The officials worked for entities to which Lucent was seeking to sell equipment and services, or existing customers, and the officials were decision makers. The company reached settlements with the DOJ and SEC that included $2.5 million in

penalties. See Letter from Mark F. Mendelsohn, DOJ Deputy Chief of Fraud Division, to Lucent Technologies (Nov. 14, 2007); *SEC v. Lucent Technologies Inc.*, Civ. Act. No. 1:07-cv-02301 (D.D.C. Dec. 21, 2007).

Changes in Enforcement

For the first twenty years after its passage in 1977, enforcement of the FCPA was sporadic with an average of three to four cases each year. Since the late 1990s, the number of cases has dramatically increased, with 2008 the most active year to date. Fifty-six enforcement actions were brought by the Department of Justice (DOJ) and Securities and Exchange Commission (SEC) in 2007 and 2008 as compared to thirty-eight cases in the five-year period from 2002 to 2006. [See Table 1]

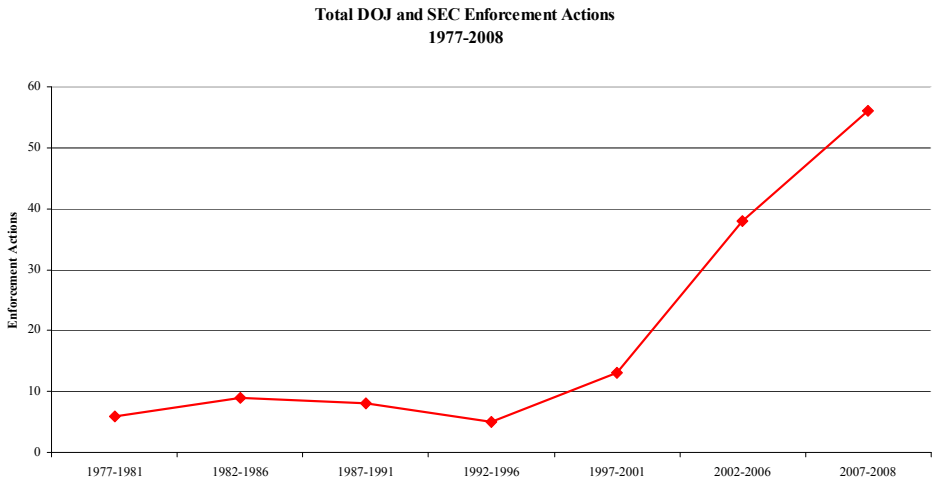

Table 1

In addition, the number and amount of penalties have increased. From 2002 to 2006, financial penalties were imposed on fourteen companies as compared to twenty-four companies in 2007 and 2008 alone. The average penalty size increased substantially from $10.2 million for the period from 2002 to 2006, to $43.5 million for the period from 2007 to 2008, due in large part to a combined $800 million penalty imposed on Siemens A.G. and three subsidiaries in 2008.

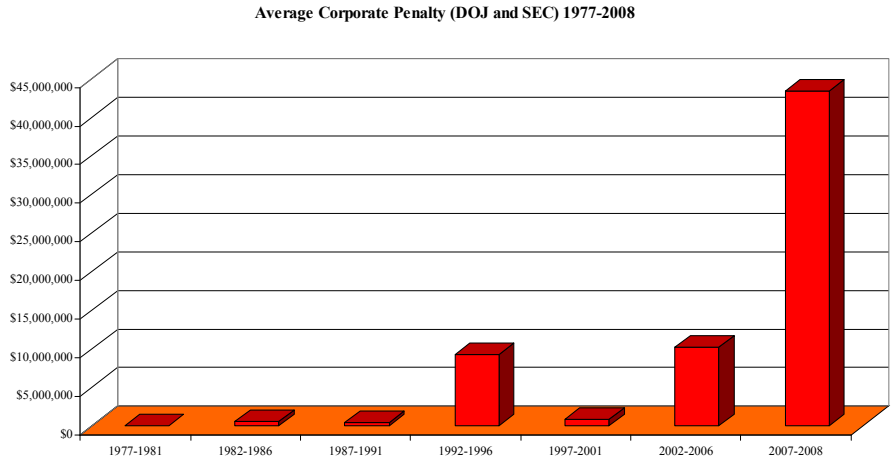

Table 2

Enforcement of the FCPA has increased for a number of reasons. One of the most important is the passage of the Sarbanes-Oxley Act of 2002 (SOX), Pub. L. No. 107-204, 116 Stat. 745 (2002). The FCPA itself does not obligate voluntary disclosure of violations, but FCPA violations may trigger SOX reporting obligations. The government encourages voluntary disclosures and claims that a voluntary disclosure may result in the government declining to prosecute or recommending a lower fine. However, a voluntary disclosure can also lead to an enforcement action against the company itself and against the employees, which further increases the number of cases.

Through voluntary disclosures and investigations, the government can learn about FCPA risks in a particular industry and use the information to investigate additional companies and individuals, which leads to more cases. In addition, the government is also cooperating more with foreign governments than they have in the past. This cooperation is a result of foreign governments joining international treaties against corruption, where they are obligated to cooperate with each other in investigating and prosecuting corruption. Governments now regularly share information (including valuable bank records tracing illicit payments) and arrest and extradite suspects.

The DOJ recently stated that they have more than 120 investigations in the pipeline. If all of those investigations lead to resolutions and enforcement actions, the amount of FCPA jurisprudence will increase significantly.

Most FCPA actions are settled and not litigated, because companies want to avoid going to trial. The DOJ and SEC thus enjoy leverage over companies and can interpret the statute aggressively without judicial interference. Over the years, the DOJ's and SEC's interpretations have evolved so that they expect higher standards of conduct from companies. For example, the government expects companies doing business overseas to have FCPA compliance programs to mitigate corruption risks. The compliance program should be tailored to a company's risk profile and periodically evaluated to ensure it is effective.

Implications of Increased Enforcement

Historically, companies in sectors such as the oil and gas industry and the defense industry, which often involve large-scale transactions in corrupt countries, were the most affected by the FCPA. Because of the recent up-tick in enforcement, there have been actions against companies and individuals in a variety of industries such as agriculture, medical devices, entertainment, freight forwarding, and retail. Today, any company doing business overseas needs to be aware of the FCPA.

The FCPA has already had an effect on international business relations and transactions. The up-tick in enforcement has certainly made more and more companies aware of the law and of the risks; therefore, companies may be more reluctant to do business in a corrupt country because of the risks. When entering risky markets, companies now take steps to protect themselves by conducting due diligence on their business partners and third parties, including contract language prohibiting corruption in their agreements, exercising increased oversight for on the ground activities, and training employees and third parties on how to identify and address corruption. Review of FCPA risks is now a standard part of pre-acquisition due diligence. These developments have identifiably changed the way companies enter markets and stay in countries where there is a problem of corruption.

Advising Clients on FCPA Issues

Attorneys provide an essential risk-mitigation role for companies. With experience, attorneys can be skilled at recognizing FCPA red flags and then determining how to address those red flags. Attorney can help answer FCPA related questions posed by a transaction: Will contract terms be sufficient to educate that third party on the FCPA and prevent behavior that could create a violation? Is the proposed transaction similar to activity previously prosecuted by the DOJ and SEC? Is the transaction consistent with local anti-corruption laws? Is the risk too great, and should the company walk away from this particular transaction?

Because there are no implementing regulations for the FCPA, reviewing past enforcement actions is one of the most valuable resources for attorneys advising their clients. The enforcement actions provide insight into how the DOJ and SEC are interpreting the statute and what types of activities can create risk for a company. In many enforcement actions, the DOJ requires that the company adopt anti-corruption compliance programs with specified elements. These programs provide guidance to attorneys designing or enhancing anti-corruption programs for their clients.

Another valuable resource for attorneys and their clients is the DOJ's website which includes the statutory language, the legislative history, a layman's guide to the FCPA, and recent court decisions. See http://www.usdoj.gov/criminal/fraud/fcpa/. The Web site also includes DOJ opinions issued pursuant to an Opinion Procedure Process. See 28 C.F.R. pt. 80. The Process allows companies to seek a statement from the DOJ of the agency's present enforcement intentions with respect to a proposed transaction. As long as the facts that form the basis of the Opinion are accurate and do not materially change, the issuance of a favorable opinion in effect immunizes the recipient from prosecution. Since inception of the Opinion Procedure Process in 1980, the DOJ has issued more than fifty opinions on topics such as: providing product samples to officials (Procedure Release 81-02); entering into a joint-venture with a foreign government (Procedure Release 93-01); sponsoring training of foreign officials (Procedure Release 96-01); funding of customs agency's anti-counterfeiting program (Procedure Release 06-01); and acquisition due diligence (Procedure Release 08-02).

Conclusion

For years after passage of the FCPA in 1977, some U.S. companies complained that they were disadvantaged in competition with foreign companies because the United States was the only country that had a law prohibiting transnational bribery. Now the playing field is becoming more level as other countries adopt similar anti-corruption laws, and more importantly, enforce those laws. The U.S. government has done what it can to go after foreign companies and individuals that violate the law, which has also helped to modify the behavior of foreign companies, and create an international concept of compliance best practices. There are still problems in competing with companies from countries such as China and Russia that do not abide by the same rules. But the international business community has come a long way and the United States and U.S. companies need to continue leading by example. The negative effects of corruption are obvious—poverty, political instability, and injustice to name a few. Anything that can be done to prevent corruption is a good thing.

James G. Tillen is responsible for coordinating more than twenty-five Miller & Chevalier Chartered lawyers involved in Foreign Corrupt Practice Act (FCPA) matters, often involving complex investigations in multiple countries. He has had significant experience with every facet of an FCPA enforcement matter, from inception to completion, including developing work plans for internal investigations, conducting internal investigations (including in-country witness interviews and document collections and reviews), developing remediation strategies (including employee discipline, compliance program enhancements, and employee training), drafting voluntary disclosures to the U.S. government, negotiating resolutions with the U.S. government, developing strategies for collateral issues (including public relations and related litigation), selecting independent monitors, and interfacing with independent monitors on behalf of clients.

Mr. Tillen also has participated in several FCPA due diligence reviews and compliance audits, drafted numerous FCPA compliance programs, developed FCPA training programs, and performed FCPA training for client operations throughout the world. He has created anti-money laundering compliance programs, incorporating Bank Secrecy Act, PATRIOT Act, Financial Action Task Force (FATF), and Know-Your-Customer (KYC) regulations and principles, for a variety of multinational financial and non-financial institutions.

While at The George Washington University Law School, Mr. Tillen was a member of The George Washington Law Review *and a member of the Equal Justice Foundation.*

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