

Gifts and Entertainment

Gifts, Travel, Entertainment and Anti-Corruption Compliance: Sources of Authority, Best Practices and Benchmarking

By Vincent Pitaro

FCPA experts report that gifts, travel and entertainment expenses are one of the most asked-about areas in anti-corruption compliance and the answers can be surprisingly hard to come by. A recent Strafford webinar provided experienced practitioners' insights into navigating the potentially perilous shoals surrounding these expenses. The program, "FCPA Gifts, Entertainment and Hospitality: Surviving Heightened Enforcement," featured Margaret M. Cassidy, a principal at Cassidy Law in Washington, D.C., and John E. Davis, a member of law firm Miller & Chevalier. Cassidy and Davis discussed available sources of guidance on gifts, travel and entertainment expenses, sources of guidance for benchmarking compliance controls and insights on implementing effective policies with regard to gifts, travel and entertainment. This article summarizes the key takeaways from that presentation. See also "Ten Strategies for Paying for Government Clients to Attend the Olympics or Other Sporting Events without Violating the Foreign Corrupt Practices Act," *The FCPA Report*, Vol. 1, No. 1 (Jun. 6, 2012).

Sources of FCPA Guidance on GTE

The only language that binds the government when it comes to the FCPA is that of the actual statute – there are no regulations alongside it. Davis said that legislative history may help in interpreting the FCPA, but that any guidance issued by government agencies with regard to the FCPA is not binding on the government. The sparse judicial scrutiny on the law leaves most of the government's theories untested.

See, e.g., "A Hot Bench Hears Oral Arguments in Historic Challenge to the Definition of Foreign Official," *The FCPA Report*, Vol. 2, No. 21 (Oct. 23, 2013).

The DOJ/SEC Resource Guide and a few Opinion Procedure Releases from the government do, however, provide some guidance, albeit nonbinding guidance. Settlements may also be instructive. See "How to Build an Anti-Corruption Policy that Allows for Appropriate Business Gifts," *The FCPA Report*, Vol. 1, No. 8 (Sep. 19, 2012).

Opinion Procedure Releases

There are two affirmative defenses to FCPA violations: (1) that the payment was permitted by local law, or (2) that the payment was a "reasonable and bona fide expenditure" directly related to product promotion or demonstration. Cassidy cautioned that asking a local official for an opinion that a certain act is legal may result in FCPA exposure if that person demands a benefit in exchange for giving the favorable opinion.

Similar to no-action letters, DOJ Opinions are specific to a company or individual and are binding only with respect to that company or individual for the conduct or transaction covered by it. Still, Davis said that DOJ Opinions illustrate the factors that the government considers in determining whether gift, travel and entertainment expenses are appropriate and whether those affirmative defenses may be available:

- *The purpose of the payment must be business-related.* The FCPA states that payment of travel expenses for “promotion, demonstration or explanation of products or services” is permissible. Davis said that DOJ Opinions have made clear that providing samples for inspection or testing, and promotional materials of nominal value, are acceptable. He added that “explanation of services” has been interpreted somewhat broadly to include travel for instructional or training purposes. Travel must not be lavish and must be business-related. He noted that a recent DOJ Opinion stated that the payer of the travel expense must not have “non-routine business” pending with the recipient. Davis interpreted this to mean that a company should not “tie a particular trip [or] gift . . . to a particular business decision.”
- *The payment must comply with local law.* Davis noted that most DOJ Opinions have included a discussion of local law. Companies should obtain independent confirmation that a gift, entertainment or travel payment is permitted under local law. Local business practices or social norms do not govern. The DOJ looks only at the law in determining the propriety of a payment.
- *Each expense must be reasonable.* Davis said that the available DOJ Opinions are not very helpful because they only address “nominal” gifts such as souvenirs. He believes that travel and entertainment expenses must be “moderate” and said that the DOJ Opinions make clear that “leisure side trips” are not permitted. Per diem expenses must reasonably approximate actual expenses.
- *The method of selecting recipients must be reasonable and transparent.* Davis said the critical question is whether

the company has pending business with the recipient. A lavish trip that is needed to seal a deal is a red flag. Periodic or routine gifts given as part of a long-term business relationship are less problematic. He pointed out that a good approach is to let the foreign government select the recipients in a transparent manner. That may defeat the argument that the payer chose a particular individual to influence. Benefits for spouses, family members and friends of officials are considered to be made to the officials, so they should not be included on any planned trips.

- *Payments should be made directly to service providers.* It is better to make payments to third-party service providers such as airlines, rather than directly to an official. Payment directly to a hotel or to an airline generally reduces the possibility that an official is receiving cash. Davis said that most compliance procedures now mandate payment directly to service providers.
- *All payments must be recorded accurately to avoid books and records violations.*

FCPA Resource Guide

Davis said that the FCPA Guide is derived from, and builds on, prior DOJ Opinions. See “Top Practitioners Analyze the DOJ & SEC FCPA Guidance (Part Two of Two),” The FCPA Report, Vol. 1, No. 14 (Dec. 12, 2012).

He stressed that the FCPA Guide says that it is “non-binding, informal and summary” and reflects only “what the DOJ thinks at the time.” Even so, he said that agency representatives have indicated that the guide may be relied on reasonably and cited in negotiations over alleged FCPA violations. Davis said that the FCPA Guide confirms that

there is no minimum threshold for gifts and observed that the FCPA Guide considers the size of a gift or payment as an indicator of intent: The larger or more extravagant the gift/payment, the more likely regulators will consider that to be evidence of corrupt intent. Small gifts may be problematic if they are part of a “more egregious pattern of conduct.” He said the message from the FCPA Guide is that companies should not focus on “cups of coffee or lunches,” but on larger and more valuable gifts.

Davis added that the examples in the FCPA Guide show that it is important to consider the reasonableness of gifts under the particular circumstances. He found one example surprising: Business class airfare, a moderate dinner and baseball and theater tickets could be acceptable in the case of an inspection and training visit. Even so, he cautioned that such expenditures may be inappropriate in a different context. He thinks an important upcoming test of the rules will be the World Cup in Brazil, because there are fewer tickets and those tickets will be very expensive. See “The Essentials of the New Brazilian Anti-Corruption Legislation,” *The FCPA Report*, Vol. 2, No. 17 (Aug. 21, 2013).

Recent Enforcement Actions

Davis and Cassidy discussed recent settled enforcement actions and investigations, which provide only guidance, not binding precedent.

- *Ralph Lauren.* Cassidy said that Ralph Lauren’s Argentine subsidiary made nearly \$600,000 in improper payments to Argentine tax and customs officials to get RL products into the country or avoid inspections. The gifts were valued at from \$400 to \$14,000 each. The subsidiary described the expenses as “stamp taxes,” “label taxes” or “delivery expenses.” RL discovered the disguised payments, did a risk assessment and implemented stricter anti-corruption controls. Cassidy said that those actions carried great weight with the SEC and DOJ. RL entered into non-prosecution agreements with those agencies and paid \$1.6 million in penalties. “SEC’s NPA with Ralph Lauren, the Agency’s First Ever, Modifies the M&A Due Diligence Requirements Traditionally Included in DOJ DPAs, and Outlines Specific Actions That Constitute Effective Self-Reporting,” *The FCPA Report*, Vol. 2, No. 9 (May 1, 2013).
- *Orthofix.* Davis said that Orthofix’s Mexican affiliates paid bribes, referred to as “chocolates,” to Mexican officials or front companies owned by those officials, to obtain contracts. Orthofix made payments for services that were never rendered, payments based on false or inflated expense reports, and payments for fabricated promotional and/or training expenses. Orthofix’s Mexican employees used those reimbursements to pay bribes. He said that the SEC and DOJ noted that Orthofix failed to have sufficient oversight over expenses that exceeded budget and failed to conduct sufficient training. It paid penalties of about \$7.5 million and must self-report for two years on its enhanced compliance program. See “Orthofix International Agrees to Pay \$7.5 Million to the SEC and DOJ to Settle Charges that It Bribed Mexican Officials with ‘Chocolates,’” *The FCPA Report*, Vol. 1, No. 3 (Jul. 11, 2012).
- *Eli Lilly.* Davis explained that Eli Lilly’s Chinese affiliate used false expense reports to fund gifts. He said this case is another example of the broad definition of foreign official under the FCPA: The

recipients were doctors at state-owned hospitals and officials responsible for approving drugs for health insurance reimbursements. He said a key takeaway from this case was that the dollar amount of each gift was small (less than a few hundred dollars); however, it involved rampant and widespread falsification of expense reports, which showed significant failures of Eli Lilly's internal controls. He noted that gift-giving in the pharmaceutical industry was a common practice both in the U.S. and abroad, and that in the last decade governments have begun to crack down on the practice. It is also an important part of the culture in China. He said China's laws actually prohibit making gifts to doctors, and that China has "finally decided to enforce" the law. See "Pharma Giant Eli Lilly Agrees to \$29.4 Million Consent Judgment to Settle SEC Charges of FCPA Violations Arising Out of Its Operations in Russia, China, Brazil and Poland," *The FCPA Report*, Vol. 2, No. 1 (Jan. 9, 2013).

- *IBM*. Davis said that IBM's Chinese subsidiary and Korean joint venture partner provided over \$200,000 in gifts, travel and entertainment to Korean and Chinese officials. The misconduct included abuse of per diem payments and payments for fictitious trips and trips unrelated to business. See "After a Protracted Battle About Reporting Requirements, Judge Leon Approves a \$10 Million FCPA Settlement Between IBM and the SEC," *The FCPA Report*, Vol. 2, No. 16 (Aug. 7, 2013).

Davis said that these cases show that travel, gifts and entertainment continue to be used to influence government action. He drew several lessons from those cases:

- Being able to show that a company had an effective compliance program and conducted appropriate training helps to lessen penalties.
- A company must conduct internal audits and reviews of payments to detect improper payments.
- Third parties are an "increasingly important challenge" in this area. He said that an important takeaway from the IBM and Eli Lilly cases is that the companies' employees colluded with third parties, such as travel agents, to provide the benefits. Those third parties provided false invoices to help employees evade internal controls. Consequently, he said, it was important to pay close attention to what vendors are doing with payments.

Suggestions for Internal Controls, Policies and Procedures

Cassidy observed that, even though some issues are quite complex, in some parts of the world, the request for a bribe is "a point blank ask." She cited, as an example, a client's sales team that received a request from a Saudi entity demanding, among other things, first-class airfare and bookings at specific hotels, and listing the U.S. destinations and stores that the persons wanted to visit. Both panelists stressed that compliance programs should be tailored to catch both hidden bribery and blatant requests for improper payments. Cassidy discussed several important elements of an effective anti-corruption compliance program and effective internal controls:

- *Leadership commitment*. Leaders must establish "ownership" of the program and accountability. They must also assure that the compliance department has sufficient resources to do its job. They must

receive reports on issues regarding anti-corruption controls and adapt to changing circumstances. She thinks about “ownership” of the process in terms of “strategic” owners and “tactical” owners. “Strategic” owners should be knowledgeable on anti-corruption laws, regulations and policies, have power to adopt, implement and oversee a program, and have access to auditors and company leadership. “Tactical” owners should handle day-to-day decisions on low-level and country-specific issues, small-value gifts and entertainment and other such matters. Those individuals should have local language skills, be familiar with country-specific rules and be available to answer employee questions.

- *Internal audit.* Audit personnel should have skills in identifying problematic payments. Cassidy noted that one issue that is becoming more common is the use of inflated or even completely false third-party invoices. Forensic audit skills are particularly helpful in detecting transactions that are not consistent with policies. Auditors should have access to management. They must document their plans, check the reliability of internal controls, identify individual transactions and patterns of transactions that may suggest a problem and have a process in place for dealing with those transactions. See “How Forensic Accountants Help Identify Corruption Risk and Delve into the Details of Books and Records,” The FCPA Report, Vol. 2, No. 12 (Jun. 12, 2013).
- *Prescriptive policies.* The more “prescriptive” a policy, the better off the company will be. Policies around gifts, travel and hospitality should be very explicit:

Use specific dollar values; provide for an escalation method if a proposed payment exceeds a specified threshold; provide for disciplinary action in the event of non-compliance; make sure the policy is consistent across all jurisdictions in which the company operates; and consider adopting specific policies for a particular major event, such as the World Cup.

- *Documentation and records.* First, Cassidy said it is important to keep track of gifts, including the identities of the persons making the gifts and the recipients, as well as the dates and amounts of the gifts, and to have the ability to aggregate and parse that data. A searchable database is particularly useful. Second, she encouraged the use of questionnaires to cover the purpose of an event, the invitees, the budget and other such matters. This provides a guide for the employees involved and a starting point for auditors. Third, the company must document actual expenses incurred, including the nature and actual cost of gifts, and information about the donors and recipients.
- *Communications and training.* Once a company has policies in place, it must conduct appropriate training with regard to overall expectations, specific policies and red flags, and the approval and reporting process. It must reinforce its compliance program through frequent communications of expectations and specific policies and alert employees of any changes in applicable laws or policies. Finally, a company should obtain certifications from employees that they have been trained, have received all relevant communications and understand the compliance policies and procedures.

Benchmarking FCPA Best Practices

Cassidy and Davis reviewed several sources of information for benchmarking best practices on FCPA compliance in general and gifts, travel and entertainment in particular:

- *Department of State.* The Office of Commercial and Business Affairs of the U.S. Department of State offers “Commercial Guides” for various countries. The guides include market analysis, and political and economic data. They may also include information on corrupt practices and other business risks. Cassidy added that there are two fee-based programs: The “Gold Key Program,” provides information on and introductions to local business partners deemed reputable by U.S. officials. The “Platinum Key Service” includes personalized guidance in particular markets.
- *Department of Commerce.* For a fee, the Department of Commerce provides international company reports that are helpful in conducting due diligence.
- *OECD.* The Organisation for Economic Co-operation and Development provides guides for international business that include corruption risks.
- *U.N. Guide.* Cassidy noted that United Nations’ “Strategy for Safeguarding Against Corruption at Major Public Events” provides useful insights, though it is not a “how-to” guide.
- *SFO Guidance on U.K. Bribery Act.* See “Britain’s Serious Fraud Office Updates Guidance on the Bribery Act, Reinforcing Its Role as a Crime Fighting Agency,” *The FCPA Report*, Vol. 1, No. 10 (Oct. 17, 2012).
- *Local Laws.* Davis said that laws in other countries have been updated (often in response to pressure from the OECD) in a number of ways to address corruption, including enactment of laws modeled on the FCPA, codes of conduct for officials or mandatory reporting of certain payments.
- *Industry Guides.* Davis noted that industry practice and industry codes are useful guides. He cited as examples the code of conduct issued by the Pharmaceutical Research and Manufacturers of America and the code of ethics adopted by PetroChina.