

The Foreign Corrupt Practices Act

US legislation with global implications

Illustration: Getty Images

Dick Thornburgh,
Edward J Fishman,
Michael J Missal,
Jeffrey B Maletta and
Matt T Morley of
K&L Gates LLP
examine anti-corruption
laws and recent
developments in
enforcement.

More than thirty years after the 1977 enactment of the US Foreign Corrupt Practices Act (FCPA), anti-corruption compliance has become one of the most important areas of risk management for business entities that transact business in foreign countries.

The multi-million dollar settlements by Chevron, AB Volvo and other multinational companies arising out of the UN Oil-for-Food Program and the management and financial fallout from a widespread corruption scandal at Siemens



show the significant risks to businesses operating in the global economy posed by violations of anti-corruption laws. These laws are being enforced more vigorously by law enforcement authorities, not only in the US, but around the world.

The Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) continue to lead the effort to eradicate bribery payments to foreign government officials. These regulatory authorities are on pace in 2008 to exceed historical levels of enforcement activity.

They have recently intensified their focus on prosecuting individuals and non-US companies that access US capital markets and the aggressive enforcement of the FCPA is likely to continue. There has also been a surge in anti-corruption enforcement by European and other non-US law enforcement authorities, based in part on greater collaboration with US authorities and increased resources for anti-bribery initiatives.

This article focuses on the significance of these developments from a compliance standpoint. The global expansion of anti-corruption enforcement requires both US and non-US companies to understand:

- The specific requirements of the FCPA and similar anti-corruption laws.
- The implications of discovering potential violations.
- The importance of conducting adequate due diligence in connection with mergers and acquisitions, joint ventures and other cross-border business transactions.

FCPA OVERVIEW

The FCPA was enacted more than thirty years ago following post-Watergate era disclosures that prominent US companies had paid substantial bribes to foreign government officials to obtain lucrative contracts.

The FCPA's extensive jurisdictional reach

The Foreign Corrupt Practices Act of 1977 (FCPA) anti-bribery provision applies to non-US business entities that:

- Register securities on US exchanges.
- File reports with the Securities and Exchange Commission (SEC) as a result of capital raising activities in the US.

These so-called "SEC issuers" include the roughly 1,500 non-US companies that trade American Depository Receipts on the US stock exchanges.

The FCPA anti-bribery provision also applies to any person who violates the FCPA while in US territory, or who makes use of US communications or banking networks in connection with a violation of the FCPA. The FCPA accounting provisions apply to SEC issuers and to non-US subsidiaries that are controlled by US companies through ownership or otherwise.

The FCPA essentially prohibits US citizens and permanent residents, both public and private US companies and certain non-US individuals and entities from bribing foreign government officials in order to obtain a business advantage. Under some circumstances, the FCPA's jurisdiction extends to non-US individuals and companies, such as those who use the US capital markets, or those who use US communications or banking networks in furtherance of improper payment schemes (*see box "The FCPA's extensive jurisdictional reach"*).

The FCPA has two main elements:

- The anti-bribery provisions, which are enforced by both the DOJ and the SEC (against US "issuers"), prohibit giving or offering money, gifts or "anything of value" to a foreign government official in order to obtain or retain business.
- The accounting provisions, which are enforced by the SEC, require subject companies to maintain adequate "books and records" and "internal controls" over financial transactions. Significantly, violations of these accounting provisions do not need to

have any connection to improper payments at all, and can be charged even if there is no violation of the anti-bribery statute.

Anti-bribery provision

The anti-bribery provision prohibits a wide range of conduct arising from interactions with officials and employees of foreign governments and state-owned enterprises. This prohibited conduct includes the payment of a bribe (in the form of money, gifts, services or other things of value) to a non-US government official in order to obtain an improper business advantage.

The anti-bribery provision also prohibits the mere offer of such a payment, either directly or through a third party agent, for the purpose of obtaining or retaining business or directing business to any person. There are three principal reasons for the expansive scope of the provision:

- The definition of a foreign government official under the FCPA is very broad so as to include not only government ministers and lower-level government employees, but also managers and employees of state-owned or state-con-

trolled business enterprises. This is particularly significant in Asia, South America and other regions of the world with a history of significant government involvement in commerce. In these regions, the managers, employees and third party agents of many business counterparties that are owned or controlled by the state likely qualify as foreign government officials under the FCPA. The foreign official definition under the FCPA also includes political party members, candidates for political office, and representatives of non-governmental organisations such as the World Bank.

- The “business nexus” required for a payment to violate the anti-bribery provision of the FCPA has been interpreted expansively by the DOJ and the SEC in recent years. Although the initial focus of the law from an enforcement perspective was on bribes made to obtain lucrative contracts from foreign governments, recent DOJ prosecutions have been initiated in connection with payments made to obtain favourable treatment regarding tax, customs and other business matters that are unrelated to particular government contracts. The US Court of Appeals for the Fifth Circuit in *US v Kay* recently upheld this broad interpretation by the DOJ of the “business nexus” requirement in a case involving alleged bribes to Haitian customs officials by the officers of a US company that sought lower customs duties for its importation of rice into Haiti (*No. 05-20604, 5th Circuit 24 October 2007*).
- US law enforcement officials have been aggressive in their interpretation of the jurisdictional scope of the statute and have initiated prosecutions against non-US individuals and business entities in certain cases despite the attenuated nature of their contacts with the US. For example, a former French executive at telecommunications firm Alcatel (whose US depository shares were traded on the

New York Stock Exchange until 2006) was recently sentenced to 30 months in a US prison for participating in an alleged \$2.5 million bribery scheme involving a mobile telephone contract in Costa Rica.

Facilitating payments exception. The anti-bribery statute contains an exception for nominal “facilitating payments” that are made to induce lower-level foreign officials to perform routine, non-discretionary tasks they are otherwise required to perform.

The FCPA specifies that such routine governmental tasks include processing governmental papers such as visas, providing police protection, scheduling inspections associated with contract performance and actions of a similar nature. In practice, the scope of this exception is extremely narrow, as it may be difficult to establish the actual purpose of a payment. For example, where a payment is made in connection with “scheduling” an inspection of a manufacturing facility, law enforcement authorities may allege that the purpose of the payment was to assure a favourable result of the inspection, rather than to assure that the inspection occur in a timely manner.

The “facilitating payment” exception to the FCPA is unusual. Most countries do not have explicit exceptions in their domestic bribery laws for any such payments made to government officials. For this reason, to ensure compliance with both the FCPA and local laws, many multinational companies either prohibit facilitating payments outright or allow such payments only within certain narrow parameters.

Defences. The FCPA anti-bribery statute contains two affirmative defences:

- The FCPA is not violated if the payment or other benefit given or offered to a foreign official was lawful under the written laws of the applicable foreign jurisdiction. In practice, this de-

fence is rarely available because most countries do not expressly condone payments to individual government officials.

- It is an affirmative defence to an anti-bribery charge if the payment or other benefit was a reasonable and bona fide expenditure (such as travel and lodging expenses) directly related to either the promotion of a product or service, or the performance of a contract with a foreign government. This means that it might be permissible under the FCPA to sponsor a visit by foreign government officials to a US manufacturing facility and to provide such officials with modest gifts bearing a company’s logo. However, recent enforcement actions against Lucent and other companies have made it clear that excessive travel arrangements (such as all-expense paid visits to Disney World), cash advances for sightseeing, or benefits given to the spouses of foreign government officials are not covered under this affirmative defence.

Accounting provisions

The FCPA’s “books and records” and “internal controls” provisions only apply to US and non-US entities that have securities registered for trading on a US exchange or are otherwise required to file reports with the SEC (so-called “issuers”). These provisions also extend to such issuers’ wholly-owned and majority controlled foreign subsidiaries and affiliates. In addition, issuers are required to use good faith efforts to cause entities in which they own less than half of the voting power to comply with the accounting provisions.

The “books and records” provision requires such entities to maintain financial records which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

The “internal controls” provision requires such entities to devise and maintain a system of internal accounting controls

sufficient to detect corrupt practices and other types of fraud.

These accounting requirements are not confined to transactions with foreign government officials, but apply to all of the relevant entity's business dealings and are a major focus of the section 404 internal controls evaluation required to be performed by SEC issuers and reviewed by independent auditors under the Sarbanes-Oxley Act of 2002.

There is no materiality threshold under the "books and records" or "internal controls" provisions, and no proof of knowledge or intent is required to establish a civil violation of these requirements. In addition, the DOJ has criminal enforcement authority to the extent there is a willful violation of the accounting provisions.

The SEC generally takes the position that any improper payment to a foreign government official that is not described as a "bribe" in the financial records of an issuer violates both the "books and records" provision and may also be an indication of insufficient internal controls. Moreover, these accounting provisions apply to all transactions by an issuer, regardless of whether any improper payments are involved. The SEC routinely charges violations of these provisions in cases relating to accounting fraud and disclosure violations by public companies.

Severity of penalties

A violation of the anti-bribery provisions may result in criminal fines. For business entities, fines may be up to \$2 million per violation or, in some circumstances, double the amount of the benefit obtained by the illegal bribery scheme.

The maximum criminal penalty for an individual is \$250,000 and five years' imprisonment per violation. A single violation of the accounting provisions may result in civil penalties of up to \$500,000 for entities and \$100,000 for individuals. A willful violation could result in criminal fines

of up to \$25 million for entities and up to \$5 million and 20 years' imprisonment for individuals.

Beyond this, the SEC generally seeks the disgorgement of any profits that can be attributed to an improper payment. In addition, companies that violate the FCPA often incur significant damage to their reputations, disruptions in their business operations, and the increasing risk of collateral private litigation (despite the fact that there is no private right of action under the anti-bribery provisions themselves).

RECENT TRENDS IN ANTI CORRUPTION ENFORCEMENT

There are several clear trends in recent FCPA enforcement actions by US and other countries' regulatory authorities.

Enforcement activity still active

The extent of FCPA enforcement activity in 2008 may exceed the record levels of prosecutions and settlements reached in 2007. This is attributable largely to the continued priority placed on anti-corruption enforcement and the devotion of significant resources to this effort by US authorities. For example, the DOJ has dedicated a team of agents from the Federal Bureau of Investigation (FBI) to focus on FCPA investigations.

The DOJ and the SEC have also continued to encourage companies to self-report FCPA violations, with the promise of potential leniency to those who come forward voluntarily.

Fines imposed in FCPA settlements continue to be severe. In May 2008, Willbros Group settled SEC civil and DOJ criminal charges arising out of \$3.8 million in alleged improper payments to government officials in Nigeria and Ecuador.

The combined \$32.3 million settlement with the DOJ and the SEC was the one of the largest in history, second only to the 2007 agreement by Baker Hughes to pay \$44 million in profits and disgorgement

for allegedly bribing officials in Kazakhstan to obtain oil-related work.

Enforcement outside US increasing

There has been increasing convergence between the anti-corruption regimes in the US and abroad. The number of parallel investigations by US and non-US regulatory authorities has increased dramatically in recent years, as a result of greater collaboration across borders by law enforcement authorities.

In addition, under significant pressure from the US, many European and other countries are beginning to prioritise the enforcement of their own anti-corruption laws, which have been enacted since 1999 in accordance with their obligations under anti-corruption conventions enacted by the United Nations, the Organisation on Economic Development and Co-operation and the Organisation of American States. These laws are virtually identical to the FCPA. As noted above, the SEC and the DOJ have taken an aggressive position regarding their jurisdiction over foreign businesses and nationals.

As a result, companies may increasingly face investigations of the same circumstances by multiple law enforcement authorities. For example, Norwegian oil company Statoil ASA settled parallel investigations by the DOJ and the SEC arising out of \$5 million in alleged payments to Iranian oil officials in exchange for access to non-public information about bids on oil field development contracts. Statoil also reached a settlement with Norwegian authorities in connection with the same conduct. The DOJ agreed to credit \$3 million in fines that Statoil paid to the Norwegian authorities as part of its \$10.5 million settlement.

More recently, the DOJ declined to pursue criminal sanctions against certain foreign businesses involved in the Oil-for-Food scandal because of enforcement action taken by the Dutch government. This trend of parallel investigations and settlements is expected to increase.

Focus on individual prosecutions and alternative remedies

The US authorities have increased their focus on prosecuting individuals. A former senior executive with Kellogg Brown & Root recently pleaded guilty to conspiring to violate the FCPA and faces seven years in prison and \$10.8 million in restitution. Many of the officers and other employees of companies that have settled FCPA charges have subsequently faced individual prosecution based on evidence gathered during the corporate settlement.

In addition, the appointment of an independent corporate compliance monitor has become a standard feature of FCPA settlements. These monitors are responsible for evaluating the company's FCPA compliance programmes and reporting on its compliance for a period of time, often up to three years. The costs of such a monitor, which can be significant, are borne by the settling company.

Emphasis on transactional due diligence

The US regulatory authorities have made it clear through their FCPA enforcement activity that extensive FCPA due diligence is expected in connection with any merger, acquisition, joint venture or other cross-border business transaction involving entities subject to the FCPA. This is particularly important in business transactions in countries with a reputation for corrupt practices, which the DOJ views, in and of itself, as a potential "red flag" from a compliance standpoint.

Many of the voluntary disclosures and subsequent settlements reached under the FCPA relate to conduct that was uncovered by an acquiring company during transactional due diligence. In an effort to avoid potential successor liability for the pre-acquisition actions of the target company, some acquiring companies have reported potential FCPA violations to the regulatory authorities and reached settlements prior to closing their business transactions.

Following the collapse of Lockheed Martin's proposal to acquire Titan Corporation due to the discovery of improper payments by Titan, the allocation of risks relating to FCPA issues that arise pre-closing has become an important focus of negotiation in merger and acquisition agreements.

Private litigation risk increasing

There has been a noticeable increase in the amount of private civil litigation that follows the public disclosure of an FCPA investigation or settlement. While the FCPA does not provide for any private right of action, plaintiffs have increasingly sought to pursue other causes of action where companies are affected by improper payment issues.

Several companies that settled FCPA charges arising out of the Oil-for-Food scandal have been sued in New York by the Republic of Iraq. The wire fraud, mail fraud, racketeering and related claims against the companies are based on an alleged conspiracy with the Saddam Hussein regime to divert approximately \$10 billion in humanitarian funds from the Iraqi people.

There also has been recent litigation by government-controlled companies against alleged payers of bribes, asserting claims that the plaintiffs' own employees have been corrupted by improper payments.

MINIMISING FCPA AND OTHER ANTI-CORRUPTION LIABILITY

In the current enforcement environment, and in light of the severity of the penalties that can be imposed, there are several steps that businesses can take to mitigate their potential anti-corruption exposure arising from business activities with foreign governments or business enterprises controlled by foreign governments. These steps include:

Effective anti-corruption compliance policies and procedures

At a minimum, any company operating in the global marketplace should have

policies and procedures in place:

- To educate managers, employees and third party agents about anti-corruption laws.
- To prevent or detect conduct that might violate anti-corruption laws.
- To monitor compliance with internal controls.
- To create an annual anti-corruption compliance certification process and mechanisms to allow employees to report potential violations in a confidential manner.

For many multinational companies, these policies need to cover both the FCPA and other applicable anti-corruption laws. They need to be translated into several languages and be customised to operating practices in particular jurisdictions. Law enforcement officials expect companies not only to have a compliance programme, but also to have it implemented effectively and enforced on a consistent basis.

Thorough due diligence in business transactions and third party relationships

Thorough due diligence is imperative for entities that are considering an acquisition, merger, joint venture or other business relationship with a company that has cross-border operations. Such due diligence should include a review of all significant interactions between the target company and foreign government officials (as defined under the FCPA).

Similarly, any business enterprise that relies on a third party agent to interact with foreign government officials on its behalf must engage in sufficient due diligence about the agent's reputation, business practices, and ties to government officials.

Sensitivity to global consequences of problematic conduct

Companies operating in, and subject to, the laws of multiple jurisdictions must be sensitive to the global consequences of

conduct that may run afoul of various anti-corruption regimes. The costs and complexities of conducting an internal investigation and responding to regulators in multiple countries can be enormous.

These challenges are exacerbated when potentially relevant evidence is reflected in different languages, stored in multiple computer systems, and recorded in divergent financial systems.

In addition, the interests of a parent company, its subsidiaries and affiliates, joint venture partners and individual employees in such an investigation and negotiation may diverge. Of course, problems are best addressed before they become issues.

Internal audit testing of high-risk business locations

It is not sufficient to have a comprehensive FCPA compliance policy without adequate and frequent testing of its effectiveness. For this reason, all companies should endeavour to conduct full scope audit work (through internal audit staff or outside auditors) at all high-risk business locations within a specified time frame (for example, no less than every three years). This audit work should include testing in high-risk areas such as cash handling and disbursements, third-party agent transactions, wire transfers, customs compliance and tax settlements.

The audit coverage schedule should be based on a risk assessment that adequately considers, among other factors, any material management or system changes, the relative size of the business unit, and the time since the last audit at that location.

Oversight of sales agents and other consultants

The unsupervised use of sales agents, tax consultants, lobbyists and other third party consultants is a breeding ground for potential FCPA problems. Any written contracts or other arrangements with such consultants should be approved by legal counsel. Consultants should be required to abide by the company's FCPA policy and provide representations and warranties regarding FCPA compliance.

Effective management and "tone at the top"

One of the best tools for managing FCPA risk is to have effective management in place at the corporate and oversight levels for any local subsidiary. In addition to setting the proper tone about the importance of ethical conduct, good managers often make frequent visits to local operating units and communicate directly with local employees. This level of interaction can facilitate the dissemination of company rules and policies and can encourage early disclosure or detection of potential FCPA problems.

Swift and thorough response to possible FCPA violations

If a potential FCPA violation comes to a company's attention, the company should conduct a prompt and thorough investigation to determine the nature of the potential violation, the adequacy of the controls in place to prevent such occurrences and the steps necessary to remedy any control deficiencies.

In certain circumstances, it is preferable to have outside counsel and forensic accountants conduct the investigation to maintain independence from management and others that might be involved in the questionable conduct. The company should consult experienced FCPA counsel about:

- Attorney-client privilege, document preservation, privacy, employment and other issues that are likely to arise in the course of the investigation.
- Whether to make voluntary disclosure of a potential FCPA violation to the US enforcement agencies or to the public.

Dick Thornburgh is of counsel at the Washington DC office of K&L Gates LLP and is a former Attorney General of the US. Edward Fishman, Michael Missal, Jeffrey Maletta and Matt Morley are partners in the Washington DC office of K&L Gates LLP.

