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Caveat Obsido: New Red Flag for Investors in Foreign Businesses

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Introduction

The recent conviction of wealthy investor Frederic Bourke by a federal jury in New York reaffirms that the U.S. government's anti-corruption enforcement program, led by the Fraud Section of the Department of Justice, continues to push to the brink the limits of an already sweeping statute. The government argued that, although Bourke did not pay or direct the bribes, he was nonetheless guilty because he knew or should have known that bribes were being paid by others involved in the investment deal. The jury unanimously agreed.¹

The *Bourke* case serves as both a reminder to investors in international deals (both individuals and businesses) that they are covered by the Foreign Corrupt Practices Act of 1977 (FCPA) and a warning shot to all that mere knowledge, a "refusal to know," or "willful blindness" may be enough to confer FCPA *criminal* liability.

No criminal defendant has successfully challenged the government's application of the FCPA anti-bribery provisions in a jury trial in more than a decade and, with the exception of two Canadian officials who argued they were immune from prosecution, and Bourke's successful bid to throw out substantive FCPA counts on statute of limitations grounds (Bourke still had to fight conspiracy to violate the FCPA and other charges at trial), few have won any significant concessions or limitations in FCPA prosecutions in U.S. courts. Thus, the government's increasingly aggressive and broad application of the statute remains relatively unchecked.

The prosecution of Bourke and some of his fellow investors, including Czech-born Viktor Kozeny, Swiss attorney Hans Bodmer, and U.S. hedge fund Omega Advisors, is the second U.S. corruption case involving *investors* in foreign business opportunities since 2002. The government's investigations involving ABB/Vetco Gray entities and their successors involved payments of more than \$3 million in bribes to foreign officials and resulted in a series of corporate criminal pleas in 2004, 2007, and 2008. The *Bourke* prosecution, initiated in 2005, involved alleged bribes to Azeri officials in connection with the anticipated sale of Azerbaijan's state-owned oil company. This closely watched case reemphasizes that even private equity, institutional, and other financial investors are covered by the FCPA's reach and that if they are not careful, they may find themselves in the crosshairs of a U.S. criminal enforcement action that could result in the loss of substantial investments and business opportunities, as well as possible jail time.

¹ Bourke was found guilty of conspiracy to violate the Foreign Corrupt Practices Act of 1977 (FCPA) and the Travel Act and making false statements.

What the FCPA Prohibits

Generally speaking, the FCPA prohibits the bribery of foreign officials.² Although this rule sounds relatively simple, the statute has an expansive reach. Specifically, the FCPA prohibits the making, promise, offer, or authorization of “anything of value” directly or indirectly to foreign officials for the purpose of obtaining or retaining business or seeking a business advantage. A “foreign official” is anyone who works for a foreign government, including those who work for foreign state-owned or state-controlled companies, such as doctors who work in state-run hospitals or clinics, or even journalists in countries such as China where the media is controlled by the government.

“Anything of value” means just that. The FCPA is not limited to cash bribes. Rather, any *quid pro quo* will suffice, including requests for donations to charitable causes, gifts, travel, entertainment, or investment opportunities. A prohibited benefit may not be conferred either directly or indirectly through a third party, such as an agent, consultant, accountant, or lawyer. Similarly, a “business advantage” is not limited to lucrative new contracts or business opportunities. Rather, it can include beneficial legislation or lower foreign customs taxes that, overall, give the company an advantage over others by lowering its expenses. The prosecution of former American Rice, Inc. executives David Kay and Douglas Murphy emphasized that FCPA liability can be predicated on the improper obtainment of a general business advantage, and does not require procurement of a specific contract or business opportunity.

Importantly, the bribe need not ultimately have its intended effect. Even if the “bribed” foreign official “stiffs” you, the government can still prosecute you. The mere offer of a payment is enough. In fact, Bourke personally lost \$8 million and others lost upwards of \$150 million in this botched investment deal, either due to Viktor Kozeny’s shenanigans, corrupt Azeri officials who took the money for nothing, or a combination of both. This substantial loss shielded few from prosecution and ensured contentious ongoing civil litigation over who was to blame.

Who Is Covered?

Who is covered by the FCPA? The answer: probably more than you think or would like to believe. The FCPA is not limited to U.S. companies or citizens.³ Rather, the U.S. government has also aggressively pursued foreign companies and foreign individuals for violating the statute’s anti-bribery provisions. The Department of Justice maintains that any company that trades on U.S. exchanges is considered to be an “issuer” under the FCPA, including those trading debt such as American Depositary Receipts (ADRs). In fact, this was the basis for jurisdiction over Statoil, a Norwegian oil and gas company and the first to settle with the U.S. government as a “foreign issuer.”

Another mechanism by which the U.S. government has established FCPA jurisdiction over foreign companies is based on minimum contacts in the United States that furthers conduct covered by the FCPA, such as emails, facsimiles, telephone calls, as well as wire transfers and payments through correspondent bank accounts in the United States. The recent settlements with Siemens and KBR highlight the government’s view that

² The books and records provisions of the FCPA require “issuers” to maintain accurate books and records and to maintain a system of internal controls designed to ensure that their financial transactions are recorded accurately.

³ U.S. domestic concerns (including U.S. citizens and companies organized under U.S. laws) are prohibited from acting in violation of the FCPA anywhere in the world.

transactions that clear through correspondent accounts in U.S. intermediary banks are sufficient to establish U.S. jurisdiction over all parties to the transactions—including foreign companies and individuals.

In recent FCPA conferences, U.S. enforcement officials have been quick to point out that they are now targeting individuals and demanding more jail time to deter others from engaging in conduct prohibited by the FCPA. They emphasize that the FCPA is not limited to U.S. citizens and that they are willing to prosecute foreign citizens over whom they can establish jurisdiction.

In addition to covering prohibited conduct by U.S. citizens anywhere in the world, U.S. enforcement officials also contend that the FCPA prohibits the same conduct by individuals, regardless of nationality, who are employed by or agents of “issuers,” as well as foreign nationals who engage in activity in the U.S. in furtherance of prohibited conduct.

Although there is little guidance in the statute as to the level of minimal contacts required, the government has not been shy to test the limits. An example of an individual whose contacts with the U.S. were minimal but who was nonetheless prosecuted under the FCPA is French citizen Christian Sapsizian. Sapsizian worked for a French company that traded ADRs on U.S. exchanges (i.e., a foreign issuer) and arranged for bribes that were paid through correspondent bank accounts in New York. Sapsizian, who was accused of bribing Costa Rican officials and did not live or work in the U.S., was arrested by U.S. authorities and jailed on an arrest warrant during a brief layover in Miami as he traveled from Central America to Paris. He later pled guilty.

Interestingly, the only persons not covered by the FCPA are the corrupt foreign officials themselves.

Mere Knowledge (or Refusal to Know)

With the *Bourke* conviction, it appears that the government’s enforcement program has reached new heights (or depths, depending on your point of view). Although the FCPA predictably requires “corrupt intent,” the *Bourke* case indicates that mere knowledge or a “refusal to know” may be enough to confer FCPA criminal liability. The government argued that, although Bourke did not pay or direct the bribes, he could nonetheless be found guilty because he knew or should have known that bribes were being paid by Kozeny and others.

Specifically, the government claimed that instead of doing adequate due diligence, he intentionally “stuck his head in the sand.” The jury agreed and unanimously voted to convict Bourke. Following the verdict, one juror was quoted as saying, “We thought [Bourke] knew [about the bribery] and definitely could have known. He’s an investor. It’s his job to know.”

Implications for Investors

What does the *Bourke* verdict mean for all investors with international business opportunities?

- **Get your house in order before investing in countries that present significant corruption risks.** Although emerging economies offer significant, high-value opportunities, they also present substantially higher risks and U.S. authorities will expect that investors adequately inform themselves and put

appropriate controls in place to avoid corruption issues.

- **The more control the investor has or the more significant the investment, the more the government will expect by way of compliance measures.** Although completely passive investors are unlikely to hear from enforcement regulators for violating the FCPA, the greater the investment and the greater the oversight of the investment dollars (for example, meetings, board seats, etc.), the less likely it is that the government will buy an argument that the investor is purely “passive,” did not know of the offending conduct, or did not have the ability to either address the unlawful conduct or withdraw from the investment.

Ownership or control does not require a 50% or more holding. Rather, investors who hold less than 50% but who still have certain controls, such as “negative control,” board seats, or involvement in managing the investment, are still at risk for FCPA enforcement.

- **Conduct thorough due diligence on your investment partners, foreign business partners, and other third parties.** In short, know your business partners and those with whom you are transacting business. Similar to the long-standing requirements of anti-money laundering, anti-terrorism, and export control laws, anti-corruption “best practices” should include appropriate pre-deal due diligence. In high-risk deals, due diligence should be rigorous, and investors may want to seek guidance from outside experts to ensure that “red flags” are appropriately addressed (if they can be). In low-risk deals, less due diligence may be required but appropriate documentation will be equally important nonetheless.
- **Avoid successor liability.** One way to avoid successor liability is to identify problematic conduct during pre-acquisition due diligence and to seek assurances that the government will not prosecute the acquiring company. This was successfully achieved in Cardinal Health’s acquisition of Syncor and in Halliburton’s recent acquisition of KBR. New private equity investors achieved similar results prior to the acquisition of ABB/Vetco Gray entities, but the government, unhappy with the new owners’ post-acquisition compliance follow-through, which did not prevent additional violations, required successor entities to enter into criminal dispositions.

Companies that fail to discover a problem until after acquisition are at risk for prosecution. However, such companies, or companies that decide not to disclose a violation to the government, can still address corruption problems through remediation and the implementation (or enhancement) of controls and compliance measures. If the government finds out about the problem later, the company will be able to argue mitigation based on the fact that it undertook appropriate steps to fix the problem.

- **Conduct due diligence sufficiently in advance of the investment to evaluate corruption risk and accompanying valuation risks.** The *Bourke* case highlights the fact that corruption not only exposes investors to potential criminal legal troubles, but can also significantly decrease the value of the investment opportunity. Not surprisingly, it is common for corrupt government officials to renege on agreements that no longer suit them, to ask for more than what was originally promised or requested, or to walk away completely when things go bad. In addition to the prospect of jail time, it is unlikely that Bourke and his fellow investors will see a return of their original capital (exceeding \$150 million in total), much less the promised returns of 10 to 20 times the investment.

- **Require training and the implementation of anti-corruption policies and procedures.** Make sure your foreign business partners understand that their conduct could subject both you and your company to criminal liability under the FCPA. Importantly, make sure that your foreign business partners understand that they are not necessarily immune from prosecution under U.S. anti-corruption law either. Establish a training program and ensure the contractual arrangement spells out the expectation that both sides will comply with all applicable anti-corruption laws.
- **Build in protections to allow for contingencies, particularly in higher-risk deals.** After addressing “red flags” in higher-risk deals, consider including additional contingencies in the contractual agreements. Consider whether it would be helpful to demand a right of audit or to seek a contractual right to withdraw the investment without penalty if corruption activity is discovered.

If these types of issues are not addressed at the outset and corrupt activity comes to light, investors may find themselves in the precarious position of either having to withdraw from an investment at a significant loss or penalty or, in the alternative, remaining in the investment with knowledge of the corrupt activity and, therefore, the possibility of prosecution if the authorities discover it. The fact that knowledge may be sufficient to confer FCPA liability raises the real possibility that well-meaning but ill-prepared investors will face this Hobson's choice in the future.

Conclusion

The *Bourke* prosecution presents a complex twist in what is already an extraordinarily complicated and difficult enforcement and business environment, but it tells us what we already knew—that the government's FCPA enforcement arm is very long and its hand is heavy and unrestrained.

How investors and businesses weigh and respond to these issues in the future remains to be seen, but one result is certain: this case will necessarily require investors and businesses around the world to focus sharply on the way they think about and address anti-corruption issues in the future.

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