

Morgan Lewis

Foreign Corrupt Practices Act (FCPA)
2009 Year in Review



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Topics of Discussion

- Overview of the FCPA and 2009 Enforcement Statistics
- The Rise of SEC Enforcement
- Individual Prosecutions
- The Travel Act and Other Statutes
- Due Diligence Procedures
- Q&A

Overview of the FCPA and 2009 Enforcement Statistics

FCPA's Two Prongs

ANTIBRIBERY PROVISIONS:

Prohibits bribery of foreign government or political officials for the purpose of obtaining or retaining business or securing any improper business advantage

BOOKS & RECORDS PROVISIONS:

Requires SEC-registered or reporting issuers to make and maintain accurate books and records and to implement adequate internal accounting controls

Antibribery Prohibited Acts

- It is unlawful for
 - an issuer, domestic concern, or anyone acting within the jurisdiction of the United States
 - with “corrupt intent”
 - directly or indirectly
 - to offer, pay, promise to pay, or authorize payment
 - of “anything of value”
 - to a “foreign official”
 - for the purpose of obtaining or retaining business or securing any improper business advantage

To Whom Do the Antibribery Provisions Apply?

- Any “**issuer**” that files reports to the SEC or trades equity or debt on a U.S. exchange
 - Includes any foreign company that trades, for example, American Depository Receipts (ADRs), on a U.S. exchange.
 - Examples: Statoil, Novo Nordisk
- Any “**domestic concern**”
 - Includes U.S. citizens, nationals, and residents as well as any entity (corporation, partnership, etc.) that is organized under the laws of the United States or a U.S. territory or that has its principal place of business in the United States.
 - Examples: Bourke, Omega Advisors
- Any “**person**,” including an organization, wherever located, that, while in the territory of the United States, does any act in furtherance of the prohibited conduct
 - Government argues minimum contacts include emails, telephone calls, transfers through correspondent bank accounts in U.S. intermediary banks
 - Examples: Seimens, KBR, Sapsizian

“Knowledge” and “Corrupt Intent”

“Knew or should have known”

Refusal to know

Corporate
Collective
Knowledge

Quid Pro Quo

“Limits” of Knowledge and Intent

- United States v. Bourke
 - Co-investors in Azeri investment deal prosecuted
 - Bourke did not pay or authorize the payment of bribes
 - The government argued that he knew or should have known his co-investor was paying bribes to foreign officials
 - Willful blindness was sufficient to support a conviction
 - Juror: “We thought [Bourke] knew [about the bribery] and definitely could have known. He’s an investor. It’s his job to know.”
- Discussion of issue in “Caveat Obsido”
 - http://www.morganlewis.com/pubs/LIT_CaveatObsidoWhitePaper_July2009.pdf

Direct or Indirect Payments Covered by Law

- Statute prohibits unlawful payments directly or indirectly through a third party
- Many enforcement cases involve indirect payments
- Examples of third parties through whom illegal payments have been made:
 - Agents or consultants
 - Distributors
 - Joint venture partners
 - Lawyers/accountants
 - Service providers

Does a Payment Need to Be Made?

- **No**
- Offers, promises, or authorizations to make prohibited payments are just as illegal as actually making a prohibited payment
- The simple offer of a payment is enough to confer liability

What Qualifies as “Anything of Value”

- Anything of Value = Any Benefit
- Must meet each of the other elements of a prohibited payment.
- Examples include but are not limited to:
 - Cash or the equivalent of cash such as a gift card, voucher, coupon
 - Entertainment or travel
 - Gifts that are more than a mere token or modest in value
 - Educational opportunities
 - Contributions to political parties, causes, candidates, and officials
 - Charitable contributions
 - Investments or property
 - Loan of a vacation home, automobile, or yacht, etc.
 - Giving a job to a family member or someone with a close personal relationship with foreign official

How Is “Foreign Official” Defined?

- Very Broadly
- Statutory definition includes:
 - Foreign government employees or officials
 - Political officials or members of their staffs
 - Employees of public international organizations
 - Candidates for political office
- Has also been interpreted by DOJ to include:
 - Employees of government-owned or government-controlled businesses
 - Examples include:
 - Employees of state-owned or state-controlled hospitals (Syncor)
 - Employees of state-owned or state-controlled media outlets, e.g. Chinese journalists (DOJ Opinion Letter 08-03)

What Is an Unfair Business Advantage?

- Focus is on gaining a competitive advantage rather than directly securing a particular contract
 - Examples include:
 - Con-way: Slotting on planes and faster customs clearance
 - Kay: Lower customs and tax duties caused lower expenses and gave a business advantage over competitors in market
 - Delta Pine: Government reports and certifications to sell seed
 - Vetco: Preferential treatment in customs clearance
 - Covino: Influence on technical specifications to influence bid
 - Monsanto: Influence over legislation
- The bribe does not need to achieve its intended effect
 - Example: Monsanto

Are There Any Exceptions?

- The FCPA permits “facilitating payments”
 - Purpose of payment must be to expedite or secure performance of “routine governmental action” by a foreign official
 - *Action must be “ordinarily and commonly performed” by the foreign official (for example, stamping passports)*
 - *Does not include decision by foreign official whether, or on what terms, to award new business to or to continue business with a particular party*
- **BUT** some companies no longer allow these types of payments
- **AND** facilitating payments are not always permitted under local foreign law

“Affirmative Defenses” Under the FCPA

- Promotional Payments
 - “Reasonable and bona fide” expenses
 - promotion, demonstration, explanation of products
 - execution or performance of contract
 - Proper documentation of expenditures
- “Lawful” under local law statutes
 - Has never been recognized as a defense to a payment prohibited by the FCPA
 - Recently argued and rejected in *Bourke*
 - Law must be a written statute

Books and Records

- Books and Records
 - Books, records, and accounts must be kept in reasonable detail to accurately and fairly reflect transactions and dispositions of assets
 - Applies to issuers
 - Parent companies may be liable for false or fraudulent entries on any book or record that is ultimately consolidated with an issuer's books and records for financial reporting purposes

Penalties for Violation of FCPA Provisions

- Significant Monetary and Criminal Penalties
 - Antibribery Violations
 - Fines up to \$2 million per violation
 - Culpable individuals may face fines of up to \$250,000 per violation and/or imprisonment for up to five years
 - Books and Records and Internal Control Violations (Willful)
 - Corporate fines in excess of \$25 million for a company
 - Fine up to \$5 million and/or imprisonment for up to 20 years for culpable individuals

Possible Collateral Consequences of FCPA Violations

- Termination of government licenses
- Debarment from government contracting programs
- Disgorgement of a company's profits on contracts secured with improper payments
- Tax implications
- Shareholder litigation
- Foreign enforcement actions
- Appointment of independent compliance monitors

The Rise of SEC Enforcement

Potential “Game Changers”

- A fundamental reorganization of the SEC enforcement division
- A national specialized FCPA unit
- An increased focus on individual liability
- New cooperation tools
- A streamlined process for seeking immunity
- Office of Market Intelligence

Specialized SEC FCPA Enforcement Unit

- August 2009:
 - SEC announces five national specialized units
- January 13, 2010:
 - SEC announces that Cheryl J. Scarborough will lead the FCPA unit
- Better capability to detect emerging fraud and misconduct
- Greater capability to file cases with “strike-force speed”
- Increase in enforcement division expertise

Specialized SEC FCPA Enforcement Unit

“ The [FCPA] unit will focus on new and proactive approaches to identifying violations. [...] While we have been active in this area, more needs to be done, including being more proactive in investigations, working more closely with our foreign counterparts, and taking a more global approach to these violations.”

– **Robert Khuzami**, Director, Division of Enforcement, U.S. Securities and Exchange Commission, New York, NY, August 5, 2009

Office of Market Intelligence

- A different sort of specialized unit
- Responsible for the collection, analysis, risk-weighting, triage, referral, and monitoring of tips, complaints, and referrals
- Responsible for harvesting that intelligence to better inform the SEC's investigative focus and priorities

More Enforcement Actions Against Individuals

- Trend toward aggressive FCPA prosecution of individuals
 - 75% of the criminal defendants in 2009 were individuals
 - 22 individuals indicted on January 19, 2010
 - 3 SEC enforcement actions against individuals during 2009
- Bases for Liability
 - Direct liability
 - Aiding and abetting liability
 - Control person liability

Individual Liability

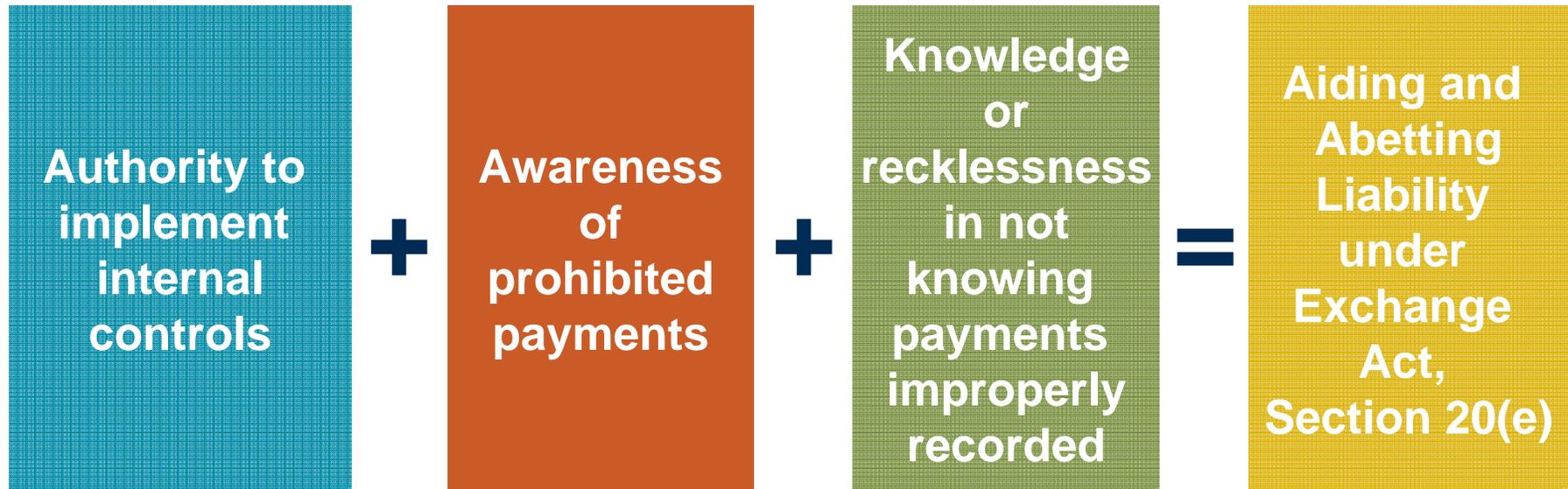
Direct
Liability



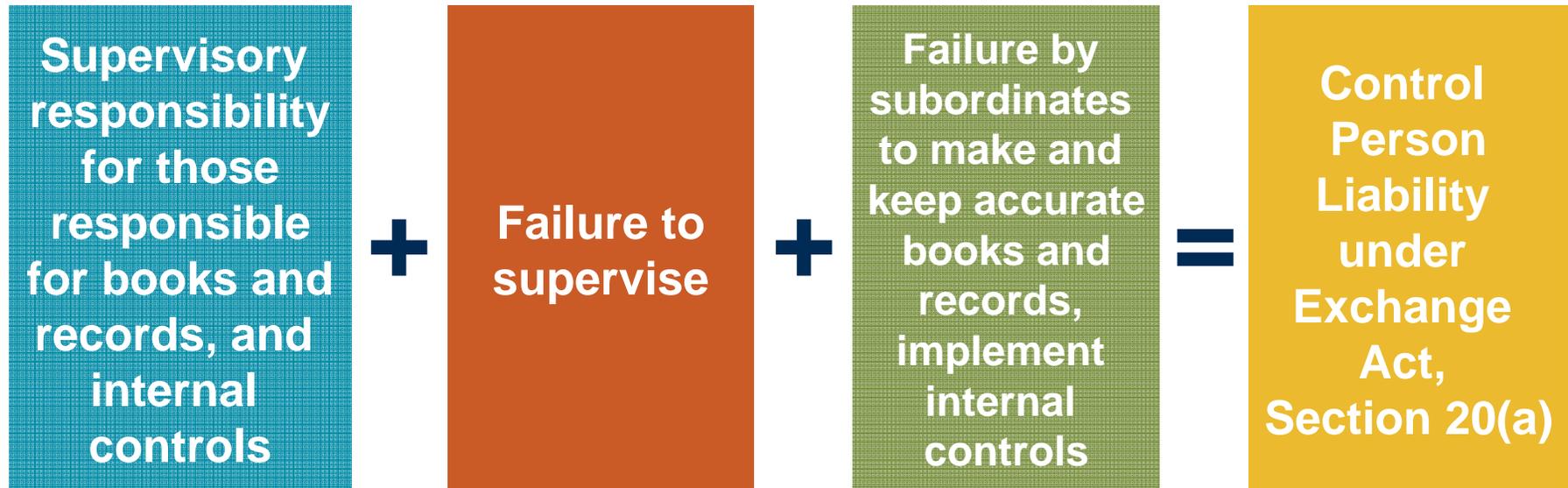
Control
Person
Liability

Aiding and
Abetting Liability

Aiding and Abetting Liability



Control Person Liability



SEC Cooperation Initiative

- Announced January 13, 2010
- A “game changer” for the Enforcement Division
- New cooperation tools
 - Cooperation agreements
 - Deferred prosecution agreements
 - Nonprosecution agreements
- SEC rules amended to allow the Director of Enforcement to seek immunity order from DOJ

Warning to Would-Be Wrongdoers

“ The reality is that when you engage in misconduct, you now have to think even harder about the possibility of others coming forward to report to the SEC your secret conversations, your hushed plans, your schemes and deceptions. ”

– **Robert Khuzami**, Director, Division of Enforcement, U.S. Securities and Exchange Commission, New York, NY, January 13, 2010

More FCPA Investigations

**More resources
focused on cases
against individuals**



**Government
attracts more
cooperating
witnesses**



**More FCPA
investigations
generated**

Individual Prosecutions

Individual Prosecutions

“The number of individual prosecutions has risen –
and **that’s not an accident.**”

That is quite intentional on the part of the Department.

It is our view that to have a credible deterrent
effect, people have to go to jail.

People have to be prosecuted where appropriate.
This is a federal crime.
This is not fun and games.”

–**Mark Mendelson**, Deputy Chief, Fraud Section, United States Department of Justice

FCPA Trials

United States v. Gerald Green
and Patricia Green, C.D. Cal.,
guilty verdict
September 11, 2009

United States v.
Frederic Bourke, S.D.N.Y.,
guilty verdict July 10, 2009

United States v.
William Jefferson, E.D. Va.,
guilty verdict August 5, 2009

RECENT CASE STUDIES: BOURKE

- **Guilty** of conspiracy to violate the FCPA and the Travel Act
- Bourke lost his entire \$8 million investment
- Bourke complained to Azerbaijan and U.S. officials
- No evidence that Bourke actually paid any bribes
- Extortion defense was rejected
- Foreman: “It was Kozeny, it was Azerbaijan, it was a foreign country. We thought [Bourke] knew [about the bribery] and definitely could have known. He’s an investor. It’s his job to know.”

RECENT CASE STUDIES: JEFFERSON

- **Charged** with violating the FCPA by offering a bribe to Nigerian official
- First time a U.S. government official has been **indicted** under the FCPA
- **Convicted** of conspiracy to violate FCPA, soliciting bribes, theft of honest services, money laundering, and racketeering
- **Acquitted** him of the single substantive count for violating the FCPA
 - Cash was still in the freezer

RECENT CASE STUDIES: Greens – Patricia and Gerald

- Also **convicted** of conspiracy, money laundering, and tax fraud
- Confidential informant to FBI testified that Greens had paid bribes
- Interviews of “present and former associates”
- Bribing the former governor of the Tourism Authority of Thailand
- \$1.8 million bribes got them \$13.5 million in contracts
- Bank accounts in Isle of Jersey, Singapore, and UK
- Dummy businesses

More to Come This Year

- Six former executives of Control Components, Inc.
 - Alleged decade-long conspiracy; at least 236 corrupt payments in 30 countries
 - Both FCPA and Travel Act charges
 - Internal investigation in 2007

Blockbuster Indictments

- 22 individuals indicted in December 2009 (sealed) and arrested in Las Vegas in January 2010
- Two-year investigation
- Included at least two foreign nationals
- Use of undercover agents posing as sale agents to convince individuals to offer to pay bribes
- Offer to pay = FCPA violation

Focus Is Not Exclusively on U.S. Citizens

Three foreign nationals indicted in 2009:

- Ousama Namaan (OFFP)
 - Canadian/Lebanese dual citizen
 - U.N. Oil for Food Program – 10% kickback to Iraqi government
 - Arrested in Frankfurt, Germany; DOJ is seeking Naaman's extradition
- Tesler and Chodan (KBR)
 - Alleged decade-long scheme by a KBR joint venture to bribe Nigerian officials for LNG plant; \$132 million for bribes
 - UK citizens; Chodan (agent of a domestic concern because reported to Stanley and other KBR employees); Tesler (an agent of an issuer, a domestic concern, and a person based on his alleged agency for the joint venture and its constituent members)
 - DOJ is seeking both defendants' extradition

Harsh Individual Penalties

Sentencings:

- Shu Quan-Sheng
 - 51 months
 - Physicist pleaded guilty to Arms Export Control Act and FCPA; illegal export of space launch technical data and defense services to the PRC
- Jack Stanley (KBR) (Oct. 28)
 - Seven years; \$10.8 million
 - KBR in Nigeria
- William Jefferson (5 years)
- David Kay (63 months) and Douglas Murphy (37 months)

The Travel Act and Other Statutes

The Travel Act

- Originally directed at organized crime
- The Travel Act (18 U.S.C. § 1952) provides that it is a federal offense
 - to travel in interstate or foreign commerce or to use interstate “facilities” (e.g., using the mail or wires)
 - to promote, facilitate, or carry on “unlawful activity,” which includes certain racketeering activity such as gambling, prostitution, narcotics and liquor offenses, bribery, extortion, arson, and illegal monetary transactions
- Clearly applies to “bribery” in violation of federal or state law (18 U.S.C. § 1952(b)(2))

The Travel Act

- Control Components Inc. (CCI) pleaded guilty on July 31, 2009 to conspiracy to violate the FCPA and the Travel Act
 - \$4.9 million to employees of state-owned customers
 - \$1.95 million to employees of privately owned companies in violation of California's commercial bribery law

The Travel Act

- Not the first Travel Act FCPA case, but first with completely independent bribes
 - *United States v. David H. Mead*, No. CR-98-240-01 (D.N.J.)
 - *United States v. Robert Richard King and Pablo Barquero Hernandez*, Nos. 01-00190-01/02-CR (W.D. Mo.)
 - *United States v. Steven J. Ott*, No. 07-CR-608 (D.N.J.); *United States v. Roger Michael Young*, No. 07-CR-609 (D.N.J.)
 - Bourke charged with Travel Act violation based on federal FCPA bribery provisions

The Travel Act

- As part of DPAs or NPAs, DOJ has required implementation of a compliance program designed to detect and prevent violations of both the FCPA and commercial bribery statutes
 - Schnitzer Steel
 - Baker Hughes
- Follow-on civil litigation

Other Developments

- Private civil lawsuits
- Overseas enforcement and cooperation

Going After the Bribe Money

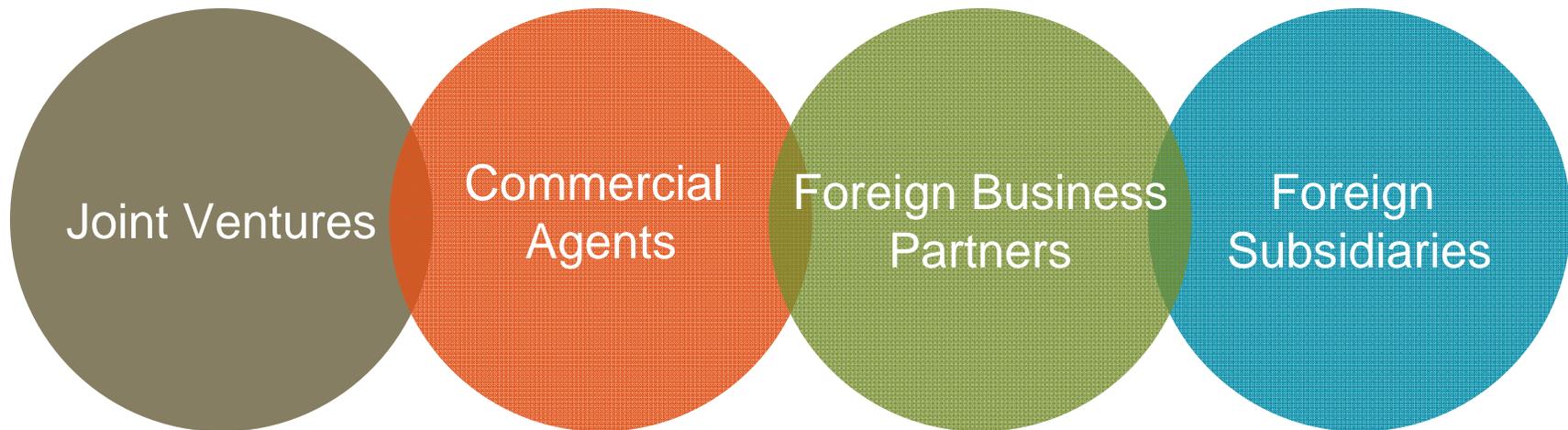
- DOJ filed an in rem action against nearly \$3 million held in a Singapore bank
- DOJ alleges that the money was the actual bribe money paid by Siemens to the son of the former Prime Minister of Bangladesh in exchange for contracts from the government
- Also filed numerous forfeiture counts in indictments brought in 2009
- Also indicted foreign officials for money laundering in the *Haiti Telecom* case

Due Diligence Procedures

Due Diligence – What Is It?

- Due Diligence = an investigation of risks across a number of regulatory and business issues
- Best practice expected by enforcement authorities in transactions with third parties:
 - M&A and joint venture transactions
 - Hiring of consultants, agents, and other third parties
- Overall objective of due diligence
 - Understand and evaluate initial and ongoing risk of doing business with a third party
 - Evaluate range of options to limit risk

Relationships of Special Concern for U.S. Companies



Examples of Third-Party Relationship Risk

- KBR/Halliburton (DOJ Opinion Release 08-02)
 - Natural gas project in Nigeria that included four multinational corporations including KBR; contracts awarded by Nigerian entity that is 49% owned by Nigerian government
 - Used consulting company in Gibraltar and Japanese trading company to facilitate corrupt payments; made payments to consultant's Swiss and Monaco bank accounts; also used Lebanese and BVI "consulting" companies
 - KBR paid \$570 million in fines and penalties
 - SEC criticized Halliburton (acquired KBR) for failing to conduct due diligence on Japanese agent and failing to detect problems with UK agent; Halliburton was jointly liable with KBR for the SEC penalties (\$177 million)
 - DOJ also charged KBR's CEO (facing 10 years in prison under plea deal) as well as salesman and consultant who set up the Gibraltar corporation
 - Halliburton disclosed in public filings that it may face civil and/or criminal liability in the UK

Examples of Third-Party Relationship Risk

- Vetco Gray companies (ABB/Vetco Gray/Aibel Group Ltd (DOJ Opinion Release 04-02)
 - ABB was a global provider of power and automation services and a Swiss corporation
 - Due diligence during private equity investors' sale of ABB's upstream oil, gas, and petrochemical business uncovered evidence of bribes to officials in Nigeria, Angola, and Kazakhstan
 - Three subsidiaries pled guilty to FCPA violations and paid \$26 million in fines for failing to implement promised compliance measures
 - One year later, a wholly owned subsidiary of the successor entity and a UK corporation paid an additional \$4.2 million fine for violating a deferred prosecution agreement
- Paradigm
 - Paradigm discovered violations in the context of due diligence for an IPO and disclosed violations to DOJ; most payments took the form of commissions and were relatively low
 - Received DPA and \$1 million penalty

FCPA Assurances and Due Diligence

No Longer an Option for U.S. Companies Doing Business Abroad

- Liability risks are too great
- Costs of investigations are significant
- Legal advisers will recommend assurances and due diligence because . . .
 - the presence of certifications and comprehensive due diligence will limit the risk of prosecution by the U.S. government
 - identifying corruption risks will enable clients to evaluate the true value of the transaction
 - it is important for the parties to understand and to agree how business will be conducted

Due Diligence for Acquisitions

- Know your target
 - Examples of inquiries include:
 - Corporate Records
 - Owners, key employees, and senior executives
 - Relationship to foreign officials and PEPs
 - OFAC/AML checks
 - Reputational Due Diligence
 - U.S. embassy
 - Published reports
 - Local contacts
- Evaluate how target was identified

Due Diligence for Acquisitions

Identifying Red Flags and Anticorruption Risk

- Identify potential interactions with foreign officials
 - Licenses, approvals, governmental filings
 - Contracts (business with state-owned entities—both sell and buy)
 - Taxes
- Identify agents, consultants, and representatives
 - Review agreements, due diligence files and financial transactions in connection with third-party relationships
- Review customer lists
- Evaluate financial records and internal controls
- Review anticorruption policies, procedures, certifications, training, and audits (if available)
- Review litigation/regulatory issues

Life after the Acquisition

- Post-acquisition follow-up
 - Implement and/or enhance anticorruption compliance program
 - Train employees
 - Reevaluate due diligence of third parties
 - Require written contractual agreements that include appropriate representations, warranties, and certification requirements
- Frequently asked questions
 - Are there time limits?
 - What are the potential successor liability issues?

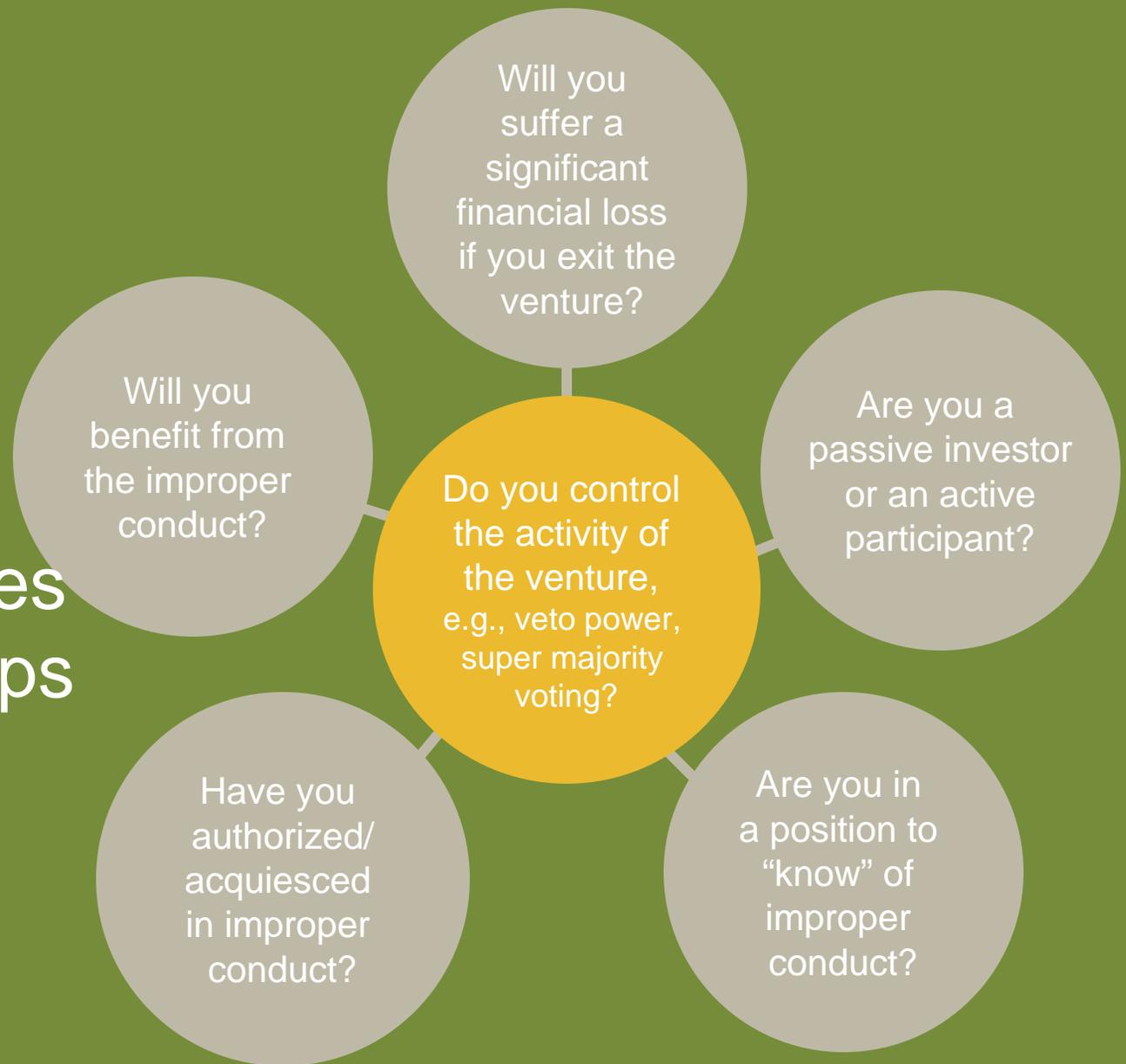
Due Diligence for Retaining Agents and Consultants

- **Know** your business partners, agents, and consultants
 - Are they state owned?
 - Are any employees government officials?
- **Know** your exposure to or contacts with foreign government officials (including employees of state-owned businesses)
- **Understand** the services to be provided and how the payments will be made

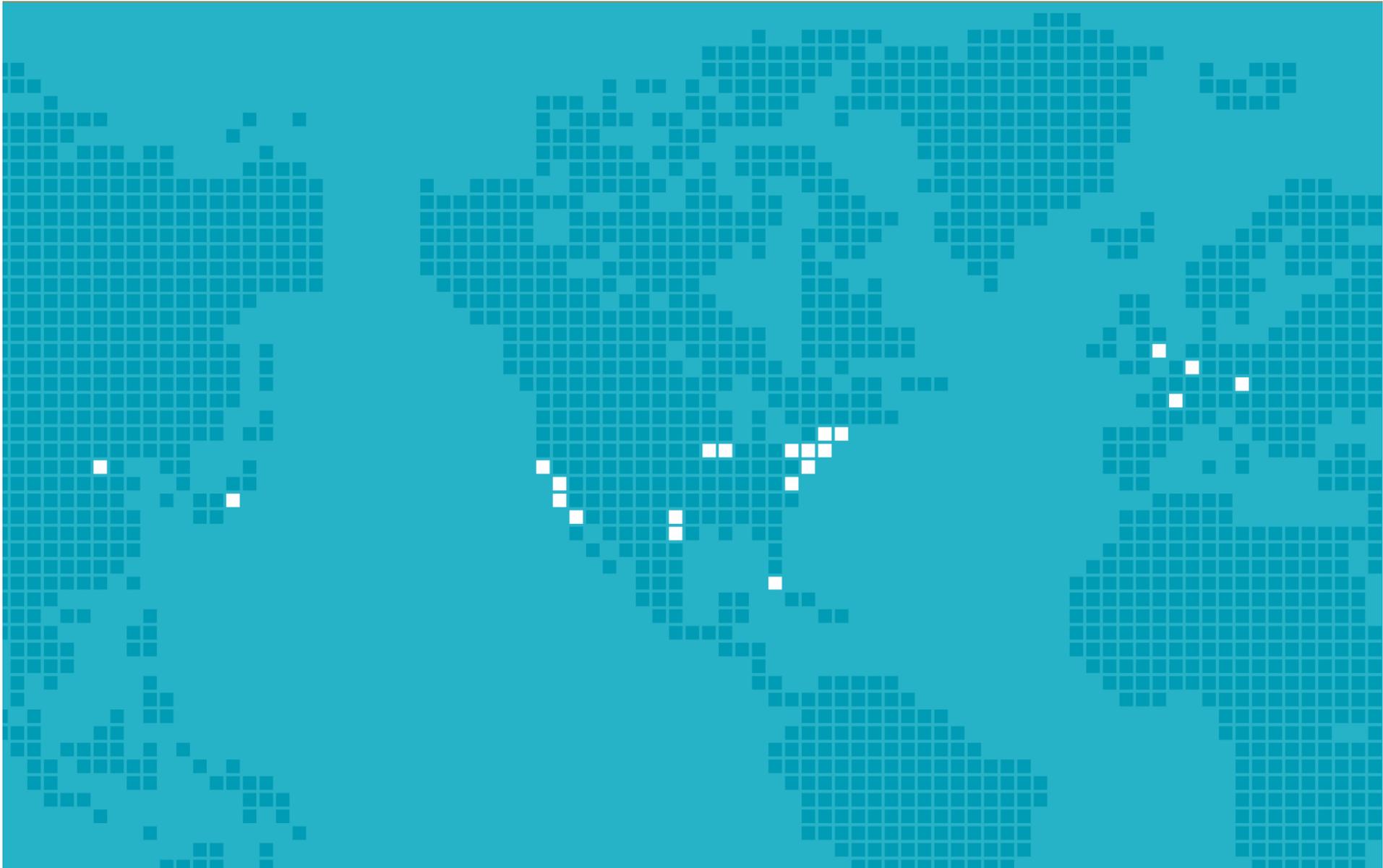
Due Diligence for Retaining Agents and Consultants

- Complete due diligence checklist for each agent
 - AML/OFAC checks
 - Background information
 - Reason for hiring
- Understand red flags
 - How payments are made
 - Where payments are made
 - Payment amounts
- Require written contracts
 - Require representations and warranties
 - Periodic certifications
 - If contract includes audit language, then follow up
 - Other documentation

Due Diligence in Joint Ventures and Partnerships



Q&A



worldwide

Beijing Boston Brussels Chicago Dallas Frankfurt Harrisburg Houston
Irvine London Los Angeles Miami Minneapolis New York Palo Alto Paris
Philadelphia Pittsburgh Princeton San Francisco Tokyo Washington