

Foreign Corrupt Practices Act Mid-Year Alert

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Summary and Analysis

The settled actions, ongoing criminal matters and other related developments, and company disclosures to date in 2007 and 2008 underscore a number of important lessons and themes of which companies should be aware in conducting their operations, designing and implementing their compliance programs, considering whether to enter into potential transactions or to affiliate with an international agent, intermediary or joint venture partner, and dealing with government agencies.

- ***Increasing Pace of Enforcement:*** The United States government continues to emphasize FCPA enforcement to a greater extent than ever before. On several occasions recently, U.S. officials have publicly stressed that FCPA enforcement is a “high priority,” and have backed those words with actions. The first half of 2008 alone saw more enforcement actions than any previous full year other than 2007. In June 2008, SEC Director of Enforcement Linda Thompson noted that “[t]he Commission has filed more FCPA cases in the last two years than in all of the preceding years combined.” Ever greater numbers of companies are disclosing that they are conducting internal FCPA investigations or are subject to government investigations. These developments have prompted several commentators to observe that FCPA violations pose one of the most, if not the most, significant corporate risk to companies operating internationally.
 - ***Larger Penalties:*** The civil and criminal fines resulting from FCPA prosecutions and settlements continued to rise in 2007 and 2008. Settlements totaling more than \$5 million have become increasingly frequent, including, Ingersoll-Rand (\$6.7 million), Flowserve (\$10.5 million), AB Volvo (\$19.6 million), York (\$22 million), Vetco (\$26 million), Chevron (\$30 million), Willbros Group (\$32.3 million) and Baker Hughes (\$44 million). In addition, as noted above, a government official has publicly speculated that the day when a \$100 million FCPA settlement occurs may not be far off.
 - ***Prosecutions and Investigations Span the World and a Wide Range of Industries:*** The 2007 and 2008 settlements and related activities illustrate the breadth of potential FCPA exposure, covering Africa, the Middle East, South and Central America, the Caribbean, East, Central and South Asia, and Europe. As illustrated by the Smith prosecution and Self plea agreement for bribing a United Kingdom Defence official, contrary to the popular misconception, the FCPA remains a concern for companies doing business even in developed countries, not simply in the developing world. The settlements range across numerous industries as well, including the oil and oil field services, defense, construction and engineering, agricultural and agro-chemical, pharmaceutical, medical, steel, industrial manufacturing, and telecommunications industries. The indictments of Gerald and Patricia Green indicate that even Hollywood is not immune from FCPA concerns.
 - ***Need for Appropriate Due Diligence:*** The watershed 2007 Baker Hughes settlement made clearer than ever the compelling need for appropriate due diligence on agents and intermediaries. The failure to conduct due diligence leaves a company in a position where it cannot rationally form a basis to conclude that no illegal payment was made and therefore
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can subject the company to liability under at least the relevant recordkeeping and internal control requirements. The AB Volvo and Textron settlements, both based in part on the failure to conduct adequate due diligence and containing broad language regarding the “endemic corruption problems” in the Middle East and the resulting need for enhanced compliance measures, reinforce these lessons. The critical need for adequate due diligence is strongly reinforced by DOJ Opinion Procedure Releases 08-01 and 08-02, which both address the issue in the acquisition context. Release 08-02 indicates that due diligence in such context must at least include (i) carefully calibrating risks (including the need for thorough examination of third party and governmental relationships); (ii) an exacting review of broad categories of documents (including e-mail and financial records); (iii) witness interviews not only of target personnel but others; and (iv) the retention of outside counsel and other professionals working with internal resources as appropriate. Release 08-01 further suggests that such due diligence should also take into account relevant local legal issues. (See, e.g., DOJ Opinion Procedure Release 08-02, DOJ Opinion Procedure Release 08-01, AB Volvo, Ingersoll-Rand, Paradigm, Textron, Delta & Pine, Baker Hughes).

- **Need to Examine Carefully the Qualifications of Agents and Third Parties:** Emphasis is placed on the need to understand the background, competence and track record of the agent or intermediary, a message reiterated in the Woolf Committee’s report on BAE. Companies that are insufficiently qualified or with little or no assets (i.e., a “brass plate” company) should be avoided. (See, e.g., AB Volvo, Chevron, Paradigm, Baker Hughes, Ott and Young, BAE Woolf Report).
 - **Careful Examination of Tasks to Be Performed by Agent and Their Relative Value:** Companies must examine the competence of the agent to provide the particular tasks for which it is being engaged together with the relative value of those tasks. “Paper tasks” will not suffice. Companies must also validate the tasks allegedly being provided by the agent to ensure they are undertaken. In addition, unusually high commissions, fees or expenses should be carefully reviewed to determine if such payments are justified on commercial grounds. (See, e.g., Faro, Willbros Group, ITXC, AB Volvo, Flowserve, Westinghouse, Akzo Nobel, York, Paradigm, Baker Hughes, Ott and Young).
 - **Source of Agent:** Companies are reminded to be especially suspicious of agents suggested to them by government officials with whom such companies are bidding or negotiating. (See, e.g., Paradigm, Baker Hughes).
 - **Need to Conduct Appropriate Employee and Third Party Training:** Companies that fail to conduct appropriate employee or third party training may face liability if the conduct of those parties ends up violating the FCPA. (See, e.g., Faro, Philip, Lucent, Fu).
 - **Need to Closely Review Changes in Agreements with an Agent or Third Party:** A significant change in the payment or other material terms of an agreement with an international agent or third party can be a potential red flag to which management should pay close attention. Several of the Oil-for-Food settlements, including those with Chevron, Flowserve and Akzo Nobel, involved scenarios whereby the arrangements entered into with a third party were altered to facilitate or mask improper payments. Thus, changes in the nature or terms of arrangements with third parties should be closely examined to ensure that they have a legitimate basis. (See, e.g., Flowserve, Akzo Nobel, Chevron).
 - **Increase in FCPA-Related Civil Suits:** As described above, there has been a noticeable increase in recent years of FCPA-related civil actions. These suits have taken several forms, including suits by foreign governments, public company shareholders and business partners. (See, e.g., Iraqi Oil-for-Food Suit, Faro, Argo-Tech v. Yamada).
 - **Clarification on Successor Liability:** DOJ Opinion Release 08-02 provides clarity on the issue of inherited liability in the context of acquisitions and joint venture partnerships. A critical question is under what circumstances, if any, can a company be held liable for acts deemed “in furtherance” of the acquired company’s or joint venture partner’s improper
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payments. In Release 08-02, the DOJ reasoned that the Requestor, Halliburton, would not violate the FCPA by acquiring the target, Expro, which may or may not have violated the FCPA prior to the acquisition because the money to be paid to acquire the company would go to Expro's shareholders, not Expro itself. Moreover, the stock ownership in Expro was widely disbursed. Thus, it was unlikely that any of the shareholders were corruptly given their shares such that they would be improperly enriched by the acquisition. Implicitly, the Release can be read to endorse the view that payments to shareholders or joint venture partners who have received their shares corruptly would violate the FCPA. (*See, e.g., DOJ Opinion Procedure Release 08-02, Kay*).

- **Direct Parent Company Involvement Not Required:** The government will prosecute based on the conduct of even far-removed foreign subsidiaries and even in the absence of alleged knowledge or direct participation of the parent company in the improper conduct. As a result, as the Willbros Group and several Oil-for-Food settlements make clear, companies must ensure that their FCPA compliance policies and procedures are implemented throughout the corporate structure and are extended quickly to newly acquired subsidiaries. (*See, e.g., Faro, Willbros Group, AB Volvo, Flowserve, Westinghouse, Akzo Nobel, Ingersoll-Rand, York, Bristow, Paradigm, Textron, Delta & Pine, Dow*).
 - **Foreign Subsidiaries Treated as Agents of the Parent:** The criminal information underlying the DOJ's action against Schnitzer Steel's Korean subsidiary describes the subsidiary as Schnitzer Steel's "agent." The government has asserted that a foreign subsidiary acted as the agent of its United States parent corporation on at least one other occasion (in the 2005 enforcement proceedings against Diagnostic Products Corporation and its Chinese subsidiary). The FCPA's legislative history and jurisdictional language suggest that a parent company cannot be held liable for an anti-bribery violation by its foreign subsidiary of which it was not aware and in which it did not participate. (When the subsidiary's financials are consolidated into its own, the parent has no such defense under the FCPA books and records and internal controls provisions). The agency theory reflected in Schnitzer and Diagnostic Products could potentially be used (at least as an initial enforcement posture) to hold parent companies liable for acts of bribery by a foreign subsidiary, despite the parent's lack of knowledge or participation. (*See, e.g., Philip (Schnitzer)*).
 - **Paper Procedures Not Enough:** Company procedures that require due diligence, FCPA covenants, or other contractual provisions and certifications, or appropriate accounting practices provide no protection (and may prove harmful) when they are not followed. (*See, e.g., Lucent, Chevron, Ingersoll-Rand, Fu, Textron, Baker Hughes, El Paso*).
 - **Hiring An Outside Law Firm Not Sufficient:** The mere use of outside counsel without due diligence being undertaken in an appropriate and careful fashion will not insulate a company from FCPA liability. (*See, e.g., Ingersoll-Rand, Baker Hughes*).
 - **Improper Payments to Foreign Ministries or Foreign Private Parties May Run Afoul the FCPA:** In the Schnitzer Steel and related settlements, the government asserted violations of the FCPA based on payments not only to government officials in China, but also to employees of private steel mills in China and South Korea, explaining "[t]hese mills were privately owned and the managers were not foreign officials. However, Schnitzer violated the FCPA by failing to properly account for and disclose the bribes in its internal records and filings." Similarly, without addressing the issue directly, the Oil for Food prosecutions are premised on improper payments made to government accounts rather than to foreign officials, with the York proceeding also including allegations of numerous payments to commercial, non-governmental parties outside the OFFP. The related proceedings against Monty Fu and Syncor similarly involved payments to doctors employed by both public and private hospitals in Taiwan. (*See, e.g., AB Volvo, Flowserve, Akzo Nobel, Philip, Chevron, Ingersoll-Rand, York, Fu, Textron, Wooh, El Paso*).
 - **Broad Reading of Obtain or Retain Business Element:** The SEC and DOJ continue to read the "obtain or retain business" element of the FCPA broadly to capture a very wide range
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of conduct beyond the prototypical payment to win a contract award, including payments to expedite and approve patent applications, to obtain favorable treatment in pending court cases, to schedule inspections, to obtain product delivery certificates, to alter engineering design specifications in favor of a particular bidder, to obtain preferential customs treatment, to avoid or expedite necessary inspections, to alter the language in an administrative decree, to obtain governmental reports and certifications necessary to market a product, and to reduce taxes. (See, e.g., *AGA Medical Corporation, Willbros Group, Bristow, Delta & Pine, Martin, Dow, Vetco, Kay*).

- **Broad Reading of Foreign Official:** Similarly, federal prosecutors continue to construe the term “foreign official” to include even relatively low level employees of state agencies and state-owned institutions, such as workers in hospitals, telecommunications companies, ship-yards, and steel mills and members of an executive committee overseeing the construction of a government-owned hotel. It appears that journalists working for state-owned media concerns and an unpaid manager of a government majority-owned entity also fall within the government’s broad interpretation of “foreign official.” (See, e.g., *DOJ Opinion Procedure Release 08-03, DOJ Opinion Release 08-01, Lucent, York, Fu, Delta & Pine, Wooh, Dow, Vetco*).
 - **Anything of Value:** The FCPA prohibits far more than mere cash payments and can be violated by the provision of such diverse benefits as travel, entertainment, scholarships, vehicles, property, watches, electronics, office furniture, stock and share of profits. (See, e.g., *PCI, AB Volvo, Lucent, Philip, Ingersoll-Rand, York, Delta & Pine, Dow, Kozeny, Jefferson*).
 - **The FCPA Covers “Promises” to Make Payments and Payments that Do Not Accomplish Their Purpose:** An executed payment that results in the company obtaining or retaining business is not necessary for an FCPA violation. As the AB Volvo and Flowserve settlements illustrate, improper payments that are authorized but never ultimately made are still considered improper. In addition, as the Jefferson indictment and Martin prosecution indicate, either a promise of a payment that is not actually delivered (because it was intercepted in the Congressman’s freezer) or an unsuccessful attempt to influence a foreign official can suffice. (See, e.g., *ITXC, AB Volvo, Flowserve, Jefferson, Martin, Textron*).
 - **Narrow View of Facilitation Payments:** The government takes an exceedingly narrow view of what constitutes a facilitation payment – a payment that expedites routine or ministerial governmental acts that does not run afoul of the FCPA. For example, the DOJ’s settlement with Westinghouse appears to rest on, among other things, payments for services such as scheduling shipping inspections or obtaining product delivery certificates that could arguably constitute facilitating payments. (See, e.g., *Westinghouse*).
 - **No De Minimis Exception:** There is no *de minimis* exception to the FCPA’s prohibitions. The Baker Hughes prosecution included charges associated with a \$9,000 payment; the Dow settlement featured numerous payments of “well under \$100”; and the Paradigm settlement involved “acceptance” fees of between \$100–200. (See, e.g., *Paradigm, Baker Hughes, Dow*).
 - **Separate Prosecutions for Companies and Individuals:** Both the SEC and DOJ remain willing to prosecute individuals when the facts warrant such action. As in *Fu, Martin, Philip, Wooh* and *Srinivasan*, individual enforcement actions can follow or coincide with settlements with the company. By contrast, in *Sapsizian* and *Steph*, the government brought cases against the individuals before reaching a resolution with their employers. Finally, the government is willing to pursue individuals in their capacity as “domestic concerns” without pursuing associated entities, as illustrated by the actions against *Gerald and Patricia Green* and the former officers of *PCI*. (See, e.g., *Willbros Group, PCI, ITXC, Philip, Green, Srinivasan, Fu, Martin, Wooh, Sapsizian, Steph*).
 - **Global Investigations:** A growing number of FCPA prosecutions stem from large-scale investigations involving numerous companies, such as the Oil-for-Food and the Nigerian Customs investigations. In other instances, as with *Siemens, Alcatel* and *ERHC*,
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investigations by foreign agencies or officials can lead to U.S. investigations or prosecutions. As seen with the Iraqi Oil-for-Food suit, action by Bahrain's state-owned steel company against Alcoa, and Argo-Tech's suit against Yamada, foreign or global investigations can lead to private actions as well. The World Bank's recently invigorated Department of Institutional Integrity and its joint task force with the IMF and several regional development organizations may be a source of ancillary and follow-on corruption prosecutions in the future. Finally, U.S. regulators may consider enforcement activities by foreign regulators in determining the ultimate disposition of a matter, as illustrated by the Flowserve and Akzo Nobel matters. Indeed, in the latter proceeding, the DOJ was willing to waive a criminal fine as long as Akzo Nobel's Dutch subsidiary satisfied the criminal sanction imposed on it by Dutch regulators. (See, e.g., *AB Volvo, Flowserve, Akzo Nobel, Chevron, Ingersoll-Rand, York, El Paso, INNOSPEC, Nigerian Customs Investigations, Siemens, Alcatel, ERHC, Textron*).

- **Mergers and Acquisitions:** FCPA issues can arise in the context of mergers and acquisitions, as illustrated by Opinion Releases 08-01 and 08-02. FCPA concerns can complicate or delay these potentially lucrative transactions, and acquirers are well-advised to conduct sufficient FCPA due diligence prior to closing, including examining the target's agency relationships and joint venture partners, to avoid unanticipated exposure due to the acquired company's undisclosed practices. When such pre-acquisition due diligence is not possible, it appears that the DOJ may grant special dispensation to conduct post-acquisition due diligence, but likely only if coupled with extensive reporting requirements. (See, e.g., *Opinion Release 08-02, Opinion Release 08-01, PCI, Baker Hughes, Vetco*).
 - **Liability for Payments Made on Behalf of Subcontractors:** The mere fact that a payment is made on behalf of a subcontractor is not a defense to the potential inappropriateness of the payment. (See, e.g., *Baker Hughes*).
 - **Commonality of Practice Not an Excuse:** Correcting a widely-held misperception, it is clear that a common but illegal practice is still illegal. Relatedly, as Chiquita illustrates, even in extreme circumstances or when broader policy concerns are implicated, prosecutors are unlikely to excuse illegal conduct. (See, e.g., *DOJ Opinion Procedure Release 08-03, Faro, Willbros Group, Lucent, El Paso, Dow, Baker Hughes, Chiquita, Textron, Kay*).
 - **Discontinue Improper Payments Once Discovered:** Once payments to an agent or others are determined to be inconsistent with the FCPA or company policies, termination of the payments is expected. Creative payment arrangements, such as a severance arrangement, or alternative structures such as the use of third party intermediaries to continue the improper practices, will not suffice. (See, e.g., *Willbros Group, Monty Fu, Philip, Baker Hughes, Delta & Pine, Chiquita, Textron*).
 - **Recidivism will be Punished Harshly:** Repeat offenders will be punished harshly. In both Vetco and Baker Hughes, the large fines reflected, in part, the fact that the companies had previously violated the FCPA and had failed to implement the enhanced compliance processes and procedures to which they agreed as part of the settlements of those earlier prosecutions. ABB, which reached an FCPA settlement in 2004 and has subsequently disclosed further potentially improper payments to the DOJ and the SEC, may face similar treatment if it is found to have again violated the FCPA. (See, e.g., *Vetco, Baker Hughes, ABB*).
 - **Requirement of Monitors or Consultants:** The 2007 and 2008 settlements continued the trend of appointing monitors or consultants to companies to help ensure FCPA compliance. Certain recent settlements, such as those with Willbros Group, AGA and Faro, appear to reflect a change in practice, where rather than the DOJ appointing the monitor directly, the settling company is permitted to choose its own corporate monitor, subject to DOJ approval. (See, e.g., *Faro, AGA, Willbros Group, Delta & Pine, Baker Hughes, Vetco*).
 - **Self-Reporting, Remedial Measures, and Cooperation:** Through a variety of means, the DOJ and SEC have signaled that companies that self-report violations and cooperate extensively with governmental investigations may face less severe penalties. For example, despite
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allegations of wide-ranging improper conduct over a sustained period, including illicit payments to government officials in Kazakhstan, China, Mexico, Nigeria and Indonesia between 2002 and 2007, the DOJ entered into a *non*-prosecution agreement with Paradigm in return for the company paying a relatively small fine of \$1 million, implementing new enhanced internal controls and retaining outside counsel for eighteen months to review its compliance with the non-prosecution agreement. In doing so, the DOJ emphasized as “significant mitigating factors” the fact that Paradigm “had conducted an investigation through outside counsel, voluntarily disclosed its findings to the Justice Department, cooperated fully with the Department and instituted extensive remedial compliance measures.” (See, e.g., *Faro, AGA, Westinghouse, Bristow, Paradigm, Textron, Dow, Baker Hughes*).

- **Continued Cooperation, Including Waiver of Attorney-Client Privilege, as a Condition of Settlement:** In many instances, initial settlements require a party to continue to cooperate with an ongoing investigation, including measures such as an agreement to waive the attorney-client privilege. Recently introduced legislation and a potential revision of the DOJ’s prosecutorial guidelines, however, may prohibit or limit the practice of seeking attorney-client waivers as an element of cooperation. (See, e.g., *Martin, Wooh, Vetco, El Paso, Textron*).
- **Use of Precedent:** In Opinion Release 08-02, the DOJ explicitly refers to one of its previous Opinion Releases as “precedent,” despite the DOJ’s longstanding position (which is repeated in Release 08-02) that the Releases apply only to the specific requestor. The DOJ’s invocation of the word precedent (even if not sufficient to be relied on in court proceedings or otherwise) underscores the seriousness with which companies should view the guidance offered by the DOJ in its releases. (See, e.g., *DOJ Opinion Release 08-02*).

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