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FCPA UPDATE: THIRD-PARTY RISKS AND ENFORCEMENT ACTIONS

Recent U.S. government guidance and enforcement activity have emphasized the importance of addressing the corruption risks posed by third-party agents or consultants operating overseas. After discussing the FCPA legal framework and government guidance on third-party management, the authors address recent cases that provide a reminder of the risks, and exemplify the compliance programs and controls that are needed to mitigate them.

By Michael H. Huneke and Ashley R. Hodges *

Third-party agents or consultants can provide critical, and legitimate, services in support of sales overseas. These agents are not *per se* illegal. Yet, these same agents carry inherent corruption risk and are in the view of U.S. enforcement authorities "commonly used to conceal the payment of bribes to foreign officials" in violation of the Foreign Corrupt Practices Act of 1977 ("FCPA").[1] Additionally, the Organisation for Economic Cooperation and Development ("OECD"), under which 43[2] nations are signatories to the Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions, has recognized there are "indications that intermediaries are involved in most foreign bribery cases."[3]

Recent enforcement activity and guidance only further emphasize the risk posed by such agents. This enforcement activity and guidance are best understood in

[1] U.S. DEP'T OF JUSTICE & U.S. SEC. & EXCH. COMM'N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 60 (2012) [hereinafter FCPA GUIDE], *available at* https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf.

[2] Signatories to the OECD Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions

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comprise 35 OECD member countries and eight non-OECD member countries.

[3] OECD WORKING GROUP ON BRIBERY IN INTERNATIONAL BUSINESS TRANSACTIONS, TYPOLOGIES ON THE ROLE OF INTERMEDIARIES IN INTERNATIONAL BUSINESS TRANSACTIONS FINAL REPORT ¶ 9 (2009), *available at* http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/43879503.pdf.

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the context of the legal framework by which companies can become liable under the FCPA for their agents' actions.

LEGAL FRAMEWORK

The FCPA amended the Securities Exchange Act of 1934 to hold both U.S. and foreign companies that meet certain jurisdictional requirements responsible for the acts of their agents. In doing so, the U.S. not only punished those having actual knowledge that agents were improperly passing all or part of their remuneration to foreign officials, but also the act of paying such agents while "aware of a high probability of the existence of such circumstance,"[4] understood generally to mean acting with "conscious disregard or deliberate ignorance of known circumstances that should reasonably alert one to the high probability" that all or part of the remuneration could be passed to foreign officials for improper purposes.[5] There is an exception, however, if a person "actually believes that such circumstance does not exist,"[6] which in practice can only be demonstrated by conducting meaningful, risk-based due diligence into third parties and the underlying economic realities of their engagement.[7]

The FCPA applies to three groups of people: (1) U.S. domestic concerns, (2) U.S. or foreign "issuers" of securities in the U.S., and (3) foreign persons or entities who take any action in furtherance of a bribe "while in the territory of the United States." Domestic concerns include U.S. citizens, nationals, or residents and companies that are either organized under U.S. law or have their principal place of business in the U.S.[8] "Issuers" of securities in the U.S. can also be held liable for FCPA violations, but only if they are subject to Exchange Act Section 12 or 15(d) registration or reporting requirements.[9] For the purposes of FCPA liability, an "issuer" is a "natural person, company, government, or political subdivision, agency, or instrumentality of government" "who issues or proposes to issue any security."[10] And for foreign persons (who are not otherwise issuers), acting while in the territory of the U.S. is interpreted very broadly by U.S. authorities to include, for example, sending e-mails or faxes to or from the U.S., or even effecting overseas transactions denominated in U.S. dollars (thereby requiring the involvement of correspondent banks in the U.S. to complete the transaction).[11]

Notably, foreign companies qualify as "issuers" subject to the FCPA's anti-bribery provisions because they list certain types of American Depositary Shares (represented by American Depositary Receipts, or ADRs) on a U.S. national securities exchange. For example, in the *Siemens* and *ENI* enforcement actions, which imposed some of the largest criminal penalties among FCPA-related enforcement actions, the companies' FCPA liability was triggered by their ADR programs.[12] Foreign issuers should be aware of the FCPA exposure associated with ADR programs, but note that not all ADR programs carry this risk. Significantly, only programs in which ADRs are traded on a U.S.

[4] 15 U.S.C. § 78dd-1(f)(2)(B).

[5] H.R. REP. NO. 100-576, at 920 (1988).

[6] 15 U.S.C. § 78dd-1(f)(2)(B).

[7] FCPA GUIDE at 60.

[8] 15 U.S.C. §§ 78dd-2(h)(1)(A)-(B).

[9] 15 U.S.C. § 78dd-1(a).

[10] 15 U.S.C. §§ 78c(a)(9),(8),(19).

[11] *See, e.g.*, Indictment ¶ 23, 25, *United States v. Tesler*, H-09-098 (S.D. Tex. Feb. 17, 2009); Information ¶¶ 48, 50, 73, *United States v. Alcatel-Lucent France*, SA, 1:10-cr-20906 (S.D. Fla. Dec. 27, 2010); Plea Agreement, App. B (Statement of Facts) ¶¶ 3, 44, *United States v. Pride Forasol S.A.S.*, 4:10-cr-00771 (S.D. Tex. Dec. 7, 2010); Plea Agreement, Ex. 1 (Statement of Facts) ¶ 9, *United States v. Alliance One Tobacco OSH, LLC*, 4:10-cf-00016 (D.D.C. Aug. 6, 2010).

[12] *See, e.g.*, Amended Complaint ¶ 10, *SEC v. Siemens AG*, 1 :08-cv-02167 (D.D.C. Dec. 15, 2008) (NYSE-traded ADRs triggered FCPA liability resulting in fines of $800 million to resolve SEC and DOJ investigations); Complaint ¶ ¶ 7-8, *SEC v. ENI, S.p.A. & Snamprogetti Netherlands B.V.*, 4:10-cv-02414 (S.D. Tex. July 7, 2010) (NYSE-traded ADRs and common stock triggered FCPA liability. ENI and its subsidiary, Snamprogetti, resolved DOJ and SEC investigations for $365 million).

national securities exchange expose foreign issuers to FCPA liability.[13]

RECENT GUIDANCE ON THIRD-PARTY RISKS

Over the past several years, U.S. enforcement agencies have issued guidance for companies on mitigating risks associated with third parties. For example, in their 2012 *Resource Guide to the U.S. Foreign Corrupt Practices Act* (the "*FCPA Guide*"), the SEC and DOJ note that companies can reduce third-party risks by conducting appropriate due diligence and list common red flags to look out for during third-party due diligence. These red flags include:

- excessive commissions to third-party agents or consultants;
- unreasonably large discounts to third-party distributors;
- third-party 'consulting agreements' that include only vaguely described services;
- the third-party consultant is in a different line of business than that for which it has been engaged;
- the third party is related to or closely associated with the foreign official;
- the third party became part of the transaction at the express request or insistence of the foreign official;
- the third party is merely a shell company incorporated in an offshore jurisdiction; and
- the third party requests payment to offshore bank accounts.[14]

Due diligence on third parties, while essential, is merely one component of a robust compliance program designed to minimize third-party risks.[15] In February 2017, the DOJ published a document titled *Evaluation of Corporate Compliance Programs,* which includes an entire section devoted to guidance on third-party management.[16] This document indicates that to effectively manage third parties, corporate compliance programs should include risk-based and integrated processes, appropriate controls, management of relationships, and real actions and consequences.[17]

As anti-corruption enforcement agencies have issued guidance on addressing third-party risks over the past five years, we have also seen government enforcement actions in the U.S. and abroad during the same period that exemplify these principles. Highlights from such U.S. actions in 2017 are explored in more detail below. These actions all provide concrete examples of red flags or compliance measures denoted in the SEC and DOJ's guidance, while underscoring the necessity of conducting effective third-party due diligence and ensuring effective third-party compliance programs and controls.

LAS VEGAS SANDS CORP.

On January 19, 2017, Las Vegas Sands Corp. ("Sands") entered into a Non-Prosecution Agreement ("NPA") with the DOJ and agreed to a $6.96 million criminal penalty in connection with the government's investigation into FCPA violations in China and Macao.[18]

With regard to third parties, Sands had several contracts with a third party that had "no discernable legitimate business purpose," Sands failed to conduct due diligence on the third-party's companies, and Sands failed to require "appropriate documentation, approvals, or justifications for the payment to the Consultant, even after Sands had become aware of Consultant's failure to account for sums of over $700,000 paid by Sands and Consultant's business practices."[19] Among the areas of

[13] *See* KEVIN T. ABIKOFF, JOHN F. WOOD, & MICHAEL H. HUNEKE, ANTI-CORRUPTION LAW AND COMPLIANCE: GUIDE TO THE FCPA AND BEYOND 3-3 (Bloomberg BNA Supp. 2016).

[14] FCPA GUIDE at 22-23.

[15] *See id.* at 23.

[16] U.S. DEP'T OF JUSTICE, EVALUATION OF CORPORATE COMPLIANCE PROGRAMS 7 (2017) [hereinafter EVALUATION OF CORP. COMPL. PROGRAMS], *available at* https://www.justice.gov/criminal-fraud/page/file/937501/download.

[17] EVALUATION OF CORP. COMPL. PROGRAMS at 7.

[18] Press Release, U.S. Dep't of Justice, Las Vegas Sands Corporation Agrees to Pay Nearly $7 Million Penalty to Resolve FCPA Charges Related to China and Macao (Jan. 19, 2017), *available at* https://www.justice.gov/opa/pr/las-vegas-sands-corporation-agrees-pay-nearly-7-million-penalty-resolve-fcpa-charges-related.

[19] Attachment A (Statement of Facts) ¶¶ 11-12, Letter from Dep't of Justice to Lawrence Urgenson, Esq., counsel to Las Vegas

concern Sands admitted to being aware of were an accounting firm's identification of missing funds, and concerns raised about the third party by both Sands' outside counsel and a Sands Finance employee.[20] In the face of these red flags, Sands did not conduct sufficient due diligence on the third-party's legal entities, require heightened approvals and close monitoring of supporting documentation for payments to the third-party's entities, review bank records, or conduct additional audits of the third-party's entities and transactions.[21]

The *Evaluation of Corporate Compliance Programs* indicates that an effective compliance program must have real actions and consequences. It instructs companies to determine whether red flags were identified during third-party due diligence and how the red flags were resolved.[22] *Sands* provides an example of a situation where a company ignored clear red flags and took no appropriate actions to address them.[23] Moreover, the DOJ's *Evaluation of Corporate Compliance Programs* instructs companies to consider the business rationale for a third party. If Sands had seriously made this a consideration, it would have avoided engaging a consultant with no "discernable legitimate business purpose."[24]

ORTHOFIX INTERNATIONAL N.V.

On January 18, 2017, Orthofix International N.V., a Texas-based medical device developer and distributor, entered into a settlement with the SEC related to FCPA violations involving schemes "with third-party commercial representatives and distributors, to make improper payments to doctors employed at government-owned hospitals" to increase sales.[25] These payments were recorded as legitimate expenses and generated illicit profits of almost $3 million.[26]

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Sands Corp. regarding Las Vegas Sands Corp. Non-Prosecution Agreement [hereinafter Sands NPA] (Jan. 17, 2017).

[20] *Id.* ¶ 30.

[21] *Id.*

[22] EVALUATION OF CORP. COMPL. PROGRAMS at 7.

[23] Attachment A (Statement of Facts) ¶ 30, Sands NPA.

[24] *Id.* ¶ 11.

[25] SEC Rel. No. 79828 at 2 (2017).

[26] *Id.*

The order describes in detail the offending conduct of Orthofix's Brazilian subsidiary ("Orthofix Brazil").[27] Orthofix Brazil used third-party representatives to pay doctors a set amount of the sales price to use Orthofix's product. Once the doctors had performed a procedure using Orthofix's product, Orthofix Brazil would bill the hospital and then pay the commercial representatives a commission of approximately 33-43% of the sales price. The commercial representatives then paid a previously agreed-upon amount of the sales price to the doctor. Additionally, Orthofix Brazil would have companies related to a commercial representative send "false invoices for services such as marketing that were never provided."[28] Moreover, Orthofix Brazil would provide discounts "of up to 70%" to distributors, "who then used part of the profit generated by that discount to make improper payments to certain doctors" at public hospitals, or pay distributors for services that were never provided and record these payments as "consulting for sales."[29] These payments were then used to facilitate improper payments to doctors.[30]

Orthofix is another case where the failure to identify or address areas of concern and implement effective compliance programs allowed bribery to happen. For example, Orthofix had no policy requiring standardization, central approval, or monitoring of commissions and discounts to third parties.[31] For this reason, exorbitant commissions and discounts that were used to make corrupt payments were paid, despite the fact that Orthofix had pertinent substantive policies in place during the time of the conduct. If Orthofix had centralized processes and monitoring, these excessive commissions — a common third-party concern identified in the *FCPA Guide* — would have been identified, scrutinized, and not pushed through. Similarly, had Orthofix required substantiation of services rendered, such as regular third-party activity reports, unsubstantiated "consulting for sales" payments to distributors and false invoices may have been caught. The *Orthofix* order also emphasizes that "Orthofix's reporting structure and relationship with its subsidiaries was decentralized during the relevant time period, complicating parent oversight, compliance monitoring, and communication."[32] In this way, *Orthofix* further

[27] *Id.* at 3.

[28] *Id.* at 4.

[29] *Id.* at 5.

[30] *Id.*

[31] *Id.* at 6.

[32] *Id.* at 4.

underscores the importance of not only having compliance policies in place, but also ensuring that there are adequate processes and checks in place to catch misconduct. Had the company tested relevant controls, as recommended by the DOJ in *Evaluating Corporate Compliance Programs*, Orthofix would have identified the "gaps" in supervision and reporting structure that allowed bribery schemes to go undetected.[33]

TELIA

On September 21, 2017, Telia, a Swedish international telecommunications company, entered into a global foreign bribery resolution and agreed to pay more than $965 million in total penalties in connection with a bribery scheme in Uzbekistan.[34]

Among other schemes, the Statement of Facts included with Telia's deferred prosecution agreement (DPA) with the DOJ indicates that Telia "agreed to make a $15 million corrupt payment to benefit [a] Foreign Official in order to obtain certain 4G frequencies. The corrupt payment involved multiple transactions, in which TELIA essentially agreed to pay $15 million to a third-party vendor to assume a debt owed to that vendor by a Swiss company that was beneficially owned by the Foreign Official in exchange for purported 'consulting services.'"[35] Moreover, the *Telia* DPA indicates that Telia made corrupt payments to a "local partner" representative of a foreign official and a Gibraltar-incorporated shell company beneficially owned by a foreign official, in order to receive frequencies, series network codes, and other benefits.[36] Payments were made to the foreign official through direct payments to the shell company, including to the shell company's bank account in Hong Kong, as well as through a series of sophisticated transactions, including the purchase and sale of shares in Telia's subsidiary.[37]

Telia provides an example of a company that was aware of improper payments in some instances and exhibited a "conscious disregard or deliberate ignorance" of the "high probability" that the payments made to the local partner and shell company were being used for corrupt purposes in other instances. For example, the *Telia* DPA details correspondence about the need for a local partner in Uzbekistan involving Telia management, which indicated that the local partner was the chief executive for the foreign official's investment group.[38] Further, Telia received a report on the political risks of the Uzbek telecommunications sector that indicated that the foreign official's relation to a proposed investment posed a "further potential issue."[39] Moreover, Telia management was able to approve a $9.2 million payment to the shell company without any requirement for Telia board approval,[40] and during negotiations with the local partner regarding an acquisition, Telia received a specific recommendation from its outside counsel to structure the acquisition in a way that would remove it from the U.S.'s jurisdiction under the FCPA.[41]

These concerns are again among those detailed in the *FCPA Guide*, including the fact that the local party was closely associated with the pertinent foreign official and the third party represented a shell company incorporated in Gibraltar with an offshore bank account in Hong Kong. Had Telia implemented an effective compliance program in line with the criteria iterated by the SEC and DOJ, some of Telia's missteps may have been avoided. In particular, Telia should have further investigated issues identified in the political risk report and required special approval procedures for large payments to third parties.

Notably, the Corporate Compliance Program Telia agreed to implement pursuant to the resolution requires Telia to include standard provisions in third-party contracts, which include the right to terminate the agreement for breach of anti-corruption laws, compliance policies, or anti-corruption representations

[33] *Id.* at 6.

[34] Press Release, U.S. Dep't of Justice, Telia Company AB and Its Uzbek Subsidiary Enter Into a Global Foreign Bribery Resolution of More Than $965 Million for Corrupt Payments in Uzbekistan (September 21, 2017), *available at* https://www.justice.gov/opa/pr/telia-company-ab-and-its-uzbek-subsidiary-enter-global-foreign-bribery-resolution-more-965.

[35] Attachment A (Statement of Facts) ¶¶ 41, Letter from Dep't of Justice to David M. Stuart, Esq. and Angela T. Burgess, Esq., counsel to Telia Company AB regarding Deferred Prosecution Agreement [hereinafter Telia DPA] (Sept. 21, 2017).

[36] *Id.* ¶ ¶ 8, 10, 12, 17.

[37] *Id.* ¶¶ 30, 39.

[38] *Id.* ¶17.

[39] *Id.*

[40] *Id.* ¶ 36.

[41] *Id.* ¶ 21.

and undertakings.[42] Including these provisions is consistent with the *Evaluation of Corporate Compliance Programs*' guidance to incentivize third parties to be compliant and ethical.[43]

HALLIBURTON COMPANY AND JEANNOT LORENZ

On July 27, 2017, Halliburton Company, an international oilfield services company, and Jeannot Lorenz, a former Halliburton Vice-President, paid $29.2 million and $75,000 respectively to settle an SEC action regarding FCPA books and records and internal controls provisions violations.[44] The underlying conduct involved Halliburton's payments of approximately $3.7 million to a local Angolan company to fulfill Halliburton's local content requirements. The local Angolan company was owned by a friend and neighbor of the government official who "had authority to veto or reduce subcontracts awarded to Halliburton by large international oil companies" and approved Halliburton's proposal to use the local company to fulfill its local content requirements.[45] Halliburton's payments to the local Angolan company were made shortly before Halliburton won lucrative oilfield services contracts.[46]

The *Halliburton* order highlights the presence of several concerns suggesting a high probability of an improper payment being made. For example, Lorenz, who identified and spearheaded efforts to engage the local Angolan company, did not comply with a Halliburton accounting control that required "contracts over $10,000 in countries with a high risk of corruption, such as Angola, to be reviewed and approved by a Tender review committee."[47] With respect to one of the contracts with the local company, "the documentation entered into Halliburton's accounting system in May 2010 provided no justification for choosing the local Angolan company as a single source provider" and the award of the contract did not include a competitive bidding process.[48] The DOJ's *Evaluation of Corporate Compliance Programs* instructs companies to determine "the business rationale for use of the third part[y] in question," and *Halliburton* is yet another example of a case where no documented rationale was provided.[49]

Further, "when Halliburton terminated payments to the local Angolan company because of allegations of misconduct, Halliburton paid the local Angolan company $3,075,000 under [an] interim consulting agreement and the Real Estate Transaction Management Agreement."[50] Around the same period when these payments were made, the government official "approved the award of seven lucrative subcontracts to Halliburton and Halliburton profited by approximately $14 million."[51]

Halliburton is a case where clear concerns were raised to, but not properly addressed by, management. For instance, when Halliburton finance and accounting personnel raised questions about the use of a single source contract and the high remuneration of $13 million under an agreement with the local company, senior Halliburton executives nonetheless "allowed the contract reviews to proceed because they believed by this time only this agreement with the local Angolan company" would appease the government as to Halliburton's local content commitments.[52] This order underscores the importance of not only conducting due diligence and ensuring misconduct is reported, as it was in many instances here, but also ensuring that business leaders meaningfully consider red flags and risks identified when making business decisions.

CONCLUSION

Compliance risks posed by third parties are a common thread that runs through the history of FCPA enforcement. The above sample of some of the enforcement actions to date from 2017 provides a reminder that these risks are ever-present today. Only by implementing risk-based due diligence on third parties and designing and implementing effective compliance programs and controls can companies hope to identify, and either resolve or mitigate, the corruption risks posed by doing business with third parties and minimize the risk of similar enforcement actions. ■

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[42] Attachment C (Corporate Compliance Program) ¶ 15, Telia DPA.

[43] EVALUATION OF CORP. COMPL. PROGRAMS at 7.

[44] Press Release, U.S. Sec. & Exch. Comm'n, Halliburton Paying $29.2 Million to Settle FCPA Violations (July 27, 2017), *available at* https://www.sec.gov/news/press-release/2017-133.

[45] SEC Rel. No. 81222 at 2 (2017).

[46] *Id.*

[47] *Id.* at 5.

[48] *Id.* at 7.

[49] EVALUATION OF CORP. COMPL. PROGRAMS at 7; SEC Rel. No. 81222 at 7.

[50] SEC Rel. No. 81222 at 7.

[51] *Id.*

[52] *Id.* at 6-7.