

NOMADS
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**FOREIGN CORRUPT PRACTICES ACT
INCLUDING THIRD PARTY
LIABILITY ISSUES**

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OUTLINE

- OVERVIEW OF FCPA ANTI-BRIBERY AND RECORDKEEPING PROVISIONS
- CONTRACTS WITH FOREIGN SALES REPRESENTATIVES, BROKERS AND CONSULTANTS
- JOINT VENTURES WITH FOREIGN PARTNERS
- MERGERS, ACQUISITIONS AND FINANCING ARRANGEMENTS
- DUE DILIGENCE REVIEWS: HOW MUCH IS ENOUGH?
- RED FLAGS AND TRAPS FOR THE UNWARY

WHAT IS THE FOREIGN CORRUPT PRACTICES ACT?

U.S. law imposing criminal penalties for:

- (a) payments (or promises of payment) made to foreign government officials to obtain or retain business or to secure an improper business advantage, and
- (b) failure to keep proper accounting records of business transactions.

DEFENSES/EXCEPTIONS:

- (a) payments allowed by local law such as training expenses, application fees for public tenders or bid rounds
- (b) payments related to **reasonable** business development (travel and entertainment)
- (c) facilitating (grease) payments for routine, non-discretionary government action (prohibited by many companies and illegal in many countries)

HISTORY

- 1977 - FCPA enacted in response to defense industry bribery scandals of the early 1970s; bitterly criticized by U.S. companies as unfair and ineffective
- 1988 - FCPA amended to add affirmative defenses; recognition that some payments are OK

- 1994 - FCPA amended to add accounting provisions; much more effective in catching violations because it is impossible to record an illegal bribe accurately
- 1998 - OECD Convention ratified and FCPA amended; companies in the UK, France, Germany, Japan, Canada and other OECD member countries are now subject to similar restrictions as U.S. companies, BUT

- U.S. is still the leader by far in enforcement proceedings and reported cases

**ENERGY COMPANIES ARE
ESPECIALLY VULNERABLE
AND HAVE COMMITTED MANY
OF THE MOST SIGNIFICANT
FCPA VIOLATIONS**

WHY?

Most developing countries with substantial energy needs from foreign companies have:

- weak legal and regulatory systems
- serious infrastructure and social needs
- partial or complete government control of the energy sector
- low-paid government officials who depend on bribes
- foreign companies spending lots of money

INCREASED ENFORCEMENT

- Over \$100M in penalties from oil, chemical and telecom companies in 2007
- More prosecutions in past three years than in previous thirty years
- Over sixty federal cases in the pipeline
- FBI has dedicated five full-time agents to FCPA investigations

PRACTICAL CHALLENGES

Actions are judged by the U.S. Government with "20/20 hindsight"

- Absence of regulatory guidance
- Most cases settled prior to trial, and therefore judicial precedent is limited
- As a result of recent accounting scandals and corporate fraud in the U.S.:
 - Enforcement is on the increase and
 - Compliance standards are going up

PENALTIES

- Up to \$2 million fine per violation for corporation (or more under alternative fines rules).
- Disgorgement of profits
- Up to \$100,000 fine and five years in prison for Officers, Directors, and Employees.
 - Employees may be prosecuted even if the company is not.
 - Fines must be paid by the employee out of personal funds and may not be paid by the company.

WHO IS COVERED?

- U.S. citizens wherever located
- U.S. subsidiaries of foreign companies
- Officers, directors, employees and agents of a U.S. subsidiary
REGARDLESS OF THEIR NATIONALITY
- Agents including brokers, lawyers, accountants and consultants
- Joint venture partners
- Acquiring or merged companies

ANTI-BRIBERY PROVISIONS

Payment of (or offer or promise to pay) money OR anything of value, directly or indirectly;

- To any foreign official, foreign political party or candidate, or anyone acting on behalf of an international organization (World Bank, IMF), or to any other person (agent) while knowing that the payment will be made to one of the above;

ANTI-BRIBERY PROVISIONS

- To “corruptly” get the person to act or refrain from acting in violation of his or her lawful duty;
- To assist in obtaining, retaining or directing business or securing an improper business advantage.

“MONEY OR ANYTHING OF VALUE”

- Cash or equivalent
 - unmarked bills in a paper bag (Saybolt)
 - wire transfers to multiple offshore accounts held by third party agents
- Payment of expenses
- Lavish gift or gratuity
- Excessive travel, meals or entertainment

“MONEY OR ANYTHING OF VALUE”

- Stock or other interest in the company or the business venture
- Offer of employment to official or family member
- Charitable contribution which would benefit the government official
- Contribution to the official's political party

"FOREIGN OFFICIAL"

- Any official or employee of a foreign government, department or agency, or state-owned (even partially) enterprise (i.e. power company or utility)
- Police officer, customs or visa official, elected official, judge, candidate for public office
- Any person "acting in an official capacity" for or on behalf of any foreign government, department, agency or instrumentality.
- Any officer or employee of a public international organization (World Bank, IMF, etc.)

"FOREIGN OFFICIAL"

- If in doubt, assume foreign official!
- Could be low-level, part-time, and not even involved in the company's area of business

"CORRUPTLY"

- For the purpose of improperly influencing an official act or decision of a government official
- To induce the official to do or omit doing anything in violation of his or her lawful duty

"TO OBTAIN, RETAIN OR DIRECT BUSINESS"

- Contract for sale of goods or services
- License or concession
- Preferential treatment on public tender
- Commission or kickback

STATOIL ASA (2004)

- Statoil paid \$5.2M in bribes to an Iranian official (and agreed to pay additional \$10M) in return for obtaining lucrative contracts to develop the South Pars gas field
- Payments were made through an intermediary company to bank accounts in the US and Switzerland
- Statoil also violated books and records provisions by recording the payments as "consulting fees"

STATOIL ASA

- No due diligence was performed on the official or the contact and management ignored internal reports of a problem
- Penalty of \$10.5M to settle DOJ charges
- Disgorgement of \$10.5M in profits and independent compliance monitor to settle SEC charges

“SECURING AN IMPROPER ADVANTAGE”

- Lower tax assessment
- Expedited customs clearance (Panalpina case)
- Preferential treatment related to registration or license
- Any favorable decision from government official

DOW CHEMICAL CO. (2006)

- Fifth-tier subsidiary of Dow Chemical paid \$200K over six year period to Indian government officials for expedited licensing and registration of chemical products for sale in India
- Officials withheld approval until payments were made, often through brokers and consultants
- Payments were uncovered through internal audits and voluntarily reported to the DOJ
- Dow agreed to extensive restructuring of its compliance program and training and avoided monetary penalty

ACCOUNTING PROVISIONS

- Proper Records
 - Must keep proper records to accurately reflect transactions.
 - Intended to prevent false records or failure to report improper payments or transactions.
 - Applies to “issuers” on U.S. securities markets (including ADRs) but recommended that private companies comply as well
 - Merger, acquisition, or subsequent financing

ACCOUNTING PROVISIONS

- Internal Controls
 - System of accounting controls to assure management approval and financial statement preparation.
 - Audit Committee must certify compliance with anti-bribery and accounting provisions and cannot do so without proper records.

S.E.C. v. BAKER HUGHES (2001)

- Illegal payment made while knowing that third party agent (KPMG affiliate in Indonesia) would pass part of payment to foreign government official to reduce tax assessment
- Indonesian tax official offered to reduce tax assessment against BHI from \$3.2M to \$270K in return for payment of \$75K bribe
- BHI and KPMG believed the correct amount was \$2.1M but the official would not reconsider without the payment
- BHI Indonesia sought advice from Houston; BHI general counsel and FCPA Advisor prohibited the payment on FCPA grounds but CFO later authorized it

- KPMG offered to send false invoice to BHI which included actual accounting fees as well as the \$75K payment (books and records violation) and made the illegal payment on behalf of BHI (anti-bribery violation)
- Upon receipt of the bribe, the tax official issued a revised assessment for \$270K which BHI paid

- Upon discovery of the bribe through routine audit, BHI took immediate corrective action:
 - fired the CFO, controller and KPMG
 - paid \$2.1M tax (believed to be the correct amount)
 - corrected the books and records and tried to reverse the illegal payment, and
 - reported the illegal payment to the US Government (did not wait to be caught)

- Settled with the U.S. Government and received relatively lenient treatment in return
- Local agents (even major international firms) are not infallible - KPMG completely failed in its role as tax advisor to BHI – not only did it fail to keep BHI out of trouble, it was a proponent of the scheme and came up with the mechanism for making the payment

AFFIRMATIVE DEFENSES

- Payments are allowed by written local law
- Reasonable and bona fide business promotion expenses

ALLOWED BY LOCAL LAW

- Payments are specifically authorized under the written laws of foreign official's country:
 - fee for purchase of data package for preparation of bid or public tender
 - signature bonus for offshore oil concession
- Often difficult to prove

REASONABLE BUSINESS EXPENSES

- Must be directly related to business promotion or contract execution
- Inviting foreign officials to travel to company facilities – allowed but need to be careful
- Meals, gifts and entertainment must be reasonable

LUCENT TECHNOLOGIES (2004)

- Lucent Technologies investigated for bribing former Saudi telecom minister with \$20M in cash and gifts from 1995-2002
- Gifts included unlimited use of Gulfstream jet for minister and family, luxury hotels in the U.S. and Europe, and \$2M charitable contribution at the minister's request

BROKERS AND CONSULTANTS

- Essential for many companies
- More connected = more risky
- Need a thorough vetting procedure and initial due diligence
- Need agreement with reps and warranties
- Brokers should be briefed on company's compliance policy, trained, and managed
- Be alert to danger signs – “red flags”

"DIRECTLY OR INDIRECTLY"

- Payment made by broker or agent is no different than payment made by employee
- Payments to brokers are prohibited if the company knew or should have known that all or a portion of the \$\$ would be paid to a government official
- Conscious disregard, willful blindness
- "Ostrich" or "Head in the Sand" approach will not work

“DIRECTLY OR INDIRECTLY”

- Many FCPA cases involve payments by brokers or agents
- Surprisingly, majority of companies are not aware of this major liability
- Need to pay careful attention to “RED FLAGS” discussed later

PANALPINA CASES (2007)

- Three subsidiaries of U.S. oil service company Vetco Gray made over 375 payments totaling over \$2.1M to Nigerian customs officials from 2004 - 2006
- Payments were made by Panalpina, a major international freight forwarding and customs clearing company
- Vetco Gray did not perform sufficient due diligence and did not include Panalpina in any training program

PANALPINA CASES

- Several additional oil service companies have since been implicated in similar schemes
- Vetco Gray was fined \$26M by the DOJ – at that time the largest fine ever imposed in an FCPA investigation

JOINT VENTURES

- Often the preferred or even required method of doing business in developing countries
- Similar liabilities as consultants and subject of increased enforcement activities
- JV agreement should include similar reps and warranties
- Even minority partners may be liable for illegal payments

MERGERS, ACQUISITIONS AND FINANCINGS

- Surviving company will be responsible for any FCPA liabilities of acquired company
- Agreements need reps that no FCPA violations have occurred or will occur
- Problems often uncovered during due diligence review and MUST be reported to DOJ/SEC
- Result – DOJ/SEC investigation, possible penalties, possible failure of merger/acquisition/financing

INVISION TECHNOLOGIES (2006)

- Dec. 2006 – GE announced acquisition of Invision Technologies and DOJ announced deferred prosecution agreements with both companies
- Due diligence review had disclosed illegal payments by Invision's distributors caused by Invision's failure to conduct proper oversight on distributors
- GE – required to integrate Invision's business into GE's compliance program, obtain independent consultant, and cooperate with DOJ/SEC
- Invision – paid \$500K civil penalty and disgorged \$589K in profits

DUE DILIGENCE

- How much is enough? Depends on the circumstances
- Two objectives – education and protection
- Education about background of consultant, agent, partner etc. to avoid an FCPA problem
- Protection against liability in case a problem develops down the road

DUE DILIGENCE

- Past activities – financial statements, CVs, background checks, embassies, local counsel, Google
- References – business, financial and personal
- Future activities - written agreement with compliance certificate, audit rights

NIGERIAN JOINT VENTURE

- JV between US oil service company and Nigerian company
- Nigerian company is 100% owned by wife of NNPC official
- no prior instances of fraud or corruption
- asking for references for company and management
- will require reps in JV agreement and side agreements with owner and general manager
- Will include owner and GM in training program

GENERAL RED FLAGS

- The country has a history of corruption – Africa, Middle East, Former Soviet Union, Asia
- The industry involved has a history of FCPA problems – energy, defense, aircraft, construction
- The U.S. company has been investigated by the DOJ or SEC in the past five years
- Recent reports of payoffs, bribes, and kickbacks – Nigeria for example

AGENT/PARTNER RED FLAGS

- charges excessive commission or share of the deal
- compensation does not relate to contribution
- cannot contribute anything to the venture except influence (i.e. no industry experience/expertise, lack of staff or facilities)
- owned or controlled by key government official or a relative of the official
- business or family ties with a government official
- new to the business or inexperienced

AGENT/PARTNER RED FLAGS

- refuses to agree not to violate the FCPA
- claims not to know about or be subject to FCPA
- recommended by a government official
- use of shell companies to obscure ownership
- poor reputation
- lack of verifiable references
- does not provide sufficient background information

PAYMENT RED FLAGS

- payment in cash or bearer instrument
- payment to offshore bank account
- excessive compensation – will depend on the country, degree of risk, services provided and other relevant factors
- request for false invoices or other documents
- refusal to allow audit of records
- request for increase in compensation
- compensation is based on “success fee” commission – creates financial incentive to bribe

RED FLAGS

- these factors do not automatically disqualify an agent BUT raise the risk profile
- The more red flags, the greater degree of care and due diligence required
- cannot claim lack of knowledge after the fact

CONCLUSION

- Conduct thorough due diligence on all intermediaries, target companies and joint venture partners
- Include all in FCPA compliance policy and training program
- Manage relationships on an ongoing basis
- Use written agreements with reps and warranties, audit rights and termination rights
- Pay careful attention to red flags