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Avoiding Trouble Overseas: Understanding the Foreign Corrupt Practices Act

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American companies with operations or business interests overseas pay heed: as technology and a global economy continue to cause our world to shrink, the opportunities for American law enforcement and regulators to reach beyond our borders to investigate and prosecute perceived wrongdoing in the world marketplace continues to increase. Prosecutions and investigations under the federal Foreign Corrupt Practices Act — both civil and criminal in nature — are on the rise, and international companies cannot afford to close their eyes to the requirements of a law that has far-reaching and often counterintuitive repercussions.

More than 30 years ago, the FCPA was enacted to prohibit bribery of foreign officials and to restore confidence in the business practices of U.S. companies in foreign countries.[1] Since its inception in 1977 enforcement has varied, but things have amped up in recent years as prosecuting corporate crime has become the federal government's second-favorite mission du jour, second only to the war on terror.

Understanding the Foreign Corrupt Practices Act: Nuts and Bolts

The FCPA contains two distinct sets of provisions, the "antibribery" provisions and the "books and records" provisions. The antibribery provisions,[2] make it unlawful to bribe foreign officials to "obtain or retain business" in the foreign country. The books and records provisions,[3] are implicated when, among other things, payments are made in violation of the antibribery provisions and subsequently are not properly recorded in a public company's books and records.[4]

Who is Covered

To fall within the jurisdiction of the FCPA, a company or individual must have some formal ties to the U.S. The language of the Act specifies application to "issuers" and "domestic concerns."[5] An "issuer" under the Act is any company (public or private) that has registered securities in the U.S., or that is required to file certain financial reports with the SEC pursuant to requirements of the Securities Exchange Act.[6] Note that it is not the issuer alone that is covered—the prohibitions in the FCPA extend to any officer, director, employee or agent of the issuer acting on behalf of the issuer.[7] "Domestic concerns" include a much broader group of individuals and entities. A "domestic concern" is anyone that is a citizen, national or resident of the U.S.[8] This includes corporations, partnerships, associations, joint stock companies, business trusts, unincorporated organizations or sole proprietorships with their principal place of business in the U.S.[9] If an entity or individual falls within either of these categories they are subject to enforcement of the FCPA even if they are a non-U.S. entity, and even if the activities in question took place entirely outside of the U.S. The bottom line is this: The FCPA casts a wide net.

The Anti-Bribery Provisions

A violation of the antibribery provisions of the FCPA occurs when there has been an:

1. Offer, payment, promise to pay or authorization of payment of anything of value
2. to a foreign official (even if through an intermediary)
3. with a corrupt motive
4. for the purpose of (a) influencing any act or decision of such official; (b) inducing such official to act in violation of his/her lawful duty; (c) securing any improper advantage; or (d) inducing such official to use his/her influence to affect or influence a government act;
5. in order to assist in obtaining or retaining business for or with, or directing any business to, any person.[10]

The concept of "obtaining or retaining business" has been construed very broadly by the courts "to apply to payments that even indirectly assist in obtaining business or maintaining existing business operations in a foreign country."[11] In recent enforcement actions, the government has interpreted this element to include payments to foreign officials to secure licenses, permits or other certifications necessary to conduct business in the foreign country.[12]

The Books and Records Provisions

The books and records provisions of the FCPA require every "issuer" to:

1. Make and keep books, records and accounts that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the issuer's assets; and
2. Devise and maintain a system of internal accounting controls to maintain accurate accountability pertaining to all of the issuer's assets.[13]

Recent enforcement of the books and records provisions of the FCPA by the SEC and the Department of Justice tell us that the activities of non-U.S. subsidiaries of U.S. companies are firmly within the sights of regulators and law enforcement. Specifically, government authorities have been investigating and prosecuting U.S. companies when a non-U.S. subsidiary makes a bribe payment in a foreign country that finds its way into the parent/issuer's books and records. The SEC has taken the position that incorporation of the improper payment by the subsidiary into the parent company's books and records creates inaccurate reporting on behalf of the parent, even if the payment is accounted for correctly under GAAP.[14]

Very Narrow Exception

The "grease payment" exception is a noted exception to the antibribery provision, but one that companies must meet with caution. The text of the FCPA permits "facilitating or expediting payment[s]" to be made to foreign officials to encourage them to perform a "routine governmental action."[15] This is a very narrow exception which applies only to small amounts of money paid to low-level government employees for routine, nondiscretionary government actions.[16] Enforcement officials have provided little guidance on how far this exception extends, making it difficult to determine the parameters of the exception, and it is therefore risky to rely on it.

Penalties

Violation of the FCPA carries both civil and potential criminal liability. Criminal violations of the antibribery provisions by individuals can result in up to 10

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years imprisonment depending on the number of violations and the level of intent. In addition to imprisonment, corporations and individuals can be penalized by criminal fines. Corporations and other business entities can face fines up to $2 million for each violation, and individuals up to $250,000, still increasing upwards if willfulness is established.[17]

Civil violations of the FCPA can result in civil fines of up to $10,000 per violation. Further, the SEC can seek additional fines depending on the circumstances up to $500,000, or any amount gained as a result of the violation of the Act.[18]

In addition to criminal and civil exposure, for publicly traded companies, the announcement of a government inquiry on a FCPA issue alone, can cause fatal reaction by investors.

Recent Prosecutions

American companies with operations or business interests overseas should, from time to time, ask their outside or in-house counsel to provide updates as to recent enforcement or regulatory actions in the FCPA arena. Looking at recent prosecutions and investigations can help businesspersons and corporate counsel understand how the authorities are looking at corporate behavior on the world stage, and how best to structure a compliance program to avoid troublesome and expensive government inquiries.

The Dow Chemical Co.

A February 2007 SEC enforcement action against Dow Chemical is a cautionary tale for U.S. parent companies to tightly monitor the activities of their foreign subsidiaries. The SEC brought a books and records action against Dow Chemical and its foreign subsidiary, DE-Nocil Crop Protection Ltd, in connection with approximately $200,000 in improper payments made by DE-Nocil to the Indian Central Insecticides Board. The Insecticides Board held the discretionary authority for inspecting and registering the company's products for sale in India. The improper payments were, according to the charges, included in the books and records of the subsidiary company via falsified sales invoices. Though the improper payments made by the subsidiary were reportedly made without the knowledge or approval of any Dow Chemical employees in the U.S., both Dow Chemical and the subsidiary settled the action with a $325,000 civil penalty.[19]

Baker Hughes

In April 2007, in the largest FCPA monetary settlement in the history of the Act, Baker Hughes and its subsidiary, Baker Hughes Services International, agreed to a total civil and criminal monetary settlement of over $44 million. According to the Department of Justice, more than $4.1 million was paid to an intermediary, knowing that funds would be paid to employees of a government owned oil company in Kazakhstan. This led to a multitude of charges by the DOJ and the SEC including violations of the FCPA, conspiracy to violate the FCPA, and aiding and abetting in the falsification of books and records.[20] It should be noted that at the time, Baker Hughes was already under a cease-and-desist Order due to alleged violations of the FCPA in 2001.[21]

Delta & Pine Land Co.

Independent acts of a foreign subsidiary also caused Delta & Pine problems in July 2007, when the Department of Justice and the SEC charged the company with violations of the FCPA. The case involved allegedly $43,000 in improper payments by Delta & Pine's Turkish subsidiary, Turk Deltapine, to the Turkish Ministry of Agricultural and Rural Affairs to secure certain government reports and certifications necessary to obtain, and retain its business operations in Turkey. The SEC alleged that Delta & Pine executives were aware of the payments, but rather than stopping them, permitted the subsidiary to continue making payments indirectly via a third party supplier. The SEC further alleged that the improper payments were then accounted for in the books as inflated invoices. According to the SEC, the improper inclusion in the books and records amounted to a violation of the FCPA by Delta & Pine. Delta & Pine agreed to settle and paid $300,000 in civil penalties.[22]

Avoiding Violation of the Act

The cases above are not anomalies. For every reported settlement, a company should expect that there are several unreported, non-public investigations under way dealing with the FCPA. Companies with global operations can reduce exposure under the FCPA by simply setting up a system that guards against violative activity. First, a company with international operations or business interests should establish clear policies to detect and prevent violations of the FCPA's antibribery provisions. Companies should also identify the functions most likely to be danger areas as well as the specific employees most in need of compliance—for instance, staff in business development or with access to funds for entertaining or marketing prospective customers or business partners. And most important, management should educate as much of the work force as is practicable about the new procedures. Management should monitor compliance, facilitate reporting, and investigate and respond to violations of law as they are discovered. An effective anticorruption compliance program depends on high-quality risk assessment. A company first must authorize oversight and consistency responsibilities—usually to the general counsel or a compliance officer or committee (with the assistance of outside counsel as necessary). In turn, these folks must master not only the Foreign Corrupt Practices Act's application to the company in question but also all anticorruption laws in the foreign countries in which the company operates.

Once the relevant legal boundaries are determined, a list of common sense questions follows: Which employees interact with officials in foreign countries? How are the company's products marketed there, and what methods are used to develop business relationships? What degree of independence does the company give to operations and agents there? What controls are in place to ensure that all expenditures for marketing or business development are documented? Beyond these basics, finding the risks is not always easy. For large companies, it may be difficult to gather the precise details of particular business practices in foreign jurisdictions. Where company reps are independent contractors, for example, monitoring compliance can be tricky. One solution is to conduct interviews with these individuals as a way both to collect information about the business practices in question and to communicate the company's commitment to obeying the law.

Training programs are another approach to getting employees in foreign nations up to speed on compliance—while also gathering intel. Such sessions often result in participants asking questions about specific situations they have experienced, so legal counsel should be present to address any noncompliance that may be discovered.

Drafting anticorruption policies for operating in a foreign country is relatively straightforward. In short, the company needs a strong, unequivocal statement of its commitment to ethical conduct and compliance with the law. The policies should clearly instruct employees how to distinguish appropriate from inappropriate conduct, including which types of marketing and sales expenditures are permissible and which are prohibited. All processes for training, reporting, and investigating misconduct and improper payments should be clearly spelled out—as should how, if allegations are substantiated, the company will respond.

Good Faith Goes Far, but Save the Receipts

The hardest part of preventing corrupt activities is putting policies into effect. The danger typically arises from a company's failure either to adequately support and enforce those policies or to expend the effort necessary to implement the program.

The costs of anticorruption efforts vary with the scope of operations and the nature of the risks. Administering the program may require overcoming not only language differences but cultural barriers. To start with, in some countries the taboo against bribery is simply not as strong as it is in the United States, and the dangers of this activity must be emphasized in communications to foreign company agents.

When it comes to implementing anticorruption compliance, the point is not to look good on paper but to get results in practice. Companies should keep their

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eye on the prize: reducing the real-world risk that an employee or agent will pay a bribe, whether through ignorance, self-interest or a misguided notion of helping the company. At the same time, since the program is a testament to the firm's good faith, careful documentation is critical. That way, if a bribe is paid to a foreign official, the company can demonstrate the steps it took to obey the law.

When allegations of improper payments arise, management should conduct a prompt, thorough investigation, gathering all relevant facts. Only then will the company be in a position to decide, with the guidance of counsel, whether it is necessary or advantageous to make disclosure to DOJ or the SEC. A failure to do so will likely weigh heavily against the company if the violations are later brought to light.

No anticorruption program is perfect. Bribery and corruption have been around since the very first economies, and are eternal temptations to the greedy soul. Still, companies with international operations or business interests are now duty-bound to reduce the likelihood that every rep in every foreign country is on the up and up—and as daunting as this may seem, the fact is that serious efforts and reasonable policies can be effective. As more and more developing-world markets see double-digit growth, the growing opportunities—and competition—will only extend business worldwide. The sooner companies analyze their anticorruption compliance, the better.

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footnotes

1 See generally Foreign Corrupt Practices and Domestic and Foreign Investment Disclosure: Hearings on S. 305 Before the Senate Comm. On Banking, Housing and Urban Affairs, 95th Cong., 1st Sess. 116-18 (1977); Unlawful Corporate Payments Act of 1977: Hearings Before the Subcomm. On Consumer Protection and Finance of the House Comm. On Interstate and Foreign Commerce, 95th Cong., 1st Sess. 1 (1977).

2 15 U.S.C. § 78dd-1 et seq.

3 15 U.S.C. § 78m(b).

4 The SEC also uses the books and records provision of the FCPA as a relatively minor, non-fraud charge in negotiated settlements with issuers in other financial investigations.

5 15 U.S.C. §§ 78dd-1(a), 78dd-2(h)(1).

6 15 U.S.C. § 78dd-1(a).

7 Id.

8 15 U.S.C. § 78dd-2(h)(1).

9 Id.

10 15 U.S.C. §§ 78dd-1(a), 78dd-2(a), 78dd-3(a).

11 *U.S. v. Kay*, 359 F.3d 738, 755-56 (5th Cir. 2004) (holding that Congress intended broad application for the provision, benefiting the payor either "directly or indirectly" – extending the provision to payments to a foreign official to obtain a lesser tax liability).

12 See infra Recent Prosecutions.

13 15 U.S.C. § 78m(b).

14 See infra Recent Prosecutions.

15 15 U.S.C. §§ 78dd-1(b), 78dd-2(b), 78dd-3(b).

16 15 U.S.C. §§ 78dd-1(f)(3), 78dd-2(h)(4), 78dd-3(f)(4).

17 15 U.S.C. §§ 78dd-1; 78ff(a).

18 15 U.S.C. §§ 78dd-1; 78u(d)(3).

19 SEC Lit. Rel. No. 20000 (Feb. 13, 2007), SEC Release No. 55281 (Feb. 13, 2007), *SEC v. The Dow Chemical Company*, 1:07-cv-00336 (Feb. 13, 2007, D.D.C.).

20 SEC Lit. Rel. No. 20094 (Apr. 26, 2007); SEC Press Release (Apr. 26, 2007); *United States v. Baker Hughes Servs. Int'l, Inc.,* Case No. H-cr-07-129 (Information and Plea Agreement unsealed Apr. 26, 2007).

21 *In the Matter of Baker Hughes Incorporated,* Admin. Proc. No. 3-10572 (September 12, 2001).

22 SEC Lit. Rel. No. 20214 (July 26, 2007), SEC Release No. 56138 (July 26, 2007), *SEC v. Delta & Pine Co.*, 1:07-cv-01352 (July 25, 2007, D.D.C.).

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