MARCH 2015

COMMENTARY

Revisiting My Brother's Keeper: Latest Learning and Best Practices on Dealings with Third Parties under the FCPA

Over the past decade, one of the most common and perplexing questions posed by U.S. multinational corporations with respect to compliance with the Foreign Corrupt Practices Act ("FCPA") is, "Am I my brother's keeper?" Corporations and their personnel have long struggled, and continue to struggle today, to answer this question as it relates to third-party intermediaries, including distributors, resellers, service providers, and other business partners who may put the company in harm's way. In 2012, the issuance of the FCPA Resource Guide by the United States Department of Justice ("DOJ") and Securities and Exchange Commission ("SEC") shed some light on this question. Since then, lessons learned from specific cases and broad experience in this area merit renewed discussion of third-party dealings.

The FCPA and the "Agency" Doctrine

As applied to organizations and corporations, the FCPA governs the extraterritorial activity of all U.S. issuers and companies, along with their non-U.S. subsidiaries, affiliates, joint venture partners, and agents. In an effort to prevent, and to criminalize, willful ignorance of FCPA violations, the statute contains express provisions prohibiting corrupt payments made by a third party on a company's behalf. As will be discussed further below, the extent of a company's liability for the corrupt actions of third parties requires an analysis of that relationship, most importantly as to the potential creation of an agent relationship. Should that third party be determined to be an agent of the parent company, the DOJ and SEC, as reflected in the Resource Guide, would take the position that the FCPA will reach the acts of those agents undertaken within the scope of their duties intended to benefit the company. A review of just a few enforcement actions made public since the release of the Resource Guide serves to highlight the practical implications of this policy for U.S. multinationals.

In April 2013, the DOJ and SEC announced the resolution of a matter that illustrates a dual-threat involving foreign agents. A U.S.-based provider of drilling services admitted to using a freight forwarder to fraudulently avoid the payment of Nigerian customs duties and tariffs on equipment exported to that country. Compounding the company's wrongdoing, the U.S. company then provided more than $1 million to an agent in order to corruptly influence a Nigerian government panel reviewing the avoidance of those duties and tariffs. Using this money to entertain members of the government panel, the agent was able to reduce the fine levied by the Nigerian government on the U.S. company from almost $4 million to just $750,000. The U.S. company entered into a deferred prosecution agreement ("DPA") with the DOJ to pay nearly $12 million in penalties and more than $4 million in disgorgement and prejudgment interest in a related SEC resolution. This matter underscores the risk of attempting to insulate the company through the use of foreign third parties to engage in misconduct on its behalf.

In July 2013, the DOJ announced the superseding indictment against two former executives of a multinational energy company and its U.S.-based subsidiary. The charges, which include violations of the FCPA and money laundering statutes, stem from a systematic bribery scheme that made corrupt payments to Indonesian officials in order to secure a $118 million power-supply contract to the country. According to the charges, the bribes were paid out through the deliberate use of consultants, who were retained specifically to funnel payments to officials in order to win the contract. A seemingly damning series of emails recounts the executives' frustration with the lack of headway made by one consultant and the hiring of a second consultant. Of particular note with respect to the hiring of this second consultant, it appears that the company did not adhere to its standard practice of paying consultants on a pro rata basis and instead made one large payment up front in order to facilitate the corrupt payments to the Indonesian officials.

In November 2013, three subsidiaries of a multinational oil services company that publicly trades in the U.S. pleaded guilty to violating the FCPA, among other crimes. Court documents indicate that the company failed to establish an effective system of internal anticorruption controls, despite the high corruption risk present in its industry and global operations. Thus, when employees of a subsidiary set up a joint venture in Africa with local foreign officials, the company failed to detect the joint venture's role as a conduit to funnel corrupt payments to these officials. In another scheme, employees of a different subsidiary in the Middle East awarded improper discounts to a distributor who supplied the company's products to a government-owned national oil company. These discounts, in turn, were used by the distributor to generate bribes to officials at the state-owned company. The multinational agreed to pay more than $252 million in penalties and fines to the DOJ, SEC, and a host of other U.S. agencies.

In December 2013, a Ukrainian subsidiary of the Archer Daniels Midland Company ("ADM") pleaded guilty to violating the FCPA and agreed to pay more than $17 million in criminal fines. The charges related to a years-long system wherein the subsidiary paid third-party vendors, which bribed Ukrainian government officials for unearned tax refunds. The corrupt payments were brought to the attention of ADM executives, but that knowledge did not result in any enhanced antibribery controls at the company or its subsidiaries. ADM itself entered into a non-prosecution agreement ("NPA") and agreed to pay more than $36 million in disgorgement and prejudgment interest to the SEC as a result of this failure to maintain an adequate compliance regime.

In July 2014, the SEC announced that it had charged Smith & Wesson Holding Corporation with violating the FCPA. As set forth in the SEC's order instituting a settled administrative proceeding, Smith & Wesson hired third-party agents to assist with sales of firearms to law enforcement agencies in Pakistan, Indonesia, Turkey, Nepal, and Bangladesh. In the course of this relationship with these third parties, Smith & Wesson employees endorsed and authorized their agent's provision of gifts (including firearms as "test" samples) and cash payments to officials in order to consummate the sales. Ultimately, the SEC order found that Smith & Wesson violated the antibribery, books and records, and internal controls provisions of the FCPA. These findings were based, at least in part, on the absence of any due diligence performed on these third-party agents, as well as the lack of internal controls over the payment of commissions to these agents and provision of firearms as "test" samples. Smith & Wesson agreed to pay $2 million in disgorgement, prejudgment interest, and penalties. Smith & Wesson also agreed to a two year period of self-reporting and, as part of its demonstrated remediation efforts, terminated its entire international sales staff.

And finally, in December 2014, a U.S.-based company, along with its wholly owned Chinese subsidiary, entered into a $135 million settlement with both the DOJ and SEC for violating the books and records and internal controls provisions of the FCPA. The factual allegations stated that in order to secure a license for direct sales under newly instituted Chinese regulations, the Chinese subsidiary gave $8 million in payments and gifts to government officials. In addition, the DOJ and

SEC alleged that the Chinese subsidiary made these payments to secure favorable media coverage—and to suppress negative media coverage—that would have decreased the likelihood of any license approval. At the time the settlement was announced, the DOJ and SEC made clear that the U.S. company initially attempted to hide the improper payments made by its subsidiary and ceased the activity upon receipt of a whistleblower complaint.

The International Arena: Local Enforcement on the Increase

The playing field for multinational companies has grown immeasurably more complex over the past several years, not only as a result of U.S. enforcement actions but also due to the increase in both the number of foreign countries passing similar anticorruption statutes and the upswing in enforcement of bribery laws already on the books. Brazil presents an excellent example of both of these paradigms.

First, in August 2013, the nation passed a landmark anticorruption law that governs the conduct of Brazilian companies, either within Brazil or abroad, as well as the operations of foreign-owned entities in Brazil. The law took effect in January 2014 and enforcement activity will continue to be closely watched to determine both the law's efficacy and the resolve of the Brazilian government to pursue prosecutions.

Second, even before the passage of the anticorruption law, the Brazilian enforcement authorities were clearly beginning to press harder in conducting bribery investigations. In November 2011, the Brazilian aircraft company Embraer SA, which trades publicly on the New York Stock Exchange, announced in a filing that it had received an SEC subpoena seeking information related to possible FCPA violations. This news was followed by disclosure of a joint investigation by U.S. and Brazilian authorities into bribery allegations stemming from Embraer's sale of aircraft to at least three other countries. The company stated that it was cooperating with agencies from both the U.S. and Brazil. The Embraer investigation, then, not only predates the new Brazilian anticorruption law, but it also would appear to provide precedent for future collaboration between Brazil and enforcement agencies from other nations.

India stands out not only as another economic power on the rise, but also as a nation with an apparently increasing commitment to pursuing corruption charges against third-party intermediaries acting on behalf of foreign multinationals. In June 2013, the Central Bureau of Investigation ("CBI") filed bribery charges against the Indian representative of a German defense manufacturer. The bribes were reportedly funneled through a U.S.-based third-party intermediary in order to corruptly influence the proposed blacklisting of the German firm by Indian government contractors. CBI's pursuit of corruption allegations is unlikely to wane anytime soon, as in 2013 the Indian government began aggressively investigating Italian and British firms for bribery related to a multimillion-dollar defense deal. The recent passage of the Lokpal Bill will also add to the recent anticorruption trend in India, as the law will establish an independent authority with a mandate to inquire into corruption allegations against public officials.

When it comes to violations of the FCPA, China has long ranked as one of the countries with the highest risk of corruption activity. Yet due to a high-visibility anticorruption campaign by the Chinese government, violations of the FCPA and U.S. law no longer remain the sole concern of multinational corporations operating in China.

No case better illustrates this fact than the Chinese Ministry of Public Security's investigation into the British global pharmaceutical company GlaxoSmithKline ("GSK"). The Chinese authorities allege that GSK funneled millions of dollars to government officials, doctors, and hospitals in order to secure prescriptions of the company's drugs. These payments were funneled through travel agencies in the form of trips, entertainment, and cash. Like many corruption investigations in China, the alleged GSK misconduct was likely revealed through one or more whistleblowers within GSK's China operations.

The Chinese government ultimately imposed a fine of nearly $500 million for these bribery allegations in September 2014, but this will surely not be the last such financial penalty imposed for this type of conduct. Throughout 2014, there was a clear signal that the Chinese authorities are continuing to investigate foreign pharmaceutical companies, with several companies making public announcements that their China offices had been searched and their employees interviewed. In almost every case, the corrupt payments were made to doctors through third parties and concealed as research grants, consulting fees, or remuneration for conducting clinical trials.

Oh Brother, Who Art Thou?

For a multinational seeking to manage its third-party business relationships and mitigate risk associated with anticorruption enforcement, the above review of recent enforcement actions portrays a daunting landscape in need of the most careful navigation. Fortunately, these actions, as well as the guidance propounded by the DOJ and SEC, do provide a roadmap to avoiding the potential FCPA perils accompanying a company's use of third-party intermediaries.

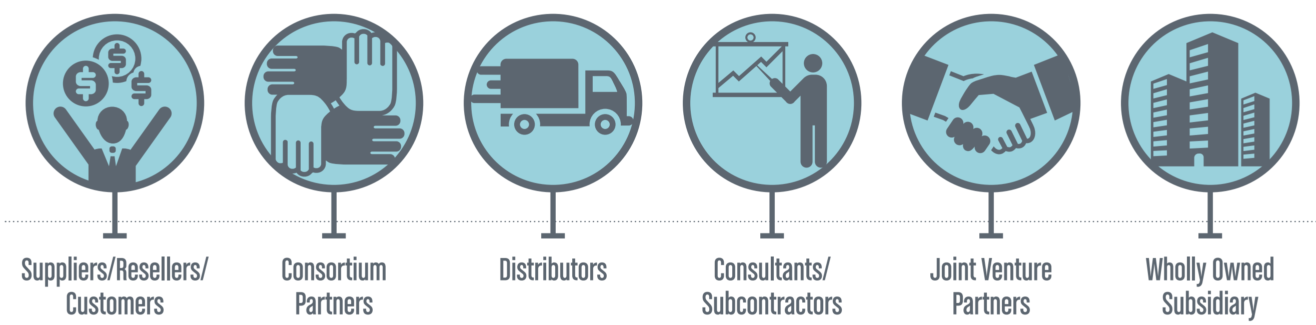
In answering the frequent question—"Am I my brother's keeper?"—a company first must answer this question: "Who is my brother?" In practical terms, this means that the company must assess the nature of those third-party relationships in order to determine whether an agency has been created. This stage of the analysis is critical, as it not only provides a useful gauge to measure the potential risk posed by the third party's conduct, but the results of this analysis also will govern the compliance program that should be implemented with respect to that third party. A handy yardstick in conducting this analysis is the amount of control retained and exercised by the parent company over the third party, regardless of the type of person or entity involved (e.g., subsidiary, distributor, consultant, contractor). The formal contractual arrangements that established this relationship are but one factor in need of close review, as the day-to-day interactions between the parent company and third party are equally important in determining control and, as a result, potential liability. Below is a chart outlining possible business relationships established by a multinational during the course of its overseas operations:

For those third-party relationships falling to the left-hand side of the chart, the parent company is, in comparison to those relationships toward the right of the chart, generally less likely to have maintained the level of knowledge and control that would give rise to the creation of an agency relationship. The arrangements depicted toward the right of the chart are typically more formalized and part of the parent company's routine business operations in the foreign country, and as such generally more likely to create an agency relationship.

Thus, while each relationship of course must be evaluated in light of the circumstances involved, the key danger zone in assessing the existence of an agency relationship often lies in the middle of this chart—third-party intermediaries such as distributors, consultants, and subcontractors. As borne out by the above review of anticorruption enforcement actions, these are the third-party relationships most likely to run afoul of bribery and corrupt payment statutes. As with any fact-based assessment, the more detail that is obtained with respect to the analysis, the better the results. Thus, a parent company should carefully review the contractual terms of the consultant or distributor (or, preferably, use a company-standard set of contracts containing anticorruption provisions), the method and frequency of payment, the scope of the duties and responsibilities undertaken by the third party, any required periodic reporting on expenditures and sales by the third party, and the level of technical or logistical support provided by the parent company. Ultimately, though, the inquiry should steer back to the question of control: How much authority does the parent company maintain to direct the activities of this third party?

All in the Family

When designing a system of compliance measures relating to anticorruption, it is useful to keep one eye on the above chart. For those less risky business relationships on the far



left of the chart, experience suggests that monitoring and compliance with anticorruption laws is perhaps best managed by the business operations personnel who have the most frequent contact with the third party. Indeed, in many overseas settings, these "third parties" are in fact customers of the parent company; the exercise of audit rights or insistence on mandatory compliance training, then, could obviously be seen as an onerous and possibly counterproductive method of enhancing compliance.

In those instances where the relationship does not lend itself to these more probing compliance steps, the parent company should certainly consider the need for heightened internal due diligence with respect to those third parties. Such steps can include consistent and regularly reviewed payment terms for those third parties, additional scrutiny on the third party's claimed expenses (especially for travel, entertainment, and leisure), and required documentation as proof that work has actually been performed. The following chart, when used along with the companion chart on page 4, can help a company to plot out the most effective course in avoiding anticorruption violations and maintaining an effective system of compliance.

Thus, when introduced at the lowest and most personal level, the least intrusive of these compliance measures are likely to result in a heightened awareness of anticorruption with the third party. By providing notice of a company's anticorruption policy and requiring an annual certification that the third party will comply with that policy, the parent company has, at the very least, initiated a conversation between the third party and the company's representative about the need to maintain a corruption-free business model. For most relationships between the company and its customers or consortium partners, this may prove to be sufficient. Whether the parent company will need to adopt additional internal controls relies to a large degree on the risks presented with respect to the third party: Does the company's industry, geographic area of operations, or the third party itself (e.g., a consultant who advertises close ties to government officials) merit additional scrutiny from the parent company? As for those relationships with tighter parent company control and direction, such as a wholly owned subsidiary or a joint venture, a stricter regime of compliance measures may be necessary after accounting for these same risk factors.

So when asked, "Am I my brother's keeper?," arriving at an answer requires care and analysis and, most critically, the exercise of judgment. Perhaps the most important first step that a company's leaders can take is asking the question in the first place. Since the answer requires ever more inquiry, and ever more thought, the process of seeking that answer may not turn up a simple "yes" or a "no." What will be answered during that process, though, is what really matters to a multinational company facing a complex, global array of interweaving anticorruption requirements: Are we at risk and, if so, what steps can we take to protect ourselves?

Further Information

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Authors

Karen P. Hewitt
San Diego

Theodore T. Chung
Chicago

Hank Bond Walther
Washington

Justin E. Herdman
Cleveland

Authors Karen Hewitt, Ted Chung, Hank Walther, and Justin Herdman are former federal prosecutors and members of Jones Day's global Corporate Criminal Investigations Practice, which defends corporations in government inquiries and in conducting internal corporate reviews around the world. Ms. Hewitt, Partner-in-Charge of the Firm's San Diego Office, was the United States Attorney for the Southern District of California. Mr. Chung was an Assistant United States Attorney in the Northern District of Illinois and is currently the Practice Leader for Jones Day's Corporate Criminal Investigations practice. Mr. Walther was Chief of the Department of Justice Health Care Fraud Unit and, before that, Deputy Chief of the FCPA Unit. Mr. Herdman was an Assistant United States Attorney in the Northern District of Ohio and, before that, a prosecutor in the Manhattan District Attorney's Office.

Lawyer Contacts

Henry W. Asbill
Washington
+1.202.879.5414
hasbill@jonesday.com

Shireen M. Becker
San Diego
+1.858.314.1184
sbecker@jonesday.com

Jean-Paul Boulee
Atlanta
+1.404.581.8456
jpboulee@jonesday.com

Charles M. Carberry
New York / Washington
+1.212.326.3920 / +1.202.879.5453
carberry@jonesday.com

Theodore T. Chung
Chicago
+1.312.269.4234
ttchung@jonesday.com

Roman E. Darmer
Irvine
+1.949.553.7581
rdarmer@jonesday.com

Richard H. Deane, Jr.
Atlanta
+1.404.581.8502
rhdeane@jonesday.com

James C. Dunlop
Chicago
+1.312.269.4069
jcdunlop@jonesday.com

Randy S. Grossman
San Diego
+1.858.314.1157
rsgrossman@jonesday.com

Justin E. Herdman
Cleveland
+1.216.586.7130
jherdman@jonesday.com

Brian Hershman
Los Angeles
+1.213.243.2445
bhershman@jonesday.com

Karen P. Hewitt
San Diego
+1.858.314.1119
kphewitt@jonesday.com

Henry Klehm III
New York
+1.212.326.3706
hklehm@jonesday.com

Weston C. Loegering
Dallas
+1.214.969.5264
wcloegering@jonesday.com

Joan E. McKown
Washington
+1.202.879.3647
jemckown@jonesday.com

Thomas P. McNulty
Chicago
+1.312.269.4142
tpmcnulty@jonesday.com

Matthew D. Orwig
Dallas / Houston
+1.214.969.5267 / +1.832.239.3798
morwig@jonesday.com

Daniel E. Reidy
Chicago
+1.312.269.4140
dereidy@jonesday.com

Peter J. Romatowski
Washington
+1.202.879.7625
pjromatowski@jonesday.com

Kerri L. Ruttenberg
Washington
+1.202.879.5419
kruttenberg@jonesday.com

Stephen G. Sozio
Cleveland
+1.216.586.7201
sgsozio@jonesday.com

Neal J. Stephens
Silicon Valley
+1.650.687.4135
nstephens@jonesday.com

Brian A. Sun
Los Angeles
+1.213.243.2858
basun@jonesday.com

Hank Bond Walther
Washington
+1.202.879.3432
hwalther@jonesday.com

James R. Wooley
Cleveland
+1.216.586.7345
jrwooley@jonesday.com