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EMERGING MARKET RISK

Implications of the Foreign Corrupt Practices Act for multinational companies

BY MARK WILLIAMS

The globalisation of business is driving companies into new territories with greater frequency. Emerging markets in particular are increasingly important for multinational companies looking to reduce costs or access growing consumer bases. This will only intensify in coming years. But the lure of emerging markets brings companies closer to corruption and bribery practices. In the annual Corruption Perceptions Index (CPI), compiled by Transparency International, the BRIC countries languished in unimpressive positions. Brazil, China and India placed 70th, 71st and 74th respectively, out of 163 countries, while Russia could only make 127th. Such findings put the implications of the US Foreign Corrupt Practices Act (FCPA) into sharp focus.

The FCPA deals with illegal payments made by individuals or corporations to foreign officials. Such officials are described under the regulations as any officer, employee or other party acting on behalf of any foreign government or any department, agency, instrumentality, government-owned or controlled entities, or of a public international organisation, such as the World Bank or World Trade Organization. Individuals that fall into this bracket can include politicians, foreign customs agents and tax collectors. Regulators apply the term to individuals regardless of rank, seniority or influence. For the purposes of the FCPA, the US government may determine that an individual is a foreign official even if that person does not consider themselves to be an official within his or her own country.

The FCPA operates with a broad scope. Companies that fall under its purview are defined as 'domestic concerns' and 'issuers'. A domestic concern is any corporation or similar entity which has its principal place of business in the US or is organised under US laws, or a US person wherever located. An issuer is any company (including a non-US company) that issues securities that have been registered in the US or that is required to file periodic reports with the SEC. The FCPA also covers non-US companies and persons, wherever located, that either directly or indirectly commit an act in furtherance of a bribe, in the US or by means of a US instrumentality, that would violate the FCPA.

Certain payments can be made to foreign officials in the form of facilitation or 'grease' payments, which are exceptions to the anti-bribery prohibitions and therefore permissible. To qualify as a grease payment, the payments must be relatively small, not out of proportion to the earnings of the recipient, offered in return for a service that the recipient is lawfully entitled to provide and ideally not part of a series of continual payments. But the use and determination of grease payments is not always straightforward. Despite being allowed under US law, they may be unlawful in the local country. They are difficult to monitor and control, and may be recorded inaccurately in a company's accounts, which may place a company in violation of the FCPA's recording and transparency provisions. Another issue centres on the amount of the payment. "One company's grease payment can be another company's bribe; there is no conclusive guidance on how high or low a grease payment should be to still retain its character as a facilitating payment," says Sharie Brown, a partner at Foley & Lardner. "Typically, a company may allow grease payments in its policies and procedures for employees to receive mail service, trash pick up, a driver's licence, phone service, electricity, individual customs clearance, a visa, or other service to which the individual is lawfully entitled, and for which the clerical level government functionary normally has no discretion to deny, assuming that all other legal requirements have been met by the requesting party."

In recent years, the US Department of Justice (DOJ) has ramped up its enforcement of FCPA regulations. It considers itself an integral part of the US effort to combat and eliminate global corruption, believing that corruption leads to multiple problems. David Weiler, a partner at Patton Boggs LLP, agrees. "Corruption undermines democracy and rule of law by allowing government officials to profit from bribes rather than making judgements and decisions in the best interests of the public they are expected to serve. Also, corruption and the expectation of corruption actually makes the playing field uneven for US companies that have to compete under the real threat of prosecution of the FCPA while other companies from other countries may not have to labour under the similar threat," he says. Several market-based and regulatory drivers are further motivating a move towards vigorous FCPA enforcement. Among them are the incidence of financial scandals and the Sarbanes-Oxley legislation that followed, which have increased DOJ awareness of possible violations or misconduct, partly by encouraging companies and auditors to disclose wrongdoing and internal controls inadequacies, and expanding whistleblower activities.

Several cases point to the mounting enforcement strategy that has pushed FCPA considerations up the corporate compliance agenda. Perhaps the most widely reported incident involved Norwegian oil & gas company Statoil, which admitted to making $5.2m in payments to senior level officials in Iran to secure oil and gas contracts. It agreed to a $10.5m criminal fine, a $10.5m disgorgement of profit and the imposition of an independent FCPA monitor for a period of at least three years. In July 2006, the SEC accused four former senior employees of ABB Ltd. subsidiaries of violating the anti-bribery provisions of the FCPA. The allegations centred on their attempts to close a contract in Nigeria by offering or paying bribes to local government officials. In the end, the four defendants all agreed to settle without admitting or denying wrongdoing. German conglomerate Siemens AG was also drawn into corruption investigations when it revealed in March 2007 that it had uncovered €420m in suspicious transactions over a period of seven years.

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There has been a considerable shift in the penalties associated with prosecutions under the FCPA. First, they are escalating. Titan paid a combined civil and criminal penalty of $28.5m while Vetco International paid the largest criminal fine of $26m, for example. Second, companies are regularly required to disgorge any actual or expected profits obtained as a result of FCPA violations. Third, it is now common for compliance monitors to be imposed on companies for a lengthy period if regulators are dissatisfied with existing compliance programs. "The imposition of an independent monitor has been a requirement for settlements with the SEC since at least 2004," explains Joseph Tompkins, a partner at Sidley Austin LLP. "It is a particularly costly and burdensome penalty because the company involved has to subject itself to a thorough compliance investigation by the independent monitor, and then the company is required to adopt whatever recommendations the monitor recommends, unless the company can demonstrate to the SEC that implementing the recommendations would be unduly burdensome or costly."

The fallout of undergoing prosecution and receiving penalties under the FCPA can have a significant impact on companies. Individuals face fines and imprisonment. Business setbacks can result from the financial burden of high fines, class action lawsuits or compliance monitors. A guilty company may be barred from doing business with the US government or governments of other countries. Damage to reputation arising from FCPA violation can affect the perception of customers, investors and employees. "Businesses are paying higher fines and penalties, enduring greater media scrutiny, and having to disclose early and often in order to have any chance of receiving a fair settlement from enforcement authorities" says Ms Brown. "Referrals to local prosecutors are also increasing, thereby raising the prospect of even more penalties and fines for companies from around the world."

Anti-bribery and anti-corruption laws continue to spread around the globe. The US has more allies and cooperation mechanisms through which to enforce FCPA violations. To date, 30 OECD and 6 non-OECD countries have enacted FCPA-like legislation, which clearly amplifies the risk for companies operating in those regions. Companies that were previously subject to FCPA compliance are now also subject to compliance with local laws, points out Manny Alas, a partner and co-head of PricewaterhouseCoopers' global FCPA practice. "The passage of these local legislations, along with the participation by over 100 countries in the UN anti-corruption treaty, have been important first steps towards zero tolerance against corruption globally. The real test will be enforcement. Notwithstanding the current activity with regulators, there is still a long road to travel before the compliance model sets a permanent foundation in global business transactions," he says. But there are positive consequences of this trend. Over time, the introduction of FCPA-like laws will erode the culture of corruption that has sprung up in many countries. The incentive is there for governments to stamp out such practices, as corruption is recognised as harmful to companies and consumers. Law-abiding companies will benefit from improvements in regional business environments that level the playing field through legislative measures.

Yet there are several ways that US and non-US companies can protect themselves or at least reduce the risk of exposure to the FCPA. Mr Alas suggest three steps businesses should consider: "First, develop, communicate, and enforce robust FCPA compliance policies and procedures. Second, train and inform employees, especially sales, finance, and accounting personnel, regarding the FCPA as well as local anti-corruption and anti-bribery provisions. Finally, monitor and test the system of controls to determine the effectiveness of compliance programs." This system should include a comprehensive internal control payment process that checks and verifies proposed payments to foreign officials. To ensure ongoing FCPA compliance, companies need to maintain constant supervision of overseas subsidiaries and affiliates, and perform full investigations of any claims of suspected FCPA violations, disclosing their results to regulators where appropriate. Further, in M&A situations, advisers recommend that international buyers incorporate corruption investigations into the due diligence process, and include anti-corruption provisions in all contracts.

Dealing with employees is one thing, but companies have less control over third-party agents and consultants they retain to provide services overseas. This, according to Mr Weiler, makes due diligence a key element. "The agent should be a reputable person who has a track record in the area for which they are being hired," he says. "Resist the temptation to hire an agent whose sole skill is their relationship to senior government decision makers. Set the compensation at an appropriate level, train the agent and include appropriate representations and warranties regarding the FCPA in the agency contract." Companies should start by making agents aware of the FCPA and its relevance to their business dealings, to avoid inadvertent violation. They must also be prepared to reject agents that have the potential to jeopardise a company's standing in relation to the FCPA. If a breach occurs, they need to make an example of the violators through strong disciplinary procedures or termination of contract, which sends a resounding message to other agents. Above all, employees of the company should be alert to identify red flags, such as demands by agents for higher compensation, dubious agent recommendations by foreign officials, or the creation of shell companies as a conduit for payments.

Preventative measures are critical given that international companies are moving more emphatically into emerging markets. The historical conundrum is how to achieve FCPA compliance and competitive excellence in jurisdictions where rivals may be cutting corners by engaging in corrupt activities. To this end, Mr Tompkins argues that there are solutions for compliant businesses. "Even in jurisdictions where there is a history of bribery and corruption, there may be ways to structure transactions or donations so that FCPA issues can be avoided," he notes. "This may include establishing pre-payment or pre-donation representations and warranties and post-payment audits or verifications so that DOJ and SEC officials are satisfied that everything reasonable has been done to avoid violations. In some cases, getting foreign government regulators or independent auditors involved in monitoring the transactions and payments may be helpful." Forcing competitors to comply with anti-corruption measures is also becoming easier as FCPA-like regulations are taken up by more countries around the world. But a priority should be placed on developing an internal culture of FCPA compliance, which requires rigorous oversight of all foreign business dealings and unwavering internal enforcement when violations are uncovered. Powerful procedural, training and monitoring systems go a long way to help companies resist the temptation to imitate underhanded local or foreign rivals. ■

Sharie A. Brown
Partner
T: 202.672.5494
E:sbrown@foley.com
www.foley.com

Sharie A. Brown is a partner and chair of the White Collar Defense & Corporate Compliance Practice at Foley & Lardner LLP. She is also a member of the Transactional & Securities Practice and the International Business and Automotive Industry Teams. Ms. Brown represents multinationals and conducts investigations and merger due diligence worldwide in the areas of the Foreign Corrupt Practices Act (FCPA), OFAC compliance and export controls, corporate ethics and compliance, World Bank procurement frauds, Economic Espionage Act (EEA), and USA Patriot Act anti-money laundering. Ms. Brown chairs the Litigation Department's Diversity Committee, and serves on the Litigation Program Committee and the Women's Network Steering Committee.

Her professional memberships include: National Foreign Trade Council (NFTC); Steering Committee of USA*ENGAGE; OFAC Working Group; Iran Working Group; and advisory board of the Georgetown Corporate Counsel Institute. She is also an ABA, ACI and D.C. Bar conference speaker in her practice areas, and serves on ABA and D.C. Bar Continuing Legal Education programming committees.

Previously, as senior counsel at Mobil Oil Corporation, Ms. Brown practiced in the above practice areas, and defended an antidumping case involving Saudi Arabia, Venezuela, Mexico and Iraq. Ms. Brown co-drafted Mobil's application to swap crude oil with Iran, developed sanctions prepositioning strategies, and wrote employee guides relating to corporate compliance, embargoed countries, and the FCPA.

As a Mobil compliance officer and ethics officer, she developed a worldwide ethics and compliance program, a code of conduct, and employee training videos, as well as pamphlets on the FCPA, and Iran, Iraq, Cuba and Libya sanctions compliance. As Mobil's policy advisor in corporate planning and economics, she handled trade, tax and sanctions issues. Previously, Ms. Brown directed Mobil's state government relations in key states.

Prior to Mobil, as an assistant U.S. attorney in the Eastern District of Pennsylvania, she handled tax, bank fraud, and securities fraud cases. She was commended by federal law enforcement agencies, including FBI Director William Sessions, for her co-prosecution of a securities fraud RICO. Ms. Brown clerked for the Honorable Richard M. Bilby, U.S. District Court, District of Arizona.

Ms. Brown received her law degree from Georgetown University Law Center in 1982 (dean's list), and her Bachelor of Arts and Master of Arts degrees in 1979 from the University of Pennsylvania (dean's list). She is a member of the bars of the District of Columbia, Pennsylvania, and the U.S. Supreme Court.

Ms. Brown recently published an article entitled "Steps to an Effective Foreign Corrupt Practices Act Compliance Program," in the Summer 2006 edition of the ABA Committee on Corporate Counsel Newsletter.