

Foreign Corrupt Practices Act Developments



FOREIGN CORRUPT PRACTICES ACT DEVELOPMENTS

The Foreign Corrupt Practices Act (FCPA) was passed in 1977 in response to the bribery of foreign government officials by U.S. companies to obtain business overseas, and it has been amended twice since originally enacted. Its antibribery provisions are enforced by the U.S. Department of Justice (DOJ) and the U.S. Securities and Exchange Commission (SEC), while its recordkeeping and accounting provisions are enforced by the SEC. Both the DOJ and SEC are increasing their enforcement of FCPA, with the SEC becoming particularly active with respect to foreign subsidiary misconduct. Companies doing business overseas — particularly in high-risk, emerging-market countries — need to make sure they have in place sound compliance processes and internal controls to prevent and/or alleviate violations of FCPA.

At Foley's sixth annual National Directors Institute on March 8, 2007 in Chicago, "Foreign Corrupt Practices Act Developments," was a featured session moderated by Sharie Brown, partner and chair of the White Collar Defense & Corporate Compliance Practice, Foley & Lardner LLP. Luis Ortega, senior manager of Forensic and Investigative Services, Deloitte Financial Advisory Services LLP, assisted as co-moderator. The panelists included Israel Floyd, corporate secretary and general counsel, Hercules Incorporated; Eric Hinton, corporate ethics and compliance manager, Caterpillar, Inc.; Joseph Perkins, senior counsel, Cummins, Inc.; Javier Robles, senior counsel and chief ethics officer, The Western Union Company; and Ivonne Mena King, partner and vice chair of the White Collar Defense & Corporate Compliance Practice, Foley & Lardner LLP.

A Hypothetical Situation for Examination

The panel's discussion of trends and issues under FCPA centered around a three-part hypothetical situation designed to address common areas in which U.S. companies are exposed under FCPA: gifts and entertainment; use of agents; and mergers and acquisitions (M&A).

Gifts and Entertainment

In the hypothetical situation, the general counsel of BeeWee, a publicly traded U.S. company, must advise the marketing vice president (VP) on certain travel and entertainment activities proposed by the vice president for Chinese public officials. The VP proposes to fly the Chinese officials and their closest business associates on the corporate jet to Australia for plant tours, meetings, and product demonstrations. The Chinese officials have requested a side-trip to the Hawaiian islands for three days of golf and recreation.

Is the trip on the corporate jet permissible and under what circumstances? Should the side-trip to Hawaii be provided, and why? If the VP did not notify the general counsel of these planned trips and took them without consultation, what is the company's exposure? What discipline should result? Will competitors or disgruntled employees attract the interest of the DOJ or SEC if reported?

Use of Agents

During the trip on the corporate jet, the Chinese officials tell the VP that BeeWee could acquire a local manufacturing company partially owned by the Chinese government — "Company Y" — that will be strategic to BeeWee's desired expansion of its Australian



operations into China. The officials tell the VP to contact local Agent M to begin negotiations for the acquisition of Company Y. When the VP mentions Agent M in a telephone call to his local business partners in Shanghai, they make comments indicating that Agent M pays kickbacks to government officials.

What concerns or issues are raised by the Chinese officials' recommendation of Agent M? What steps should companies take to engage reputable agents? Do red flags have to be addressed before proceeding with Agent M? What procedures could require the VP to report all information to the general counsel?

M&A Approval

When the general counsel briefs the board of directors on the possible deal to acquire Company Y, should he or she advise the board of negative comments about Agent M's activities? What is the board's duty prior to giving approval for acquisition regarding Company Y and Agent M? Who should determine style and method of review (e.g., board of directors, general counsel, chief financial officer, internal auditors)? How and when can outside counsel and forensic accountants help? What issues would you think about as company legal counsel when the marketing vice president approaches you?

Examining the Hypothetical Situations

Joe Perkins commented that one of the first things he would do is start asking a lot of questions. He would want to confirm, first of all, that this person is a government official, although he noted that in China it is pretty easy for someone to qualify as a government official. He also would want to know the purpose of the trip. If it stopped at just plant tours, product demonstrations, and the like, then this would be a somewhat borderline scenario. If the trip were limited strictly to those activities, Mr. Perkins said he probably would be comfortable with the use of the company plane for that purpose. The question is: By flying that official on the company plane to visit the plant in Australia, is the company supplying something of value that rises to an FCPA issue? Other facts would have to be known, such as how the VP would get to Australia: If the VP also flew on the company plane from China to Australia, Mr. Perkins would be more comfortable with the scenario.

When presented with this scenario, Mr. Robles said he would look immediately at the affirmative defenses available under FCPA. The DOJ looks to intent, so it would be important to document the company's intent carefully. He said his company probably would let the trip proceed but would have controls in place. For example, what guests are coming? The "close business associates" would have to be scrutinized and limited, as would any expenses. If they were staying at a hotel, the receipts need to be examined carefully to make sure the official was not taking advantage of the company dollar. Generally, Mr. Robles said that he thought the scenario sounded acceptable.

What about a side trip to Hawaii or another major event in the United States?

Israel Floyd commented that one question would be: How commensurate is a trip like that to the company's treatment of other potential customers? Is this typical or is it being specially geared for the Chinese officials? As a side note, he said it also would be important to make sure the company is not exporting technology inadvertently (the



“deemed exports” issue) by having the Chinese official view various products and processes at the plant in Australia.

With regard to the corporate jet, Eric Hinton noted that he would look into the company’s insurance and the liability of flying that person on the jet. He said it also would be important to know the level and stature of that person and whether other customers of comparable stature would be treated the same way. He emphasized that this is a very fact-specific inquiry. Caterpillar’s preference, according to Mr. Hinton, is to take the more conservative position and avoid the possibility of an FCPA challenge. In the end, if these matters ever are litigated or settled, the determination of liability is going to be made by an enforcement official.

When planning a trip like this, it is important to make sure the company’s books and records accurately reflect the trip, Sharie Brown commented. The DOJ has viewed some trips, including even business travel, as extravagant and designed to induce a public official to do something improper.

The threshold for what the DOJ would consider “extravagant” is quite low. One example is the Metcalf & Eddy case. Another example is a case on which Ivonne King worked last fall, where the SEC was investigating 42 separate trips. Not only is the dollar threshold decreasing, but as happened in this particular case, once the SEC starts investigating, it will scrutinize even small dollar amounts.

From a forensic perspective, the key issue is documentation, noted Luis Ortega. It is crucial that these trips and related activities are well-documented. If a trip is not well-documented, that in itself raises a red flag — it is not necessarily a violation but it will require further investigation and analysis. The documentation should explain the purpose of the trip, demonstrate that the company investigated these public officials, and show that in the treatment of this official the company followed its standard business practices. He said his firm always advise clients to play on the safe side.

Ms. Brown added that it is also important to make sure the proposed action is lawful under the written local law of that country. She mentioned one company actually going to the local DOJ equivalent and getting an advisory opinion, rather than relying on the local law opinion that a certain method of transportation was lawful. Most companies will not do that, but it is an option if you do not have local counsel and are fairly sure the local government will grant its approval.

What do you suggest doing when the VP learns of the potential acquisition opportunity and the Chinese official recommends an agent?

Agency issues are always a challenge, Mr. Hinton explained, since a company can be liable for the actions of its agents or distributors. The key issues are the controls you have in place for dealing with agents and what you do in the context of M&A due diligence. It is important to put into place baseline processes and to follow your controls. Mr. Hinton pointed out that there are some definite red flags in this hypothetical fact pattern and so the company would want to take extra care.

Mr. Perkins commented that under Cummins’ policies, the VP would be obligated to get in touch with the law department relatively quickly once he had information that the agent



had questionable conduct in his past. They would then conduct due diligence on the agent. Mr. Perkins emphasized that it is important for people in the position of VP or even subordinate positions to be tuned-in to their obligations. The company needs to create a culture that advances awareness of FCPA so employees will bring such issues to the law department right away.

Ms. Brown noted that the majority of bribes in due diligence involve agents overseas. She said companies must ensure that they have processes in place to screen them and monitor their activities.

Regarding the government official recommending a specific agent, Mr. Robles did not think this was fatal, but it definitely would raise a red flag. He pointed out that although his company has a sophisticated compliance program, he is not convinced that every employee would pick up on the possible FCPA problem here. However, the company has procurement policies that would require a Request For Proposal (RFP), and this would ensure a competitive evaluation of their choice of agent and would function as a checkpoint along the way. Regarding M&A, Mr. Robles noted that lawyers would be heavily involved in the transaction and so any FCPA concerns certainly would be addressed.

The next step with regard to the M&A would be to find out what the company is really dealing with, said Mr. Floyd. In Asia especially, this can be problematic because public disclosures and filings do not exist and many of the extensive and complicated family connections running through companies are not readily apparent. Assets likely can be moved around very easily and secretly, which poses a danger to the acquiring company. The fact that the government official mentioned the agent raises a red flag, and the company should spend as much time as possible investigating the agent.

Mr. Robles added that Western Union is a member of TRACE (a nonprofit member association that provides antibribery support for companies and commercial intermediaries), which helps them deal with these issues. If they are not comfortable with an individual, the company can force them to undergo a rigorous TRACE review of their procedures and training.

Mr. Ortega was asked at what point a forensic accountant should be brought in along with the lawyers. He said that unfortunately forensic accountants usually are reactive and not proactive. Forensic accountants usually become involved when a company has controls in place, but a transaction still ends up going unnoticed — usually exposed because of a whistleblower. He went on to say that he is involved in a lot of FCPA compliance programs that address employee training, vendor training, and vendor/agent/client certification. Having those programs in place is a good start for a company and he noted that Deloitte helps companies develop, implement, and, importantly, monitor such programs. Companies constantly are changing in terms of their operations, employee makeup, and risks. Compliance programs need to be adapted to changing circumstances.

Mr. Perkins commented that a robust training program is also important because it is a mitigating factor under the Federal Sentencing Guidelines. Training, added Mr. Hinton, is just one component of compliance under the Federal Sentencing Guidelines — controls need to be in place, too. Mr. Floyd noted that if a company does not have the training, it probably has Section 404 internal controls problem — hence, in effect, training is an



actual requirement. Ms. King added that compliance programs are an important factor in DOJ/SEC investigations in terms of settlement, especially if a company wants to avoid having a (very expensive) compliance monitor appointed.

In terms of the M&A portion of the hypothetical, at what point, if ever, is a general counsel obligated to give a report to the board that might effect the decision of whether or not to go forward with the acquisition? What would the board look to the general counsel for in terms of guidance and due diligence?

Mr. Ortega commented that this is a very hot topic. If a company does not perform the proper due diligence and acquires a company overseas, then it is liable for future actions of that company — and through “successor liability,” possibly past actions as well. In certain countries with a high corruption index, not knowing with whom you are doing business with is a huge mistake. A company should do a thorough business intelligence: Who owns this company? Does it have a history of problems? The acquirer must get a good handle on these issues.

An audience member asked if it is fatal to a transaction if one of the shareholders of a company is a government official. Mr. Ortega responded that it is not necessarily fatal, but good due diligence is necessary. The due diligence should be detailed to the level that you are analyzing the business plans. This is important, for example, when this shareholder is expected to help the company win government contracts in the future.

Mr. Robles commented that anything that requires or considers requiring outside counsel or forensic accounting services requires the notification of the general counsel, and the board should know that you are going forward and conducting due diligence. The general counsel has an obligation, according to Mr. Perkins, to make sure the chair of the audit committee is informed and that he or she is taking the right investigative steps to look at the agent and its background as well as at the acquisition target, and that thorough due diligence is done on both.

Mr. Hinton said that he shared largely the same view, but added that once the acquisition was made, one of the best insurance policies a company can have is to include the ethics and compliance policies in the integration process. The acquirer needs to take affirmative steps to implement its compliance program in the acquired company.

Mr. Floyd explained that there is a two-step process for acquisitions. First inform the board; then get a vote on it. He also noted that companies should be cautious when acquiring a company that includes a government official. While the deal may look beneficial at the time, political winds can change quickly and suddenly that official may no longer have useful connections. Before you acquire a company, it is important to evaluate the perceived benefits associated with that person as well as the sustainability of those benefits.

To learn more about FCPA and its enforcement, visit www.FCPAenforcement.com.



For More Information

For more information on this session or the sixth annual National Directors Institute, visit Foley.com/ndi2007 or contact the panelists directly.

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