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Debunking Common Foreign Corrupt Practices Act Misperceptions

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This December, the Foreign Corrupt Practices Act ''celebrates'' its 30th anniversary. Enacted in 1977 in response to widespread post-Watergate allegations that U.S. companies were securing foreign government contracts by making improper payments to foreign government officials, the FCPA generally prohibits U.S. companies and their personnel from paying or offering anything of value to foreign officials in order to obtain or retain business.

Business leaders largely remained in the dark about the FCPA, despite the fact that it had been on the books for many years, until 1994 when news of Lockheed Corp.'s FCPA transgressions started appearing on the front pages of major newspapers and being discussed in corporate boardrooms and executive suites. The Lockheed FCPA enforcement action (in which the company pleaded guilty to conspiracy to violate the FCPA and paid total penalties of approximately $25 million in connection with improper payments to a member of Egypt's parliament in order to obtain a lucrative Egyptian Ministry of Defense aircraft contract) ushered in a new era of FCPA compliance initiatives and lead to a much-needed increase in FCPA awareness and understanding by business leaders.

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It is now assumed—30 years after the FCPA was enacted—that most business leaders have a basic understanding and awareness of the FCPA. However, a basic understanding of the broad-reaching statute does not assure FCPA compliance because several FCPA nuances are still not well understood by business leaders and thus present a trap for the unwary.

In fact, most current FCPA enforcement actions brought by the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) (the two government agencies with joint enforcement authority of the FCPA) involve not a ''suitcase full of cash'' to an elected government official type of scenario, but rather seemingly less culpable scenarios that can result in FCPA violations just the same. Yet, it remains the case that business leaders lack a clear understanding and appreciation for these scenarios, not because of deliberate ignorance or a lack of commitment to FCPA compliance, but because of common FCPA misperceptions.

The eve of the FCPA's 30th anniversary is as fitting a time as ever to debunk common FCPA misperceptions, particularly given the increased FCPA enforcement activity by DOJ and the SEC in recent years. Correcting common FCPA misperceptions widely held by business leaders may avert potential FCPA violations and save business leaders from embarrassing questions by an incensed board of directors or audit committee members should FCPA noncompliance occur.

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First, a brief FCPA primer. While the FCPA contains two sets of provisions—the anti-bribery provisions and the books and records and internal control provisions—the common FCPA misperceptions discussed herein all relate to the anti-bribery provisions. In general, the anti-bribery provisions prohibit payment, offering, or authorization of payment of money, a gift or ''anything of value'' to any ''foreign official'' or foreign political party for purposes of influencing any act or decision or securing any improper advantage in order to assist the payor in ''obtaining or retaining'' business. See 15 U.S.C. § § 78dd-1(a) et seq. Misperceptions regarding these key FCPA elements, as well as certain other jurisdictional issues, abound and are debunked below.

Common FCPA Misperceptions

The FCPA doesn't apply to conduct that takes place entirely outside the United States without U.S. parent company involvement.

Not true. The harsh reality is that turning a blind eye as to business operations in the far reaches of the globe is a sure-fire way to invite FCPA noncompliance and regulatory scrutiny.

The 1998 amendments to the FCPA expanded the jurisdictional reach of the statute to include an alternative nationality test. Prior to the amendments, ''use of the mails or any means of instrumentality of interstate commerce in furtherance of'' an improper payment was needed for the FCPA to apply. Under the alternative nationality test, the FCPA also applies to improper payments made by U.S. companies and citizens that take place wholly outside the United States without regard to whether ''the mails or any of other means of instrumentality of interstate commerce'' were used in furtherance of the improper payment. See 15 U.S.C. § § 78dd-1(g), 78dd-2(i).

Accordingly, proof of a U.S. territorial nexus is not required for the FCPA to be implicated, and FCPA violations can, and often do, occur even if the prohibited activity takes places entirely outside of the United States.

Indeed, most of the recent FCPA enforcement actions concern business activity by U.S. companies that occur in foreign countries *without* the knowledge or involvement of any U.S.-based employee. For example, in February 2007, the Dow Chemical Co. settled an FCPA enforcement action concerning improper payments made to Indian government officials by a ''fifth-tier subsidiary'' even though the payments ''were made without knowledge or approval of any Dow employee.'' See SEC Litigation Release No. 20000 (Feb. 13, 2007) and SEC Release No. 55281 (Feb. 13, 2007). Similarly, in June 2004, Schering-Plough Corp. settled an FCPA enforcement action concerning improper payments made to a Polish government official by a branch office of a wholly owned subsidiary even though the payments ''were made without the knowledge or approval of any Schering-Plough employee in the United States.'' See SEC Release No. 49838 (June 9, 2004).

Business leaders are mistaken if they believe that reliance on foreign incorporation where there is U.S. management and control over the foreign subsidiary is a shield against parent company liability for FCPA violations. Indeed, the FCPA's legislative history affirms that parent companies may remain indirectly liable for FCPA violations by a foreign subsidiary and cautions U.S. companies against adopting a ''head-in-the-sand'' approach as to foreign business conduct. See H.R. Rep. No. 95-831 (1977).

For this reason, business leaders must be knowledgeable about all business activity, including activity that takes place thousands of miles away from U.S. corporate headquarters, because how a U.S. company obtains or retains business in Beijing, Cairo, and Moscow is as relevant as how it obtains or retains business in Boston, Chicago, and Miami.

The FCPA doesn't apply because the company is a private company—not a public company.

False. While it is true that the FCPA's books and records and internal control provisions apply only to ''issuers''—companies that have a class of securities registered with the SEC—the FCPA's anti-bribery provisions apply to issuers as well as ''domestic concerns,'' a defined term that includes ''any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship'' with a principal place of business in the United States or organized under U.S. law. See 15 U.S.C. § 78dd-2(h)(1)(B). Under this definition, the international business activity of private U.S. companies falls under the FCPA as well.

Indeed, several recent FCPA enforcement actions demonstrate that foreign business activity by private U.S. companies is subject to the FCPA. One of the largest criminal FCPA enforcement actions ever involves Vetco Gray Controls Inc., a private Texas company, which, along with its foreign affiliate companies, settled allegations that it violated and conspired to violate the FCPA in connection with improper payments to Nigerian customs officials. See *United States v. Vetco Gray Controls Inc.*, No. 4:07-cr-00004 (S.D. Tex. 2007), 2 WCR 47, 2/16/07 (see DOJ News Release, Feb. 6, 2007). Similarly, in March 2005, Micrus Corp., a privately held California company, resolved its FCPA liability in connection with improper payments made to foreign officials in France, Turkey, Spain, and Germany to obtain or retain business. See DOJ News Release, March 2, 2005.

While it may be true that business leaders at U.S. private companies can ignore certain laws that apply only to U.S. public companies, the FCPA is clearly not one such law, and business leaders at private companies ignore the FCPA at their peril.

The FCPA doesn't apply because the company only does business in mature and stable markets—not emerging Third World markets.

A common FCPA misperception often heard in the business community is that only resource extraction companies operating in Third World markets need to be concerned about FCPA compliance. While it is true that oil and gas companies operating in Indonesia, Nigeria, and Kazakhstan (among other countries) have run afoul of the FCPA, it also true that the FCPA does not discriminate against any one industry or region of the world.

Several recent FCPA enforcement actions show that companies across many different industries are being entangled in the FCPA enforcement net. One such recent trend has been the rise of FCPA enforcement actions against U.S. health care companies. Since 2002, six health care companies have either settled FCPA enforcement actions or disclosed conduct that may violate the FCPA. In addition to the Micrus and Schering-Plough matters, such matters include the following.

- In February 2007, U.S. healthcare conglomerate Johnson & Johnson disclosed that it may have violated the FCPA as a result of ''improper payments in connection with the sale of medical devices in two small-market countries.'' See Johnson & Johnson Feb. 12, 2007, Statement on Voluntary Disclosure, http://www.jnj.com/news/jnj_news/20070212_192452.htm.
- In May 2005, Diagnostic Products Corp., a California developer and manufacturer of diagnostic test systems, agreed to settle an FCPA enforcement action in connection with improper payments to Chinese officials. See DOJ News Release, May 20, 2005, SEC Release No. 51724 (May 20, 2005).
- In February 2005, Immucor Inc., a Georgia-based global diagnostics company, disclosed in an SEC filing that it may have violated the FCPA in connection with improper payments to an Italian official. See Immucor, Form 10-K (Feb. 28, 2005).
- In December 2002, Syncor International Corp., at the time a California-based radiopharmaceutical company, agreed to settle an FCPA enforcement action in connection with various improper payments to officials in Taiwan, Mexico, Belgium, Luxembourg, and France. See SEC Litigation Release No. 17887 (Dec. 10, 2002) and SEC Release No. 46979 (Dec. 10, 2002).

It is also clear that the FCPA does not affect only companies operating in emerging Third World markets. While it is true that Third World countries traditionally fare the worst on Transparency International's Corruption Perception Index (CPI) (a ranking of countries in terms of the degree to which corruption is perceived to exist among its public officials and politicians), the above FCPA matters against U.S. health care companies indicate that FCPA noncompliance can just as easily occur in more mature and transparent European markets. Moreover, a substantial number of recent FCPA enforcement actions and corporate disclosures involve business activity in China, a country that can no longer be relegated to Third World status given its fast growing and maturing economy.

In sum, business leaders in every industry must ensure FCPA compliance in all international locations, not just those perceived to be high-risk, emerging Third World markets. Granted, a company that sells only in Finland and Iceland (the perpetual CPI ''winners'') has less to worry about than a company that sells in African countries, but the point remains that FCPA noncompliance can occur in any industry in any country.

The FCPA doesn't apply because the company does not sell to foreign government customers.

This misperception concerns the ''obtain or retain business'' element of an FCPA anti-bribery violation and the wide misunderstanding among business leaders that the FCPA applies only to improper payments to secure foreign government contracts or business. Left unchecked, this misperception can result in a host of FCPA compliance issues.

The scope of the ''obtain or retain business'' element was in flux and subject to much debate until *United States v. Kay*, 359 F.3d 738 (5th Cir. 2004). In *Kay*, the court held that making improper payments to foreign officials to lower corporate taxes and custom duties could satisfy the ''obtain or retain business'' element of an FCPA anti-bribery violation by providing an unfair advantage to the payor over competitors. The court concluded that there was ''little difference'' between this type of improper payment and improper payments to a foreign official to award a government contract or commercial agreement. In short, the *Kay* court was convinced that Congress, in passing the FCPA, intended to prohibit a wide range of improper payments, not just those that directly influence the acquisition or retention of government contracts or similar arrangements.

Since the *Kay* decision, there have been several FCPA enforcement matters where the improper payment to a foreign official was *not* alleged to have influenced any government contract or business, but rather to have provided the company an improper advantage (in the general sense) compared with competitors doing business in the relevant foreign country. For instance, in the Dow Chemical matter, the improper payments were made to various Indian officials with discretionary authority as to whether the company's products would receive various government registrations required before the company could sell its product in country. See SEC Litigation Release No. 20000 (Feb. 13, 2007) and SEC Release No. 55281 (Feb. 13, 2007).

Similarly, in a January 2005 FCPA enforcement action against Monsanto Co., improper payments were allegedly made to a senior Indonesian environmental official to persuade the official to repeal an environmental impact study requirement that was necessary before the company could sell its genetically modified crops in country. See DOJ News Release, Jan. 6, 2005, SEC Litigation Release No. 19023 (Jan. 6, 2005), and SEC Release No. 50978 (Jan. 6, 2005). The Monsanto FCPA enforcement action also instructs that even unsuccessful bribery attempts that fail to accomplish the intended result violate the FCPA as the foreign official who received the improper payment never did succeed in repealing the environmental impact study requirement.

Clearly, U.S. enforcement agencies will not hesitate to bring FCPA enforcement actions where the improper payments to a foreign official allow a company to secure an improper advantage over competitors even though the payments may not directly lead to any specific government business. For this reason, business leaders must be cognizant of the FCPA risks not only in doing business with government customers, but also in obtaining government licenses or registrations that allow the company to do business in a foreign jurisdiction.

The FCPA doesn't apply because company personnel don't interact with elected government officials.

Not true because of the broad application of another key element of an FCPA anti-bribery violation: the ''foreign official'' element. The FCPA defines ''foreign official'' to include ''any officer or employee of a foreign government or any department, agency, or instrumentality thereof . . . or any person acting in an official capacity for or on behalf of any such government or department, agency or instrumentality . . . '' 15 U.S.C. §§ 78dd-1(f)(1) et seq.

Generally, a foreign national can be classified as a ''foreign official'' under the FCPA in one of two ways. First, an employee of a foreign company can be deemed a ''foreign official'' directly in his own right by virtue of a parallel position or appointment he may have with a government entity. Second, and much more a risk for the unwary, an employee of a foreign company can be deemed a ''foreign official'' when his employer is an ''instrumentality'' of a foreign government—a term not defined in the FCPA or delineated in the FCPA's legislative history. Once a foreign company is deemed an ''instrumentality'' of a foreign government, every single employee, from the lowest ranking employee to the chairman of the board, will be considered a ''foreign official'' for purposes of the FCPA.

Recent FCPA enforcement actions demonstrate that U.S. enforcement agencies consider employees of state-owned or state-controlled entities (collectively ''SOEs'') to be ''foreign officials.'' In this regard, China has emerged as a high-risk FCPA country because of the prevalence of SOEs in that country. The following FCPA enforcement actions all involve China and all involve improper payments to employees of SOEs, *not* traditional elected government officials.

■ In October 2006, Schnitzer Steel Industries agreed to settle an FCPA enforcement action for making improper payments to managers of government-controlled steel mills in China. See *United States v. SSI International Far East Ltd.*, No. 3:06 cr 00398 (D. Ore. 2006), SEC Release No. 54606 (Oct. 16, 2006).

■ In May 2005, Diagnostic Products Corp., as referenced above, agreed to settle an FCPA enforcement action in connection with improper payments to physicians and laboratory personnel employed by government-owned hospitals in China. See DOJ News Release, May 20, 2005, and SEC Release No. 51724 (May 20, 2005).

■ In February 2005, InVision Technologies Inc., a manufacturer of explosive detection systems used at airports, agreed to resolve its FCPA liability in connection with improper payments to employees of a government-owned and controlled airport in China. See DOJ News Release, Dec. 6, 2004, and SEC Litigation Release No. 19078 (Feb. 14, 2005).

Given the expansive scope of the FCPA's ''foreign official'' element and the broad interpretation of that element by U.S. enforcement agencies, it is imperative that business leaders ''know their customer'' in every foreign country and inquire whether any customers are considered SOEs. If they are, the FCPA applies to interactions with employees of these customers even though the employees are clearly not elected government officials.

The FCPA doesn't apply because the company does business in foreign countries indirectly through agents, representatives, and distributors.

In sum, U.S. companies, whether public or private, are not insulated from FCPA risks by doing business in foreign countries through third parties such as agents or distributors. Rather, U.S. companies are responsible under the FCPA for ensuring that improper payments are not made indirectly through others because FCPA anti-bribery violations can be based on the wrongful acts of others under the FCPA's third-party payment provisions which prohibit improper payments made to ''any person, while *knowing* that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly to any foreign official.'' 15 U.S.C. §§ 78dd-1(a)(3) et seq. (emphasis added). Like so many other elements of the FCPA, the knowledge requirement is broad and can be satisfied by ''willful blindness'' even if a company does not have actual knowledge that an improper payment has been made to a foreign official.

In April 2007, the largest monetary FCPA settlement ever—$44 million—was announced and involved Baker Hughes Inc. where the principal improper payments were made to a foreign agent ''while knowing that some or all of the money was intended to bribe government officials in Kazakhstan'' in connection with certain oil service contracts. See *United States v. Baker Hughes Services International Inc.,* No. H-07-129 (S.D. Tex. 2007), *SEC v. Baker Hughes Inc. et al*, No. H-07-1408 (S.D. Tex. 2007).

The FCPA compliance risks of engaging foreign distributors is best demonstrated by the 2005 enforcement against InVision. In this matter, the company was allegedly aware of the ''high probability'' that it agents or distributors in China, Thailand, and the Philippines paid or offered to pay money to foreign officials or political parties in connection with transactions or proposed transactions involving the sale of its airport security screening machines. See DOJ News Release, Dec. 6, 2004, and SEC Litigation Release No. 19078 (Feb. 14, 2005).

The InVision matter also highlights that FCPA risks are present in dealing with foreign distributors even if no actual payments are exchanged between the company and the distributor. It was alleged that the contemplated improper payments to Thai officials were funded not through actual payments from InVision to the distributor, but rather were generated by the distributor's profits on resale, from which the distributor intended to offer gifts or other forms of payments to foreign officials. Business leaders must also be skeptical of unusual price discounts requested by distributors as such discounts could be used by the distributor to fund an improper payment.

Given the FCPA's broad third-party payment provisions, business leaders are wise to fully understand the company's ''go-to-market'' strategy in each foreign country in which the company operates. If foreign agents or distributors are part of that strategy, appropriate FCPA due diligence should be conducted on the third party prior to engagement. Third-party due diligence is best accomplished through an on-site visit to the third party, through a detailed questionnaire, or through membership in nonprofit associations that specialize in anti-bribery due diligence, such as Trace International. At a minimum, the due diligence should answer the following questions as to each business partner: (i) What is the ownership structure of the third party, including all owners, partners, and directors; and (ii) Is the third party providing similar services to similar clients or otherwise qualified and competent to provide the anticipated services.

The FCPA doesn't apply to intangible benefits provided to a foreign official.

The notion that improper payment arrangements include only a ''suitcase full of cash'' scenario is misguided because the FCPA applies to a host of other, potentially limitless, improper payment arrangements that business leaders must be able to recognize.

The term ''anything of value'' is not defined in the FCPA, yet it has been broadly construed to include not only cash or a cash equivalent, but also, among other things, discounts; gifts; use of materials, facilities, or equipment; entertainment; meals and drinks; transpor-

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tation; lodging; insurance benefits; and promises of future employment. Further, there is no de minimis threshold; rather, the perception of the recipient and the subjective valuation of the thing conveyed is often a key factor in determining whether ''anything of value'' has been given to a foreign official.

The June 2004, FCPA enforcement action against Schering-Plough represents perhaps the broadest interpretation of the ''anything of value'' element of an FCPA anti-bribery violation. While the alleged improper payments appeared to be bona fide company donations to a Polish charitable foundation, they were nevertheless found to be improper because the founder and president of the foundation was the director of a government health fund that provided money for the purchase of pharmaceutical products by hospitals throughout the country. See *SEC v. Schering-Plough Corp.*, 1:04 CV 00945 (D.D.C. 2004), SEC Release No. 49838 (June 9, 2004), SEC Litigation Release No. 18740 (June 9, 2004). It was thus alleged that the donations were made not in the spirit of giving but to improperly influence the director to purchase the company's products, and, in fact, sale of the products in question increased during the time the contributions were made.

The Schering-Plough matter reinforces the broad interpretation of the ''anything of value'' element of the FCPA and should alert business leaders to investigate any request for unusual expenditures by foreign employees or business partners. However, it would be imprudent to conclude that only unusual expenditures can satisfy the ''anything of value'' element, because ordinary travel, marketing, and promotional expenditures can often result in FCPA noncompliance as well.

The FCPA contains an affirmative defense for expenditures relating to the ''promotion, demonstration, or explanation of products or services'' or the ''execution or performance of a contract'' 15 U.S.C. §§ 78dd-1(c)(2). However, in order to meet the affirmative defense, a company must show that the expenses are both ''reasonable'' and ''bona fide'' and ''directly related'' to a business purpose. As explained below in connection with a common FCPA misperception about foreign official travel, it is improper for a company to fund even portions of nonbusiness travel to the United States.

The FCPA doesn't apply when foreign officials travel to the United States if the predominant purpose of the travel is business related.

Included in the broad definition of ''anything of value'' are travel expenses not connected to a legitimate business purpose. Thus, while it is perfectly acceptable for a U.S. company to pay for the travel expenses of SOE customers or other foreign officials to travel to the United States to meet company personnel, to inspect product or a manufacturing facility, or to execute a contract, it is not acceptable, and not FCPA compliant, for the company to fund any nonbusiness portions of the trip to the United States.

For instance, in an FCPA enforcement action against Metcalf & Eddy Inc., a private environmental engineering firm, the company was prosecuted for providing improper travel benefits to an Egyptian government official and his family. See *United States v. Metcalf & Eddy Inc.*, No. 1-99-CV 12566 (D. Mass. 1999). Even though the official did visit the company's manufacturing facilities while in the United States, the company also paid for the official and his family to visit Disney World and other side sightseeing destinations unrelated to a business purpose.

Ensuring that travel expenses for SOE customers or other foreign officials are reasonable and bona fide expenditures directly related to a business purpose can be a challenge for business leaders because the task of arranging travel details is often left to a different corporate department or even an outside travel agency. In many cases, business leaders only know that the SOE customer or foreign official is arriving at the plant ''on a Tuesday,'' but does not know where the individual or delegation has been before or after the plant visit. Yet, such ''before'' or ''after'' travel often lacks a business purpose, and, if paid for by the company, is not FCPA compliant.

For this reason, it is imperative that business leaders maintain a degree of control over all SOE customer and foreign official travel to the United States and ensure that travel arrangements are not left solely to individual foreign sales representatives. Achieving FCPA compliance in connection with SOE customer and foreign official travel is particularly challenging if the foreign officials traveling to the United States are from non-Western cultures because they may view travel to the United States as a ''trip of a lifetime'' complete with visits to New York City, Washington, D.C., Las Vegas, the Grand Canyon, and other popular tourist destinations. However, such nonbusiness sightseeing travel, even if in connection with a legitimate predominant business trip, is not FCPA compliant if paid for by the company.

FCPA policies and procedures are voluntary.

This is a trick question, as there is no law or regulation that *requires* U.S. companies to have effective and comprehensive FCPA policies and procedures. However, should FCPA noncompliance occur, U.S. enforcement agencies will factor the absence of effective FCPA policies and procedures into their view of the matter and their assessment of appropriate fines and penalties. For example, in the Schnitzer Steel matter it was specifically noted that the company ''provided no training or education to any of its employees, agents or subsidiaries regarding the requirements of the FCPA'' and that the company also failed to establish a program to monitor its employees, agents, and subsidiaries for compliance with the FCPA. See SEC Release No. 54606 (Oct. 16, 2006).

In sum, with FCPA enforcement on the rise and with fines and penalties approaching $50 million, business leaders are playing with fire if the company does business internationally without FCPA policies and procedures that are well communicated to all employees. At a minimum, an effective FCPA training program should accomplish the following objectives: (i) inform that FCPA compliance is part of the company's overall ethical values; (ii) provide an overview of the FCPA, including the broad application of the ''anything of value,'' ''foreign official,'' and ''obtain or retain business'' elements; (iii) provide an overview of recent FCPA enforcement actions to emphasize the ''real world'' and serious nature of the issue; and (iv) provide hypothetical scenarios that force employees to understand and apply key FCPA concepts.

Conclusion

Given the extent of international business activity and the aggressive FCPA enforcement climate, business leaders can no longer afford to have only a basic understanding and awareness of the FCPA. Rather, they must be able to recognize and anticipate FCPA compliance risks in otherwise common corporate conduct and transactions. Recognizing the common FCPA misperceptions will better assist business leaders in achieving full FCPA compliance regardless of the industry or country in which the company does business.

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