The Foreign Corrupt Practices Act enforcement juggernaut steams on in 2007

By Brian S. Chilton

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The Foreign Corrupt Practices Act (FCPA) provides for substantial criminal and civil penalties for violations of its anti-bribery provisions that prohibit bribery of foreign government officials, or violations of its books and records/internal controls provisions that prohibit mischaracterizing or failing to record a transaction, or failing to maintain proper accounting controls. A full explanation of its provisions is well beyond the scope of this article.[1]

Aggressive enforcement of the (FCPA) continues in 2007 from where it left off in 2006. On February 6, the Department of Justice (DoJ) announced record fines totaling $26 million imposed against three Vetgo Gray entities for violations of the FCPA. On February 7, the Securities and Exchange Commission (SEC) announced settlement of FCPA allegations against Texas-based El Paso Corporation requiring disgorgement of $5,482,363 and a civil fine of $2,250,000. And, on February 13, the SEC settled an FCPA complaint filed against The Dow Chemical Company.

The healthcare industry has not been immune to FCPA enforcement. In 2004, two Health-South Corporation officials pleaded guilty to bribing a Saudi Arabian government official to get a Saudi hospital contract (two other Health-South officials were tried and acquitted on related charges). Later that year, the SEC filed a complaint against Schering-Plough Corporation for alleged improper payments to a charitable foundation headed by a Polish health official who influenced the purchase of pharmaceuticals by state-owned interests. On February 12, 2007, Johnson & Johnson acknowledged it had disclosed to the DoJ and SEC "that subsidiaries outside the United States are believed to have made improper payments in connection with the sale of medical devices in two small-market countries" which "may fall within the jurisdiction of the Foreign Corrupt Practices Act." Even though the matter is in the early stages, Johnson & Johnson pointedly announced that Michael J. Dormer, Worldwide Chairman, Medical Devices & Diagnostics, had retired, citing the internal review in his resignation letter and stating he had "ultimate responsibility by virtue of my position" for the subsidiaries at issue in the disclosure.

With no sign that FCPA enforcement will abate, it is helpful to review the three most recent enforcement cases for clues about how the US government exercises its enforcement discretion.

Vetgo Gray

On February 6, 2007, three Vetgo International Ltd. subsidiaries (Vetco Gray UK Ltd., Vetco Gray Controls Inc., and Vetco Gray Controls Ltd.) agreed to pay criminal fines of $6 million, $8 million, and $12 million, respectively, for bribery charges arising out of the same Nigerian deepwater oil drilling project. These record fines have their genesis in a 2004 FCPA enforcement action against two of the same entities when they were owned by Swiss conglomerate ABB, Ltd. On July 6, 2004, ABB settled FCPA-related claims with the SEC and DoJ, arising out of $1.1 million in illegal payments made by people affiliated with ABB Vetco Gray, Inc. (U.S.) and ABB Vetco Gray Ltd. (U.K.) to government officials in Nigeria, Angola, and Kazakhstan. The fine, agreed to by ABB, was the largest FCPA fine to date–a civil penalty of $10.5 million and disgorgement of $5.9 million.

ABB's 2004 settlement occurred in conjunction with the sale of its upstream oil, gas, and petrochemical businesses, including the two Vetgo Gray entities involved in paying bribes. Before going ahead with the transaction, the private investment purchasers wanted to know what risk of further enforcement they faced if they bought the Vetgo Gray entities. Following the DoJ's formal Opinion Procedure, where a requestor can get the attorney general's opinion on whether future, non-hypothetical conduct conforms with DoJ's present FCPA enforcement policy, the purchasers made various representations to DoJ about what they would do to avoid "in the future, a knowing violation of the FCPA." These included promises to discipline employees involved in wrongdoing; continued cooperation with the SEC and DoJ; disclosure of any additional violations found post-acquisition; adoption of controls designed to ensure accurate books, records, and accounts; and adoption of a rigorous anti-corruption compliance code. The Department responded favorably to the request, stating in FCPA

Opinion Procedure Release No. 04-02 (July 12, 2004) that it did "not presently intend to take an enforcement action against the Requestors or their recently-acquired entities, for violations of the FCPA committed prior to their acquisition from ABB."

But the Vetgo Gray entities have obviously fared no better under the new owners than they did under ABB. The new charging documents allege that beginning in February 2001, Vetco Gray UK began providing engineering and procurement services on Nigeria's first deepwater oil drilling project, and that from at least September 2002 to at least April 2005, each of the defendants used international freight forwarding and customs clearing companies to make at least 378 corrupt payments, totaling approximately $2.1 million, to Nigerian Customs Service officials to obtain preferential customs treatment.

Deputy Attorney General Paul McNulty said, "This case represents the largest criminal penalty the Department of Justice has ever sought in a Foreign Corrupt Practices case and confirms our commitment to root out corruption." DoJ also noted the new ownership's failure to live up to its promises, emphasizing that "the corrupt payments underlying [the February 6, 2007] guilty pleas continued unabated from the period prior to the acquisition until at least mid-2005, notwithstanding the acquirer's commitments to the Justice Department under the Opinion Release."

El Paso Corporation

On February 7, 2007, the SEC filed an FCPA-based complaint against El Paso Corporation, a Texas-based energy company. The complaint alleged that, beginning in August 2000, officials of Iraq's State Oil Marketing Organization, began demanding illegal kickbacks in connection with purchases of crude oil under the United Nations Oil for Food Program, and that from June 2001 through June 2002, El Paso and its predecessor in-interest indirectly made approximately $5.5 million in illegal payments by way of surcharges sent to Iraqi-controlled accounts at banks in Jordan and Lebanon.

The complaint alleged that El Paso knew, "or was reckless in not knowing," that $5.5 million in illegal surcharges were made on various contracts and passed back to El Paso in premiums. The complaint faulted El Paso with failure to maintain an adequate system of internal controls to detect and prevent the payments. The SEC observed that although El Paso inserted a provision in some contracts requiring the third party to represent that it had not paid surcharges, it not only failed to conduct due diligence to ensure that surcharges were not paid, but was aware the provision was being violated. The SEC also alleged that El Paso's accounting for its Oil for Food transactions improperly recorded the true nature of the payments where, in at least fifteen transactions, a portion of the company's price for oil constituted kickbacks to Iraq, but was still recorded simply as part of the cost of goods sold.

Without admitting or denying the allegations in the Commission's complaint, El Paso consented to a final judgment permanently enjoining it from future violations of the FCPA's books and records and internal controls provisions, disgorging $5,482,363 in profits, and paying a civil penalty of $2,250,000.

The Dow Chemical Company

On February 13, 2007, the SEC filed a settled civil action and related administrative cease-and-desist order alleging that The Dow Chemical Company violated the FCPA's books and records and internal controls provisions. The allegations related to approximately $200,000 in improper payments made to Indian government officials from 1996 through 2001 by Dow's Mumbai, India subsidiary, DE-Nocil Crop Protection Ltd., which manufactured and sold agro-chemical products. Without admitting or denying the allegations, Dow agreed to a $325,000 civil penalty and a cease-and-desist order. The SEC's treatment of Dow, however, appears to have been quite favorable for the company, due largely in part to the way Dow handled the situation.

Dow's involvement with DE-Nocil first began in 1994 as part of a joint venture when another majority-owned Dow subsidiary acquired a 51% interest in a local, family-owned Indian company. In 1997, the majority-owned Dow subsidiary became a wholly-owned subsidiary, and by 2001, had increased its stake in DE-Nocil to 75.7%. Finally, in January 2005, Dow attained 100% ownership of DE-Nocil.

The SEC alleged that beginning in 1996, DE-Nocil made $39,700 in improper payments to an official in India's federal-level Central Insecticides Board (CIB) to expedite product registration. The official had threatened DE-Nocil that he would delay or refuse product registration unless he received financial payments. Most of these payments were made through contractors, who would invoice DE-Nocil for fictitious charges, collect the money, and then at DE-Nocil's direction, pay the CIB official. The complaint also alleged that from 1996 to 2001, DE-Nocil made an additional $87,400 in improper payments to state inspectors "who could prevent the sale of a product by drawing samples and falsely claiming that the samples were misbranded or mislabeled." The complaint alleged that "although the payments were in small amounts–well under $100 per payment–the payments were numerous and frequent."

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The Complaint expressly noted that "the payments were made without knowledge or approval of any Dow employee."

Interestingly, the SEC did not charge Dow with violations of the FCPA's antibribery provisions, but instead restricted charges to violations of the books and records and internal controls provisions, because the transactions involving improper payments were not fairly and accurately recorded in DE-Nocil's books, records and accounts, and because "DE-Nocil failed to take steps to ensure that its employees and consultants complied with the FCPA and to ensure" that payments made to Indian government officials "were accurately reflected in its books and records." The SEC's $325,000 civil penalty against Dow appears to have been calculated based upon the $329,295 in economic benefits that Dow estimated it had received by payment of the bribes to the CIB official.

There are any number of reasons why the SEC may have chosen not to pursue anti-bribery charges against Dow, such as insufficient evidence of knowledge or corrupt intent necessary to establish an anti-bribery violation. However, another possible reason Dow received such relatively favorable enforcement treatment, where the possibility for more severe treatment likely existed, can be discerned in the SEC's final recitation of the facts in the complaint:

> Dow conducted an internal investigation of DE-Nocil and, upon its completion, voluntarily approached Commission staff and presented the results. Dow also undertook certain remedial actions relating to the DE-Nocil matter, including employee disciplinary actions. Dow retained an independent auditor to conduct a forensic audit of the books and records and internal controls at DE-Nocil; reported its internal investigation to the Audit Committee of the Board of Directors; and provided FCPA compliance training to employees at DE-Nocil . . . . In addition to the remedial actions relating to DE-Nocil, Dow restructured its global compliance program; improved and expanded FCPA compliance training for employees of Dow and its subsidiaries worldwide; training its internal auditors to recognize FCPA issues; and joined a non-profit association specializing in anti-bribery due diligence that, among other things, screens potential partners and other third parties that work with multinational corporations and provides FCPA training to them. Dow also hired an independent consultant to review and assess its FCPA compliance program.

Some practical observations

For those who follow FCPA enforcement, the above matters confirm several useful lessons.

Your compliance program must be real. The Vetgo Gray and El Paso enforcements stand as excellent examples of how a compliance program can potentially be a two-edged sword. In the recent Memorandum from Deputy Attorney General Paul J. McNulty entitled "Principles of Federal Prosecution of Business Organizations" (December 12, 2006), McNulty stressed that

> the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents. Indeed, the commission of such crimes in the face of a compliance program may suggest that the corporate management is not adequately enforcing its program. Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner.

Vetgo Gray had promised the Department it would implement an effective compliance program, but apparently fell short of that goal when the violations continued despite the program. DoJ cited that failure as one of the reasons for the record fines. Similarly, it was counted against El Paso by the SEC that there were appropriate antibribery provisions in its contracts, but that it not only made no effort to enforce the provisions, but knew that the provisions were being violated. Thus, while businesses must adopt the mechanisms of an effective compliance program, if the company doesn't put its full weight behind those mechanisms, the company's lack of commitment to the program will be counted against it.

The SEC's "Seaboard" Principles are alive and well. Just as DoJ has its Principles of Federal Prosecution, the SEC has its "Seaboard" factors that detail how it views its discretion. In the Seaboard decision, the SEC stated that "self-policing, self-reporting and remediation" were three paramount factors in determining that enforcement against the parent company was unnecessary when an allegedly corrupt controller caused the company's books and records to be inaccurate and its periodic report misleading. The SEC clearly applied the Seaboard factors in a way favorable to Dow, stressing in the portion of the complaint quoted above, the exhaustive and voluntary nature by which Dow investigated and then self-reported the violations. The positive effect this had on how Dow was then treated by the SEC was reflected in several important ways, including the SEC's apparent decision not to charge anti-bribery violations. The relatively modest fine was apparently calculated based only on the bribes involved with the federal-level Indian official, but not based upon the more numerous but smaller bribes involving the state level officials.

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Get in front on disciplinary personnel actions. Previously, upon finding and disclosing FCPA violations to the US government, companies would often wait until the government had concluded its investigation before taking decisive steps to remove company officials or employees who were responsible in some way for the violations. Now, however, as in the recent Johnson & Johnson or Dow Chemical disclosures, it is becoming more common for companies to move quickly in taking disciplinary actions. As in Dow, the government will often take a more favorable view if decisive, early personnel actions tangibly demonstrate a company's commitment to holding its human agents responsible, as opposed to disciplinary decisions that appear to be made grudgingly only at the last possible point in the process, when the government leaves the company with little choice. Obviously, company disciplinary actions must be driven by the underlying facts, but once those facts are known to a company and responsibility can be appropriately assigned, then the company should take decisive against the responsible human agents sooner rather than later.

Know what you are buying. As with many of the recent FCPA enforcement matters in the last few years, the above cases emphasize that liability under the FCPA is something that can potentially be "purchased." Both fact patterns leading to liability in Vetgo Gray and Dow/DE-Nocil began under prior ownership. The new owners found themselves held responsible, not only for conduct that occurred under their ownership, but also for conduct that occurred under prior ownership. Because the FCPA prohibits obtaining or retaining business by use of improper payments made either directly or indirectly through a third party, it is possible to "purchase" FCPA liability by knowingly acquiring a business entity that has made improper payments, even if the bribes were paid prior to the acquisition. Often times, US companies eager to enter a competitive or unknown foreign market view local joint venture partners as the lowest-risk way to get a foot in the door. While that approach makes sense from a commercial standpoint, it is imperative that the FCPA risk of the joint venture partner – and the entrenched business practices acceptable in the local culture – must also be carefully evaluated to determine whether the otherwise commercially desirable partner presents an unacceptable risk of inheriting the economic benefit of corrupt payments that violate the FCPA.

Extortion by the foreign government official is no defense. In both the El Paso and Dow matters, the improper payments to government officials were part of a widespread practice of corruption extending far beyond either company. Based on the pleadings, the payments have every appearance of having been extorted by the corrupt officials involved, as opposed to being suggested by company personnel. Companies placed in positions like Dow's subsidiary often feel themselves victimized by the corrupt official, who extorts the payment by threatening unlawful action like, in DE-Nocil's case, falsely claiming that, absent a payment, products would be denied necessary registration. It can be frustrating – particularly for US companies whose foreign competitors regularly make and benefit by the payments – but, the US government does not accept this kind of "extortion" as a defense for improper payments being made by persons or companies subject to the FCPA. ■

1. If you would like a detailed explanation of the FCPA, or analysis of a particular question regarding compliance or enforcement of the FCPA, please contact the author at bchilton@foley.com.

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