WHITE COLLAR DEFENSE & CORPORATE COMPLIANCE

Legal News Alert™

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The FCPA Perils of Hosting Foreign Customer Visits

A recent U.S. Department of Justice (DOJ) and U.S. Securities and Exchange Commission (SEC) enforcement action against telecommunications company Lucent Technologies Inc. should alert all companies to the substantial Foreign Corrupt Practices Act (FCPA) risks of hosting foreign customer visits or otherwise paying travel expenses for foreign customers. The Lucent enforcement action also provides an opportunity for companies to re-examine and fine-tune FCPA compliance policies and procedures related to marketing and promotional expenses. While allegations of inappropriate marketing and promotional expenses have long appeared in FCPA enforcement actions, Lucent is the only enforcement action in recent years where the FCPA violations were based solely on the improper recording of excessive marketing and promotional expenses and related internal control failures.[1]

The Lucent Enforcement Action

In December 2007, Lucent agreed to settle parallel DOJ and SEC FCPA enforcement actions by paying $2.5 million in combined fines and penalties for improperly recording travel expenses and other things of value to employees of Chinese companies that were owned or controlled by the state (SOEs).[2] Such individuals are deemed to be "foreign officials" under the FCPA's anti-bribery provisions.

Pursuant to a DOJ non-prosecution agreement, Lucent acknowledged that from at least 2000 to 2003, it spent over $10 million on approximately 315 trips involving over 1,000 employees of Chinese SOEs that had a disproportionate amount of sightseeing, entertainment, and leisure. According to the government, while the trips Lucent paid for were "ostensibly designed to allow the Chinese foreign officials to inspect Lucent's factories and to train the officials in using Lucent's equipment … the officials spent little or no time in the United States visiting Lucent's facilities [but instead] visited tourist destinations throughout the United States, such as Hawaii, Las Vegas, the Grand Canyon, Niagara Falls, Disney World, Universal Studios, and New York City." On some occasions, the Chinese SOE

[1] The only other FCPA enforcement action based solely on excessive marketing and promotional expenses is believed to be *U.S. v. Metcalf & Eddy, Inc.*, Civil Action No. 99 CV 12566NG (D.Mass 1999). In that case, the government sought a final judgment of permanent injunction restraining and enjoining Metcalf & Eddy from violating the FCPA based on allegations that it paid excessive marketing and promotional expenses such as non-business sightseeing expenses for an Egyptian government official (and his family) while in the United States. Without admitting or denying the allegations in the complaint, Metcalf & Eddy agreed to entry of a final judgment by which it agreed to, among other things, pay $450,000 in combined fines and penalties.

[2] *See* Department of Justice Release No. 07-1028 (Dec. 21, 2007); DOJ Non-Prosecution Agreement (Nov. 29, 2007); SEC Litigation Release No. 20414 (Dec. 21, 2007); *SEC v. Lucent Technologies Inc.* (D.D.C. Dec. 21, 2007). In November 2006, Lucent completed a merger with Alcatel SA. The merged entity, Alcatel-Lucent, is incorporated in France and has its headquarters in Paris.

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customers spent as little as one or two days on legitimate business, while spending up to two weeks on Lucent-funded sightseeing, entertainment, and leisure. The government noted that Lucent's internal documents often identified the SOE employees as "decision-makers" or "influencers" and that Lucent often obtained or retained lucrative SOE customer contracts after the trips occurred.

The trips were categorized by Lucent as either "pre-sale" or "post-sale" trips. Regarding the "post-sale" trips, the government noted that Lucent's contracts with SOE customers typically included provisions requiring Lucent to provide expense-paid trips to the United States for factory inspections and training and that it was "under the guise of fulfilling its contractual obligations" that Lucent paid for these "post-sale" trips. Regarding the "factory inspection" visits, the government noted that beginning in 2001, Lucent began relocating its manufacturing operations to various locations, including China, "leaving few factories in the U.S. for the customers to visit." With no Lucent factories to visit, the government alleged that the visits "became primarily sightseeing, entertainment, and leisure trips, although one day of the visit would generally involve touring Lucent's headquarters or a Lucent facility (but not a factory) in order to create the appearance of legitimacy." Regarding the "training" visits, the government alleged that even though engineers and technical employees from the SOE customers received some "bona fide" training at a Lucent facility, there also was a disproportionate amount of sightseeing, entertainment, and leisure activities for the visitors as well as per diems.

The trips were funded by Lucent's wholly owned subsidiary in China (Lucent China) through its sales department, were approved by Lucent China executives, and were arranged by Lucent China employees based in the United States. According to the government, Lucent improperly recorded expenses for these trips and failed to maintain adequate internal controls to monitor the travel of Chinese SOE customers.

Specifically, the SEC alleged that the trips were either booked to a "Factory Inspection Account" (even though the customers often did not visit a Lucent factory at any time during the trip) or booked as "services rendered — other services," "transportation international," "lodging," or "other services." In addition, the SEC alleged that "although Chinese government officials were routinely identified by name, organization, and title ... Lucent China's internal controls provided no mechanism for assessing whether any of the trips violated the FCPA [and] Lucent employees made little or no inquiry regarding whether the Chinese visitors were government officials under the FCPA, and no Lucent policies or controls were triggered with respect to whether the entertainment and leisure activities Lucent paid for could constitute things of value under the FCPA, or whether the purpose of the visit may have violated the anti-bribery provisions of the FCPA." Further, the SEC alleged that the FCPA violations occurred because Lucent failed "to properly train its officers and employees to understand and appreciate the nature and status of its customers in China in the context of the FCPA."

In addition to the improper travel expenses, Lucent also acknowledged spending over $100,000 during the relevant time period to provide "educational opportunities" to relatives or associates of Chinese officials such as: (i) paying approximately $70,000 in tuition and living expenses for an employee of a government ministry to obtain a master's degree in China; (ii) paying approximately $20,000 for a deputy general manager of a Chinese SOE to obtain an MBA in China; and (iii) paying approximately $10,000 to fund an internship for the daughter of a Chinese government official to work at the Chinese embassy in the United States. According to the government, these payments were improperly recorded as "marketing expenses."

The Broad Scope of the FCPA

While the Lucent matter involved FCPA books and records and internal control charges only, it also highlights the importance of understanding certain broad elements of the FCPA's anti-bribery provisions to ensure FCPA compliance when hosting foreign customer visits or otherwise paying travel or entertainment expenses for foreign customers.

The books and records and internal control provisions generally require

issuers (companies that have a class of securities registered with the SEC or who are required to file periodic reports with the SEC) to: (i) make and keep books, records, and accounts that, in reasonable detail, accurately and fairly reflect transactions and the disposition of company assets; and (ii) devise and maintain a system of internal accounting controls to maintain accountability of assets. [3]
The anti-bribery provisions generally prohibit any domestic company or foreign company listed on a U.S. stock exchange from directly or indirectly paying, offering, or authorizing the payment of money, a gift, or "anything of value," to a "foreign official" for purposes of influencing any act or decision or securing any improper advantage in order to assist in obtaining or retaining business.[4]

The Lucent matter highlights the broad interpretations given to the "anything of value" and "foreign official" elements of an anti-bribery violation. The term "anything of value" is not defined in the FCPA, and the statute's legislative history is not illuminating. The term, however, has been broadly construed and can include not only cash, but other tangible and intangible benefits given to a foreign official including (as in the Lucent matter) the payment of non-business travel expenses. [5]

The anti-bribery provisions broadly define the term "foreign official" to include "any officer or employee of a foreign government or any department, agency, or instrumentality thereof…"[6] As in the Lucent matter, enforcement agencies will consider an individual to be a "foreign official" if his or her employer is an "instrumentality" of a foreign government — a term not defined in the FCPA or in the legislative history.[7] Once a foreign company is deemed an "instrumentality" of a foreign government, every single employee, from an administrative assistant to the chief executive officer, will be considered a "foreign official" for purposes of the FCPA.[8] This is true regardless of how local law may characterize the employee.[9]

Given the enforcement authorities' expansive interpretation of the "foreign official" element of the FCPA's anti-bribery provisions, companies must "know their customer" in all foreign countries and must determine whether a foreign government has any ownership interest in, or control of, the entity. If a foreign customer is an SOE, FCPA problems can arise, even when the company treats these customers to the same marketing and promotional activities made available to purely private customers.

The Lucent matter should alert all companies subject to the FCPA that enforcement authorities will subject a wide range of business activity to FCPA scrutiny — not just payment schemes involving a suitcase full of cash to an elected foreign leader in order to secure a lucrative government contract.

Another compliance lesson learned from the Lucent matter is the importance of fully understanding the limited scope of the FCPA's affirmative defense for marketing and promotional expenses. While it is an affirmative defense to an FCPA anti-bribery violation if the payment or benefit given to a "foreign official" is a *reasonable* and *bona fide* expenditure that is *directly related* to the promotion, demonstration, or explanation of products or services or the execution or performance of a contract, the Lucent matter demonstrates that payment of a "foreign official's" non-business travel expenses is hardly ever reasonable or a bona fide expenditure directly related to a business purpose.[10]

Avoiding FCPA Pitfalls

While the FCPA risks in hosting foreign customer visits and engaging in other similar marketing and promotional activities are high, the risks can be effectively managed through FCPA-compliant travel policies and procedures that are clearly communicated throughout the company, particularly among sales and marketing personnel.

The full-scope of such policies and procedures should be tailored to the specifics of the business yet be able to address the internal control issues in the Lucent matter, namely: (i) does the company train its officers and employees to understand and appreciate the nature and status of its customers in the context of the FCPA; and (ii) does the company evaluate foreign customer travel mindful of the FCPA and are any policies and procedures triggered with respect to whether the

[3] 15 U.S.C. § 78m(b).
[4] 15 U.S.C. § 78dd-1 *et seq.*
[5] Indeed, several recent FCPA enforcement actions have been based, in part, on the following "things of value" being given to a foreign official: jewelry, gift certificates, perfume, use of a corporate golf club membership and a condo time-share (*see U.S. v. Wooh*, (D.Ore. 2007); DOJ News Release 07-474 (June 29, 2007); *SEC v. Wooh*, (D. Ore. 2007); SEC Litigation Release No. 20174 (June 29, 2007)), laptop computers and electronics (*see U.S. v. York Int'l Corp.*, (D.D.C. 2007); DOJ News Release 07-783 (Oct. 1, 2007); *SEC v. York Int'l Corp.*, (D.D.C. 2007); SEC Litigation Release No. 20319 (Oct. 1, 2007)).
[6] 15 U.S.C. § 78dd-1(f)(1)(A).
[7] Indeed, the "foreign officials" allegedly bribed in several recent FCPA enforcement actions have been employees of companies deemed to be an "instrumentality" of a foreign government. *See, e.g., U.S. v. Young / U.S. v. Ott*, (D.N.J. 2007); DOJ News Release 07-556 (July 27, 2007) ("foreign officials" were employees of state-owned or state-controlled telecommunications companies in Nigeria, Rwanda, Senegal, Ghana, and Mali); DOJ Non-Prosecution Agreement with Paradigm B.V. (Sept. 21 2007); DOJ News Release 07-751 (Sept. 24, 2007) ("foreign officials" were employees of state-owned or state-controlled oil and gas companies in Kazakhstan, China, Mexico, Nigeria, and Indonesia).
[8] *See* DOJ Brochure, "Foreign Corrupt Practices Act Anti-Bribery Provisions," ("The FCPA applies to payments to any public official, regardless of rank or position. The FCPA focuses on the *purpose* of the payment instead of the particular duties of the official receiving the payment …") (emphasis in original).
[9] *See* DOJ Opinion Procedure Release No. 94-01 (May 13, 1994) (DOJ opining that a general director of a state-owned enterprise being transformed into a joint stock company is a "foreign official" under the FCPA despite a foreign legal opinion that the individual would not be regarded as either a government employee or a public official in the foreign country.).
[10] *See* 15 U.S.C. § 78dd-1(c)(2)(A)-(B).

activities paid for by the company could violate the FCPA.

The Lucent enforcement action is instructive on many levels. It reinforces the broad interpretations of the "anything of value" and "foreign official" elements of the FCPA anti-bribery provisions and sends a clear signal to those subject to the FCPA's jurisdiction that enforcement actions may proceed based solely on the improper recording of excessive marketing and promotional expenses and related internal control failures. For this reason, companies cannot afford to be complacent in the emerging area of FCPA liability for foreign customer travel.

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