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Compliance Lessons From an Active Year in FCPA Enforcement

BY MIKE KOEHLER

The Foreign Corrupt Practices Act marked its 30th year in 2007, and what it year it had. From front page coverage in the *New York Times* and the *Wall Street Journal*, to dedicated Web sites and blogs, to standing-room-only crowds at conferences, the FCPA is indeed a hot topic in the business and compliance community.

Enforcement of the FCPA by the Department of Justice and the Securities and Exchange Commission is also red hot, and 2007 will be remembered as the most active enforcement year in the statute's history. Understanding the facts and circumstances of each enforcement action, and assessing the issues raised in them, is key to ensuring FCPA corporate compliance, particularly given the lack of substantive caselaw and meaningful substantive guidance from the enforcement agencies.[1]

This article is intended not to serve as a 2007 FCPA enforcement ''year in review'' but rather to highlight key compliance lessons from the enforcement year. Business leaders who heed these lessons can better steer their companies (and themselves) down the path of FCPA compliance and avoid scrutiny in the coming years.

Statute Not Complex

In an era of negotiated settlements resulting in deferred-prosecution or nonprosecution agreements, it is rare for an FCPA enforcement action to result in substantive caselaw. However, one such action that has resulted in several judicial rulings involves American Rice Inc. and two of its executives, David Kay and Douglas Murphy. In 2007, the U.S. Court of Appeals for the Fifth Circuit affirmed the convictions of Kay and Murphy for violating the FCPA in connection with improper payments made to Haitian customs officials to reduce cus-

[1] See, e.g., *United States v. Kozeny*, 493 F. Supp. 2d 693 (S.D.N.Y. June 21, 2007), where court noted that ''there has been surprisingly few decisions throughout the country on the FCPA over the course of the last thirty years.''

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toms duties and taxes owed by the company.[2] The court noted that the FCPA may contain certain imprecise language, but it is not complex and suffices to put people of ''common intelligence'' on notice of what is forbidden. [3] While the *Kay* decision may spark debate in the business and compliance community where daily struggles occur over FCPA concepts, *Kay* nevertheless stands for the proposition that those subject to the FCPA can violate it without specifically knowing that it prohibits certain conduct. [4] The *Kay* decision thus provides a good backdrop to other key FCPA compliance lessons from the active 2007 enforcement year, starting with the fundamental notion that problems can arise in *any* business in *any* country.

No Business Immune, No Save Havens

For much of the FCPA's 30-year existence, conventional wisdom suggested that only resource-extraction companies operating in emerging Third World markets needed to be concerned about complying with the Act. Although it is true that oil and gas companies operating in countries such as Indonesia, Nigeria, and Kazakhstan have run afoul of the FCPA, the 2007 enforcement actions demonstrate that no industry is immune from the statute and that business activity in all countries will be subject to scrutiny.

The breadth of enforcement actions in 2007, both in terms of the companies involved and the countries where the improper payments occurred, show that FCPA problems can occur in any business in any country. Sectors in which enforcement actions were pursued last year included telecommunications, software and information technology, chemicals, agriculture, oil and gas, heating and air conditioning, and health care.[5] The geographical range of enforcement efforts in 2007 was similarly broad, as evidenced by actions taken concerning business activity in India, Turkey, Italy, China, Nigeria, Indonesia, Costa Rica, Mexico, and the United Arab Emirates.[6]

A popular metric utilized by business leaders in prioritizing FCPA compliance is Transparency International's Corruption Perception Index.[7] However, this past enforcement year instructs that it would have been a mistake to focus FCPA compliance efforts *solely* on CPI ''high-risk'' countries because several of the countries in which improper payments occurred (such as Italy and Costa Rica) were deemed relatively ''low-risk'' in the 2006 CPI Index. While FCPA compliance should focus on high-risk countries, the 2007 enforcement year highlights that business leaders in every industry must be alert to the risk present in all countries.

Broad Scope of FCPA

The FCPA's anti-bribery provisions generally prohibit U.S. companies and citizens, foreign companies listed on a U.S. stock exchange, or any person acting in the United States from corruptly paying, offering to pay, or authorizing the payment of money, a gift, or anything of value, directly or indirectly, to any foreign official in order to obtain or retain business.[8] Several broadly applicable elements of the offense that are not well understood or appreciated by business leaders can result in FCPA exposure for a whole range of conduct less culpable than a suitcase full of cash given to an elected government official in order to secure a lucrative government contract. [9]

Several FCPA enforcement actions in 2007 make clear that the ''anything of value,'' ''foreign official,'' and ''obtain or retain business'' elements of an FCPA anti-bribery violation continue to be interpreted broadly.

'Anything of Value'

The FCPA does not define ''anything of value,'' and the legislative history is not illuminating. However, the term has been broadly interpreted, and 2007 enforcement actions demonstrate that it can include jewelry, gift certificates, perfume, use of corporate club memberships, and condo time shares.[10]

Several FCPA enforcement actions in 2007 were based, at least in part, on providing a ''foreign official'' with excessive travel benefits. For instance, in an action against Paradigm BV, things of value included payment of all of a Mexican foreign official's expenses for travel to California for a ''relationship building'' trip (which happened to coincide with his birthday), including lavish dinners and visits to various wineries.[11] Similarly, in an enforcement action against Ingersoll-Rand Co. and certain of its subsidiaries—principally based on improper payments to the Iraqi government under the United Nations' Oil-for-Food program—the company allegedly arranged and paid for several Iraqi govern-

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[2] *United States v. Kay*, 2007 WL 3088140 (5th Cir. Oct. 24, 2007). Related cases include *United States v. Kay*, 200 F. Supp. 2d 681 (S.D. Tex. 2002), and *United States v. Kay*, 359 F.3d 738 (5th Cir. 2004).

[3] *Id.*

[4] *Id.*

[5] See *SEC v. Lucent Technologies Inc.,* No. 1:07-cv-02301 (D.D.C. Dec. 21, 2007); Paradigm nonprosecution agreement (Sept. 21, 2007); *SEC v. The Dow Chemical Co.,* No. 1:07-cv-336 (D.D.C. Feb. 13, 2007); *SEC v. Delta & Pine Land Co.,* No. 1:07-cv-01352 (D.D.C. July 25, 2007); *United States v. Baker Hughes Services International Inc.,* No. H-07-129 (S.D. Tex. April 11, 2007); *SEC v. York International Corp.,* No. 1:07-cv-01750 (D.D.C. Oct. 1, 2007); *SEC v. Akzo Nobel NV,* No. 07-cv-02293 (D.D.C. Dec. 20, 2007).

[6] See *SEC v. The Dow Chemical Co.*; *SEC v. Delta & Pine Land Co.*; *SEC v. De Chirico,* No. 1:07-cv-2367 (N.D. Ga. Sept. 28, 2007); *SEC v. Lucent*; *United States v. Vetco Gray Controls Inc.,* No. 4:07-cr-00004 (S.D. Tex. Jan. 5, 2007); Paradigm NPA; *United States v. Sapsizian,* No. 1:06-cr-20797 (S.D. Fla. June 7, 2007); *SEC v. York International Corp.*

[7] See Corruption Perception Index at http://www.transparency.org. Transparency International is a global, nonprofit organization dedicated to fighting corruption and its effects worldwide. Its annual CPI is a ranking of countries in terms of the degree to which corruption is perceived to exist among its public officials. The index is compiled from corruption-related data from various experts and business surveys conducted worldwide.

[8] 15 U.S.C. § § 78dd-1(a), 78dd-3(a).

[9] However, in a couple of 2007 enforcement actions, a suitcase full of cash or an envelope full of cash was indeed the means by which improper payments were made. See *United States v. Steph,* No. 4:07-cr-00307 (S.D. Tex. July 19, 2007); *SEC v. Martin,* No. 1:07-cv-0434 (D.D.C. March 6, 2007).

[10] See United States v. Wooh, No. 3:07-cr-00244 (D. Ore. June 29, 2007).

[11] See Paradigm NPA.

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ment officials to visit Italy, where some of the officials spent two days touring the company's facilities and the remainder of the week ''on holiday.''[12]

The 2007 enforcement year also saw what is believed to be only the second FCPA enforcement action based solely on allegations of excessive travel and marketing expenses. Lucent Technologies Inc. agreed to settle parallel FCPA enforcement investigations by DOJ and the SEC by paying $2.5 million in fines and penalties for improperly recording travel expenses and other things of value provided to employees of Chinese state-owned or state-controlled enterprises (SOEs). Lucent acknowledged spending more than $10 million on hundreds of trips that involved over 1,000 SOE employees and that had a disproportionate amount of sightseeing, entertainment, and leisure. [13] While the Lucent matter involved FCPA books and records and internal control charges only, it highlights the importance of understanding the broad ''anything of value'' element of the FCPA's anti-bribery provisions to ensure compliance when hosting visits by foreign customers or otherwise paying travel and entertainment expenses for foreign customers.

'Foreign Official'

The FCPA's anti-bribery provisions broadly define ''foreign official'' as including ''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 . . . .''[14] Someone can be classified as a ''foreign official'' under the FCPA's anti-bribery provisions not only by virtue of his status as an elected official, but also by an appointment to a government ministry or agency. A person may also qualify as a ''foreign official'' by virtue of employment with an ''instrumentality'' of a government, a term that is undefined in the Act. Once a company is deemed an instrumentality of a government, every single employee, from an administrative assistant to the chief executive officer, will be deemed a ''foreign official'' for purposes of the FCPA, regardless of how local law characterizes the employee.

It is clear that the enforcement agencies view SOEs as ''instrumentalities'' of a government and their employees as ''foreign officials'' for FCPA purposes. In fact, many of the enforcement actions in 2007 involved improper payments to ''foreign officials'' who were not elected government officials but SOE employees.[15]

The broad scope of the ''foreign official'' element means that business leaders must understand that SOE employees—people with whom they likely have contact on a daily basis—will be deemed ''foreign officials'' under the FCPA and that interactions with them will be governed by the Act. For this reason, it is imperative that business leaders ''know their customer'' in all foreign countries and find out whether the government has an ownership interest in or control of the entity. This exercise is particularly important in countries, such as China and nations in the Middle East, where the state or a ruling family has a direct influence on business.

'Obtain or Retain Business'

The FCPA's ''obtain or retain business'' element also applies broadly. It is satisfied not only when the thing of value given to a foreign official leads to a government contract or government business, but also when the thing of value influences a foreign official to take action or refrain from taking action that benefits the payor in conducting business generally, such as in seeking reduced tax payments or customs duties or obtaining a government-issued license or permit.

Several enforcement actions in 2007 fall into this category. For instance, the action against the Dow Chemical Co. was based on the improper recording of payments and gifts given to Indian agricultural officials who had discretionary authority in registering and inspecting company products for sale in that country. [16] Similarly, the enforcement action against Delta & Pine Land Co. was based on improper payments given to Turkish agricultural officials in order to obtain various governmental reports and certifications necessary for the company to operate there.[17] Further, the action against Vetco Gray Controls Inc.— which resulted in a $26 million criminal fine, the largest ever under the FCPA—was based on the improper recording of payments made to Nigerian customs officials, through various freight-forwarding companies and customs agents, to induce them to give the company's products preferential treatment as they entered the country.[18]

These actions demonstrate that the enforcement agencies will not hesitate to bring FCPA charges when those subject to the Act make improper payments or improperly record payments to a foreign official to secure an advantage over competitors, even though the payments may not directly lead to any specific business. They also highlight the need for companies to educate all personnel about the FCPA compliance risks of interacting with foreign officials, including those involved in the seemingly mundane task of securing government licenses, permits, or certifications that a company must have in order to do or continue doing business in a country.

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[12] *United States v. Ingersoll-Rand Italiana SpA,* No. 1:07-cr-00294 (D.D.C. Oct. 31, 2007); *SEC v. Ingersoll-Rand Italiana SpA*, No. 1:07-cv-01955 (D.D.C. Oct. 31, 2007).

[13] See *SEC v. Lucent Technologies Inc.,* No. 1:07-cv-02301 (D.D.C. Dec. 21, 2007); Lucent NPA. The only other FCPA enforcement action based solely on excessive marketing and promotional expenses is believed to be *United States v. Metcalf & Eddy Inc.,* No. 1:99-cv-12566 (D. Mass. 1999). In that case, the government sought a permanent injunction restraining and enjoining Metcalf & Eddy from violating the FCPA, based on allegations that the firm paid excessive marketing and promotional expenses such as nonbusiness sightseeing expenses for an Egyptian official and his family while in the United States.

[14] 15 U.S.C. § 78dd-1(f)(1).

[15] See *United States v. Young,* No. 3:07-cr-00609 (D.N.J. July 25, 2007); *United States v. Steph,* No. 4:07-cr-00307 (S.D. Tex. July 19, 2007); *United States v. Baker Hughes Services International Inc.,* No. H-07-129 (S.D. Tex. April 11, 2007); Paradigm NPA (Sept. 21, 2007).

[16] *SEC v. The Dow Chemical Co.,* No. 07-cv-336 (D.D.C. Feb. 13, 2007).

[17] *SEC v. Delta & Pine Land Co.,* No. 1:07-cv-01352 (D.D.C. July 25, 2007).

[18] *United States v. Vetco Gray Controls Inc.,* No. 4:07-cr-00004 (S.D. Tex. Jan. 5, 2007).

Finance and Audit Personnel Must Play a Meaningful Compliance Role

Beyond the anti-bribery provisions, the FCPA contains books and records and internal control provisions. They generally require issuers, which are companies with a class of securities registered with the SEC or that are required to file periodic reports with the commission, to: (i) make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of assets in reasonable detail; and (ii) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are executed in accordance with management's authorization and are accurately recorded.[19]

The 2007 enforcement actions instruct that ensuring FCPA corporate compliance is a task best shared by personnel throughout the company. While FCPA policies and procedures will likely emanate from the legal department, merely having them is not enough. Rather, enforcement agencies expect that a company will monitor and audit its policies and procedures and that finance and audit personnel will play a meaningful role in ensuring compliance by reviewing business arrangements and payments. For this reason, finance and auditing personnel should be provided sufficient FCPA training to spot issues.

Finance and audit personnel should be particularly vigilant in reviewing business relationships and payment arrangements with third-party agents or representatives. Several FCPA enforcement actions in 2007 demonstrate that the funds needed to bribe foreign officials are often generated with the assistance of a third party via inflated invoices or sham consulting arrangements and then paid by the third party to a foreign official.[20] Such payments, even if made by a third party, are prohibited under broad FCPA provisions that make those subject to the Act liable for the actions of others, including agents, distributors, and joint venture partners. Under those provisions, it is improper to make any payment to ''any person, while *knowing*'' that all or a portion of the payment will be given ''directly or indirectly to a foreign official.''[21]

For example, in the enforcement action against Baker Hughes Inc., several improper payments were made to third-party agents under circumstances that demonstrated that the company failed to ''adequately assure'' itself that such payments were not being passed on, in whole or in part, to SOE officials.[22] The combined fine and penalties against Baker Hughes of $44 million was the largest ever in an FCPA enforcement action.

Finance and audit personnel should closely scrutinize the recording of payments under the following descriptions, each of which was used by companies to hide improper payments during the 2007 enforcement year: commissions, consulting fees, advertising and promotions, transportation expenses, cost of goods sold, processing fees, and miscellaneous expenses.[23]

Generally, any time a questionable payment is made to a foreign official, how a company recorded that payment in its books and records, and why the company's internal controls did not stop the payment, will be subject to scrutiny. For instance, in the York International Corp. enforcement action, in which the company agreed to pay approximately $22 million in fines and penalties to settle DOJ and SEC investigations relating to improper payments made by various subsidiaries to the Iraqi government under the Oil-for-Food program, the SEC was critical of the company's finance and audit personnel.[24] The SEC alleged that: (i) ''York International's management had the ability to review or cause internal audit to review [the problematic contracts] and, had this been done, it would have been immediately apparent that the consultancy agreements were a sham''; and (ii) it was ''clear that local finance personnel did not provide an independent internal control function, but rather acquiesced in questionable practices and documentation without critical review.''[25] Similarly, in the Baker Hughes action, the SEC alleged that the company made several problematic payments to third parties without ''adequately assur[ing] itself'' that the payments were not being passed on, in whole or in part, to foreign officials to obtain or retain business.[26]

Increased Scrutiny of Executives

The 2007 enforcement actions also demonstrate that FCPA compliance is not just a matter of corporate compliance but an issue of individual compliance as well. Business leaders should heed the lessons of last year's many actions against individuals and make FCPA compliance a high priority in their daily tasks.

The FCPA applies to all U.S. citizens, whether they show up to work each day at company headquarters in the United States or at a branch office in a foreign country. Indeed, individuals subjected to FCPA prosecution in 2007 included a U.S. citizen based in London who was responsible for his company's operations in the Middle East and Africa, and a U.S. citizen serving as his company's general manager in Nigeria.[27]

Additionally, the FCPA applies to the actions of non-U.S. citizens to the extent the individual takes action in the United States in furtherance of a bribe payment.[28] For instance, in 2007, Christian Sapsizian, a French citizen and former executive of the French telecommunications company Alcatel CIT, pleaded guilty to violating the FCPA in connection with bribe payments to Costa Rican government officials.[29] U.S. enforcement agencies were able to prosecute the French citizen for mak-

[19] 15 U.S.C. § 78(m)(b).

[20] See, e.g., *United States v. Steph*; *SEC v. The Dow Chemical Co.*; *SEC v. Martin,* No. 1:07-cv-0434 (D.D.C. March 6, 2007); *United States v. Baker Hughes Services International Inc.*

[21] 15 U.S.C. § 78dd-1(a)(3).

[22] *SEC v. Baker Hughes Inc.,* No. H-07–1408 (S.D. Tex. April 26, 2007).

[23] See, e.g., *SEC v. Baker Hughes Inc.*; *SEC v. Fu,* No. 1:07-cv-01735 (D.D.C. Sept. 28, 2007); *United States v. Vetco Gray Controls Inc.*

[24] *SEC v. York International Corp.,* No. 1:07-cr-00253 (D.D.C. Oct. 1, 2007); *United States v. York International Corp.,* No. 1:07-cr-00253 (D.D.C. Oct. 1, 2007).

[25] *SEC v. York International Corp.*

[26] *SEC v. Baker Hughes Inc.*

[27] See *United States v. Young,* No. 3:07-cr-00609 (D.N.J. July 25, 2007); *United States v. Steph,* No. 4:07-cr-00307 (S.D. Tex. July 19, 2007).

[28] 15 U.S.C. § 78dd-3(a).

[29] *United States v. Sapsizian,* No. 1:06-cr-20797 (S.D. Fla. June 7, 2007).

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ing improper payments to Costa Rican officials because he processed various payment requests from a consultant, which were used to fund the improper payments, through his employer's bank account located in New York.[30]

FCPA enforcement has also crept into the highest levels of the executive suite. Top executives subject to enforcement in 2007 included Robert Philip, Schnitzer Steel Industries' former president, chief executive officer, and board chairman, and Monty Fu, the former CEO and chairman of the board for Syncor International Corp.[31]

In both of these FCPA enforcement actions, the SEC charged the executives with aiding and abetting the company's internal control violations in connection with certain improper payments. For instance, in the Philip matter, the SEC alleged, among other things, that as president and CEO, he had the authority to implement internal controls relating to the FCPA yet failed to provide any training or education to any of its employees, agents, or subsidiaries regarding the statute. The agency further charged that Philip failed to establish a program to monitor its employees, agents, and subsidiaries for compliance with the Act and that he failed to require the company ''to devise a system of internal controls adequate to detect and prevent Schnitzer's violations of the FCPA.''[32] Similarly, in the Fu case, the SEC alleged that ''Fu had the authority to maintain compliance with existing internal controls, and to implement additional internal controls designed to comply with the FCPA's books and records and internal control provisions, yet failed to do so.''[33]

The active 2007 enforcement year clearly shows that the enforcement agencies will hold individuals, not just corporations, responsible for FCPA failures. Business leaders who fail to heed the lessons of 2007's many actions against individuals risk not only FCPA statutory fines and penalties, but also disgorgement of bonus compensation. For example, as part of the settlement in his case, Philip was required to disgorge approximately $170,000 in bonuses he allegedly received from profits generated by the improper payments.[34]

The Importance of Being Proactive

Even with robust compliance policies and procedures, FCPA problems may arise in a company. If they do, it is imperative for a company to be proactive and engage competent FCPA counsel with experience conducting internal investigations and knowledge of the enforcement agencies' policies and procedures. Among other things, competent FCPA counsel can advise the company on remedial measures the enforcement agencies have come to expect when problems arise and can aid in deciding whether to voluntarily disclose the results of an internal investigation to the agencies.

The disclosure analysis is a difficult decision for business leaders, but the enforcement agencies have made clear that companies that do opt to disclose will be rewarded with real and tangible benefits. [35] For instance, according to DOJ, had Paradigm not voluntarily disclosed improper conduct, the department would not have entered into the nonprosecution agreement with the company.[36] Further, DOJ has indicated that in several instances no enforcement action was undertaken when a company voluntarily disclosed conduct that could implicate the FCPA.[37]

The rise in FCPA enforcement actions shows no signs of abating. In fact, enforcement is only likely to increase in the coming years as the enforcement agencies have beefed up their FCPA resources, including the hiring of additional attorneys within the DOJ fraud section and the hiring of additional FBI agents dedicated exclusively to investigating and prosecuting FCPA violations.[38]

By heeding the compliance lessons from the active 2007 FCPA enforcement year, business leaders will be better able to steer their companies, and themselves, down the path of FCPA compliance and avoid scrutiny in the coming years.

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[30] *Id.*

[31] See *SEC v. Philip,* No. 07-cv-1836 (D. Ore. Dec. 13, 2007); *SEC v. Fu,* No. 1:07-cv-01735 (D.D.C. Sept. 28, 2007).

[32] *SEC v. Philip*.

[33] *SEC v. Fu*.

[34] *SEC v. Philip*.

[35] Comments of Alice S. Fisher, assistant attorney general, DOJ's Criminal Division, at the American Conference Institute FCPA Conference, Alexandria, Va., Nov. 13, 2007.

[36] Comments by William D. Jacobson, assistant chief, DOJ's Fraud Section, Criminal Division, at the ACI's FCPA Conference, Nov. 14, 2007.

[37] *Id.*

[38] Comments by Fisher, Nov. 13, 2007.