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Here's How U.S. Companies Can Practically Manage FCPA Risks That Come With Global Distribution Networks

BY DAVID SIMON
AND ALEXANDER KRAMER

For companies big and small, doing business abroad often requires the use of a foreign distributor or agent to assist in selling products to end-users across the globe. The benefits are clear. Leveraging local contacts to open new and different markets provides companies with increased opportunities in the marketplace to bring in new revenue and expand their product reach. But using distributors and agents abroad brings with it significant legal risk, particularly with respect to the Foreign Corrupt Practices Act and other anti-corruption laws.

Enforcement Is on Rise

Enforcement of the FCPA, enacted 35 years ago, is at an all-time high. In 2011 alone, U.S. enforcement agencies brought 48 FCPA enforcement actions and assessed monetary penalties against corporations totaling $652 million.[1] Both the Department of Justice[2] and Securities and Exchange Commission[3] have indicated, in no uncertain terms, that FCPA enforcement is and remains a top priority.

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Other countries are getting in on the act, too. Since the signing of the Organisation for Economic Cooperation and Development Convention on Combating Bribery, numerous countries have begun enacting and, even more significantly, enforcing, anti-bribery laws. In some cases, these laws are even more stringent than the FCPA. For instance, the UK Bribery Act extends anti-bribery requirements to payments made to non-government officials.[4]

David Simon is a partner in the Milwaukee and Washington, D.C., offices of Foley & Lardner LLP and a member of the firm's Government Enforcement, Compliance & White Collar Defense; Securities Enforcement & Litigation; and Antitrust Practices. Alexander Kramer is an associate in the firm's Washington, D.C., office and a member of its Business Litigation & Dispute Resolution and Government Enforcement, Compliance & White Collar Defense Practices. The authors can be reached at dsimon@foley.com and akramer@foley.com.

[1] *United States: 2011 FCPA Enforcement Actions Reach Second-Highest Level*, Mondaq (Feb. 1, 2012), available at http://www.mondaq.com/unitedstates/x/162240/White+Collar+Crime+Fraud/2011+FCPA+Enforcement+Actions+Reach+SecondHighest+Level; *2011 DOJ Enforcement of the FCPA—Year In Review*, Corporate Compliance Insights (Jan. 12, 2012), available at http://www.corporatecomplianceinsights.com/2011-doj-enforcement-of-the-fcpa-year-in-review/.

[2] Lanny A. Breuer, assistant attorney general, Criminal Division, Prepared Address to The 24th National Conference on the Foreign Corrupt Practices Act (Nov. 16, 2010), available at http://www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html.

[3] Robert Khuzami, director, Division of Enforcement Securities and Exchange Commission, speech by SEC staff, Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement (August 5, 2009).

[4] Ministry of Justice, *Bribery Act*

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Companies often look to use foreign distributors or agents because they do not have sufficient resources in a new market. These companies rely on agents or distributors for market knowledge and for guidance on how best to sell a product in a given market. This also means companies sometimes do not have as good a handle on how their distributors or agents conduct business on their behalf. If distributors or agents provide bribes to foreign officials to obtain or retain business, U.S. enforcement agencies will likely look to attach liability to the original company.

Distributors Attract Scrutiny

For proof of this, one need look no further than the recent history of FCPA enforcement actions. Over the last five years, the majority of enforcement actions have involved at least some alleged violations by third parties, including some involving distributors. While in some areas of the law selling a product to a distributor may insulate a company from liability, the same cannot be said for the FCPA. When a distributor purchases a product, title technically shifts, but if the distributor is seen as acting as a representative of the company whose goods it sells in foreign countries, and that distributor engages in bribery of foreign officials, FCPA liability may very well attach to the company. Consequently, companies need to be careful when working with distributors to ensure they do not engage in corrupt conduct that may wind up costing a company millions in fines and penalties and investigation and defense costs.

Agents present fairly straightforward cases for analyzing FCPA exposure. Under traditional corporate agency law, a third party creates corporate liability for the principal so long as there is a principal-agent relationship and the agent is acting within the scope of its employment (including situations where the agent may be acting contrary to the policies established by the principal).

A sales agent clearly represents the company when, for example, it seeks to secure a government contract on behalf of its principal-company. If such an agent pays a bribe to obtain the contract, the company will be responsible for the FCPA violation if it participates in, approves, knows about, or is willfully blind to the violation.

Don't Be Willfully Blind

To address the risk presented by this scenario, FCPA compliance specialists recommend a comprehensive process for vetting, certifying, and training agents on the requirements of the FCPA. This minimizes the risk of a willful-blindness charge.

This makes perfect sense in the context of agents, but what about distributors? Many companies employ vast distributor networks, sometimes including hundreds, if not thousands, of distributors around the world. Many distributors are more like customers than agents; they merely purchase a product and resell it to others, often in conjunction with other products purchased from other manufacturers.

Is it really practical and necessary to conduct full FCPA due diligence on every one of those distributors? Do the U.S. companies in these situations even have the leverage to insist on FCPA representations and warranties in the written agreements, to demand audit rights, and to require certifications by and training of these distributors? The question thus arises whether U.S. companies are faced with a difficult choice either to accept substantial FCPA risk or to devote disproportionate resources to running an FCPA compliance program that fully vets all distributors.

We think the answer to this question is ''no'' and that there is a practical way to minimize the FCPA risk associated with a global distributor network without devoting an unreasonable and disproportionate amount of resources to compliance. The key is to employ a risk-based approach to distributor compliance, focusing on those relationships that pose the greatest FCPA risk. The U.S. government has endorsed the use of a risk-based approach to FCPA compliance, and we see no reason why those principles should not apply equally in this context.

The first step in a risk-based approach is to identify those parts of the distribution network that pose the greatest FCPA risk. Companies should look at the countries of operation, including their respective reputations for corruption, the end-user base (are there government contacts or state-owned enterprise customers?), the level of government regulation and the amount of interaction with the government, the industry, and other factors that would help assess FCPA risk generally.

The goal should be to determine which distributors are the most likely to qualify as agents, for whose acts the company can be held responsible.

Those parts of the world and parts of the company's operation that pose the greatest risk should get the greatest attention. Distributors in Norway who sell to private commercial customers will require less scrutiny than those in India who bid on government contracts.

We recommend that companies following a risk-based approach take this risk analysis a step further and focus on the nature of their relationships with their distributors. The goal should be to determine which distributors are the most likely to qualify as agents, for whose acts the company can be held responsible.

Think about this as a continuum of risk. On the low-risk end are distributors that are nothing more than resellers with little actual affiliation with the supplier company. On the high-risk end are distributors who are very closely tied to the supplier company, who effectively represent the company in the market and end up looking more like a quasi-subsidiary than a customer.

In order to determine where a distributor falls on this continuum of risk, and therefore how the distributor should be treated for FCPA due diligence and how it will likely be treated by enforcement agencies, basic principles of agency law are instructive.

The Restatement (Third) of Agency defines agency as ''the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act.''[5] It is this relationship that gives rise to potential FCPA liability for the actions of distributors.

2010, available at http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf

[5] Restatement (Third) of Agency § 1.01 (2006).

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Review These Factors

As with liability for a principal in any agency relationship, whether a distributor qualifies as an agent for FCPA purposes will turn on the amount of control a principal exerts over the distributor and whether the distributor is seen to be acting under the authority of the principal. Factors to consider include:

- the volume of sales made to the distributor,
- the percentage of total sales of the distributor's total business the principal's product represents,
- whether the distributor represents the principal in the market, including whether it can (and does) use the company trademarks and logos in its business, and
- whether the principal company is heavily involved in the internal running of the distributor's business (such as by training the distributor's sales agents, imposing performance goals and objectives, or providing reimbursement for sales activity).

Once a company segregates the high-risk distributors that likely qualify as agents and potentially subject the company to FCPA liability from those that are mere resellers and pose little FCPA risk, FCPA compliance procedures can be tailored appropriately. For those distributors that qualify as ''agents'' and also pose FCPA risk, full FCPA due diligence, certifications, training, and contract language are imperative. For those that do not, more limited compliance measures that reflect the risk-adjusted potential liability are perfectly appropriate.

Notwithstanding our proposed practical, risk-based approach to FCPA compliance measures for distributors, it is critical to remember that FCPA liability can attach in any circumstance where a distributor pays a bribe to obtain or retain business for a company and the company participates in, or actually knows about, the bribe. For example, in enforcement actions against Biomet Inc.[6] and Smith & Nephew Inc.[7], U.S. enforcement agencies alleged that both the companies used distributors that provided kickbacks and cash incentives to foreign officials to induce the purchase of their products. In both these cases, the companies allegedly had actual knowledge that these payments were being made by the distributors. Because of this knowledge, the companies were held liable for the acts of their distributors. In order to settle charges with the DOJ and SEC, Biomet agreed to pay $22.8 million[8] and Smith & Nephew agreed to pay $22.2 million[9] Both companies were required to obtain an independent compliance monitor.

Looking at the Biomet enforcement action in more detail, we see the types of actions taken by distributors, and the relationships between companies and those distributors, that lead to liability under the FCPA.

In the complaint filed by the SEC, Biomet is alleged to have engaged in corrupt conduct in Argentina, Brazil, and China.[10] The SEC alleges that Biomet's exclusive distributor in Brazil paid bribes to doctors employed by publicly owned hospitals to purchase Biomet's products.[11] The bribes were paid in the form of commissions of 10 percent to 20 percent of the value of the products. Biomet's Brazilian distributor informed Biomet of this practice.

Agents Are Blessing and Curse

According to the complaint, the ''commission'' payments were openly discussed with Biomet executives in the United States and by 2002, the director of internal audit and the operations manager were aware of the practice but took no action to stop the conduct.[12] The SEC complaint alleges that Biomet's Chinese distributor informed various employees, including the Biomet president of international operations, that it was providing higher-than-average ''commissions'' to surgeons at state-owned hospitals for using Biomet products.[13] The Chinese distributor separately informed a Biomet senior vice president, president of international operations, and operations manager that it could make a very important doctor very loyal to Biomet if it sent him to Switzerland to visit his daughter. Here, as in Brazil, Biomet gave at least tacit approval to its Chinese distributor.[14]

According to the allegations in the SEC's complaint, Biomet clearly had knowledge of the actions of its distributors; there was also clearly a relationship where the distributors were acting under the control of Biomet and with authority. As evidenced by the various communications between high-level Biomet employees and the distributors, the distributors were acting not as mere resellers but as agents of Biomet.

Using distributors can be both a blessing and a curse. In many ways, utilizing a distributor's knowledge of a local market can minimize the risks of operating in an unknown market, including the legal risks that can arise from a lack of familiarity of local law. Using a distributor necessarily also means giving up a certain amount of control and opens up a company to liability for the acts of its distributor, including under the FCPA. To manage these risks, a U.S. company should identify distributors that require greater scrutiny and, for those that do, undertake thorough due diligence before entering into any relationships, be aware of red flags, and exercise appropriate oversight over its distributor.

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[6] Litigation Release, DOJ, Medical Device Company Smith & Nephew Resolves Foreign Corrupt Practices Act Investigation (February 6, 2012), available at http://www.justice.gov/opa/pr/2012/February/12-crm-166.html.

[7] Litigation Release, DOJ, Third Medical Device Company Resolves Foreign Corrupt Practices Act Investigation (March 26, 2012), available at http://www.justice.gov/opa/pr/2012/March/12-crm-373.html.

[8] Id.

[9] Litigation Release, DOJ, Medical Device Company Smith & Nephew Resolves Foreign Corrupt Practices Act Investigation (February 6, 2012), available athttp://www.justice.gov/opa/pr/2012/February/12-crm-166.html.

[10] Complaint, *Securities and Exchange Commission v. Biomet Inc.*, No. 1:12-cv-00454, available at http://www.sec.gov/litigation/complaints/2012/comp22306.pdf.

[11] Id. at ¶¶ 39-44.

[12] Id. at ¶¶ 39-44.

[13] Id. at ¶¶ 45-53.

[14] Id. at ¶¶ 45-53.