

March 2008

A Renewed Area of Emphasis for the SEC & DOJ: Foreign Corrupt Practices Act Enforcement

There is renewed emphasis on enforcement of the Foreign Corrupt Practice Act (FCPA or the Act) by the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ or Justice). Last year, the SEC and DOJ brought 38 FCPA enforcement cases — more than twice as many as the year before. Two of those cases resulted in the largest fines to date in FCPA cases. At the same time, one circuit court decision significantly broadened the reach of the Act's anti-bribery provisions, while an SEC consent decree and two key DOJ releases reflect a constrictive view of permissible promotional expense payments. By year end, there were reportedly over 100 open FCPA investigations along with a docket of cases heading for trial, including the 16-count indictment against U.S. Congressman William Jefferson. In addition, government enforcers are promising more cases that focus not only on corporate violators but on individuals, too. Indeed, there were as many individuals charged in 2007 (10) as there were from 2004 through 2006.

In view of this trend, issuers and their directors, employees and counsel should carefully review their FCPA compliance procedures for compliance not only with the FCPA's anti-bribery provisions, but also the much broader books and records provisions and internal controls requirements. This review should include analysis of due diligence procedures relating to mergers, retention and payment of foreign agents, country risk, and training and compliance.

The FCPA

The FCPA, 15 U.S.C. §§ 78dd-1, *et seq.*, has two primary components: the anti-bribery provisions, which generally prohibit payment of bribes to foreign officials to obtain or retain business; and the books and records and internal control provisions. Although the anti-bribery provisions may be better known, the books and records and internal control provisions have a much more extensive reach.

Generally, the SEC enforces the FCPA through civil injunctive and administrative proceedings brought against issuers and their employees and agents. DOJ initiates criminal actions to enforce the Act as well as civil injunctive actions against domestic concerns (essentially U.S.-based entities not subject to SEC jurisdiction).

Expansive Scope

The FCPA's reach is perhaps best illustrated by two key cases from last year. The first is *U.S. v. Kay* in which the Fifth Circuit defined the key "obtain or retain business" language of the anti-bribery provisions. The second is the SEC's action in *SEC v. Lucent Technologies*, Civ. Action No. 07-092301 (D.D.C. filed Dec. 21, 2007), which, when coupled with two DOJ opinions, defines the permissible limits regarding promotional expenses.

"Obtain or Retain Business" Language Viewed Broadly

The Fifth Circuit Court of Appeals took an aggressive, expansive approach in interpreting the key "obtain or retain business" language of the FCPA's anti-bribery provisions. When promulgating the FCPA in 1977, Congress carefully limited the scope of the anti-bribery provisions to preclude only payments made to "obtain or retain" business. Although that language remained unchanged in 1988 amendments to the Act, legislative reports indicate that, at that time, Congress viewed the limitation as including payments to secure favorable tax payments. Those statements by law makers seem to conflict with passages in the 1977 legislative reports.

Last year, the Fifth Circuit Court of Appeals interpreted the provision in a manner which may include efforts to obtain favorable tax payments and more. In *U.S. v. Kay*, defendants were charged with bribing Haitian Customs officials to accept false documents that understated shipments by about one-third to reduce taxes. Since the indictment stated only that the bribe was paid to obtain or retain business, the District Court dismissed the case, concluding that bribes to obtain favorable tax treatment are not made to “obtain or retain business.” The Fifth Circuit reversed, holding that “Congress intended for the FCPA to apply broadly to payments intended to assist the payor” in business. The Court went on to note that not every bribe to reduce taxes is prohibited because “it still must be shown that the bribery was intended to produce an effect — here, through tax savings — that would ‘assist in obtaining or retaining business.’”

In a second appeal following conviction, defendants again raised an issue concerning the key “obtain or retain” limitation. This time, the Fifth Circuit held: “If bribery to obtain favorable tax and customs obligations was indeed as common as established in the record, then it is reasonable to imply that businesses viewed these practices as one of the only guarantees of maintaining a successful business in Haiti in the 1990’s.” Under these circumstances, the court reasoned, such actions were taken to obtain or retain business within the meaning of the FCPA.

Promotional Expenses Defense Construed Narrowly

Another key limitation on the FCPA’s reach is the defense added in 1988 regarding payment of promotional expenses. Under that provision, payment is permissible when it “was a reasonable and bona fide expenditure, such as travel and lodging expenses, ... and was directly related to ... the promotion, demonstration, or explanation of products or services.” 15 U.S.C. § 78dd-2(c)(2).

The SEC’s settled enforcement action against Lucent Technologies last year hints at the government’s view of this defense to the FCPA’s anti-bribery provisions. According to the SEC’s complaint, Lucent paid more than \$10 million over a three-year period for approximately 1,000 Chinese foreign officials to travel to the United States. Approximately 315 of those trips involved payment of a disproportionate amount for sightseeing, entertainment and leisure and were charged to a “factory inspection account,” according to the complaint. The SEC claimed that, during the three-year period, Lucent provided inadequate FCPA training. Lucent settled with the SEC by paying a \$1.5 million fine and entered into a non-prosecution agreement with DOJ, paying a \$1 million fine.

Two DOJ opinions in 2007 further defined the scope of the “promotional expense” defense. In one case, a company sought to pay domestic travel expenses for a six-person foreign government official delegation. DOJ noted that it would not bring an enforcement action if the expenses were properly recorded, there was a legal opinion that the payments were proper under local law, the expenses were paid through a service provider, no spending money was provided, and the gifts were of nominal value. In a similar matter, DOJ stated that it would not prosecute when payments included daily incidental expenses, backed by receipts, and a modest, four-hour sightseeing tour.

Larger FCPA Penalties

Two cases last year involved the largest fines ever levied in FCPA cases. In the first case, three subsidiaries of Vetco International pled guilty to FCPA bribery violations while a fourth entered a non-prosecution agreement. According to the indictments, the Vetco companies authorized a freight forwarding agent to make at least 378 corrupt payments totaling \$2.1 million to Nigerian Customs officials to obtain preferential treatment relating to the provision of services and construction equipment to Nigeria’s first deep water oil drilling project. The plea agreements required: (i) the payment of \$26 million; (ii) an undertaking to conduct a complete investigation of the conduct in various countries; and (iii) a commitment that, if any of the companies were sold, the acquirer would be obligated to honor the terms of the plea agreement. The fine was the largest imposed by DOJ in an FCPA case.

A second case, which was against Baker Hughes, involved the largest amount paid to all authorities in an FCPA case. In this case, the company paid more than \$44 million in penalties, criminal fines, disgorgement and interest. The settlement also involved payment of a \$10 million civil penalty for violating a 2001 cease-and-desist order entered in an SEC administrative proceeding — another record. The SEC’s complaint was based on three groups of allegations: (i) the company paid about \$5.2 million knowing that some or all of the money was

intended to bribe officials of state-owned companies in Kazakhstan – money that, in fact, was used to obtain an oil-field contract that yielded over \$219 million in gross revenue; (ii) the company paid a \$1 million fee to obtain a second contract with KazTranOil, the national oil transportation operator; and (iii) the company had insufficient controls and procedures to determine the nature of the payments made in several other countries. The company settled by agreeing to an SEC consent decree and paying over \$19 million in disgorgement, \$3 million in prejudgment interest and a \$10 million penalty in addition to retaining a consultant. With DOJ, the company entered into a deferred prosecution agreement and submitted to an independent monitor for three years.

Emerging Trends in FCPA Matters — Focus on Individuals

Both the SEC and DOJ have made it clear in various statements that one focus of FCPA cases will be individuals. For example, in 2007, 10 individuals were criminally charged for FCPA violations (compared to just 10 individuals charged in the prior three years). The individuals charged in 2007 included:

- a former executive of Schnitzer Steel, who settled with the SEC and DOJ after they alleged that he conspired to violate the FCPA by paying over \$200,000 to managers of government-owned steel mills in China to induce them to buy scrap metal;
- a former executive of Willsbros Group, who pled guilty to conspiring to violate the FCPA by paying Nigerian officials to obtain and retain gas pipeline construction business controlled by a government company;
- three former executives of global telecommunications IXTC Corporation, who each pled guilty to conspiring to violate the FCPA and the Travel Act by paying about \$266,000 to foreign officials of state-owned and foreign-owned telecommunications carriers in Nigeria, Rwanda and Senegal;
- the former Government Affairs Director of Asia for Monsanto Co., who settled with the SEC for his involvement in a payment to Indonesian Ministry of Environment officials;
- the former President of A.T. Kearney India, a subsidiary of EDS, who settled a matter with the SEC concerning his authorization to pay \$720,000 in illicit payments to senior employees of Indian state-owned enterprises to avoid having contracts cancelled; and
- the founder and former Chairman of Syncor International, who settled a matter with the SEC regarding his payments over a 17-year period to doctors in private and public hospitals in Taiwan as commissions and referral fees, which were booked as “advertising and promotional expenses.”

Emerging Trends in FCPA Matters — Industry-Wide Investigation

Another trend in current FCPA enforcement is industry-wide investigation. The best-known example of this trend is the investigation into the United Nations Oil-For-Food-Program (“OFFP”). The Report of the Independent Inquiry Regarding the OFFP identified 2,253 companies who paid over \$1.8 billion in illicit income to the Iraqi government. Approximately two dozen companies have disclosed inquiries from either DOJ or the SEC, and, like the cases described above, these cases involve steep penalties. In 2007 alone, six different issuers settled matters with the SEC, DOJ, and other enforcement agencies, resulting in payments of over \$70 million.

The Docket — High Profile Prosecutions

There are a number of significant FCPA cases pending. One is a high-profile, sixteen-count indictment against U.S. Congressman William Jefferson that includes counts alleging violations of the FCPA's anti-bribery provisions along with wire fraud, money laundering, and obstruction of justice. The indictment is based on claims that the Congressman promised a \$500,000 “front-end payment” to a Nigerian official for regulatory approvals and a “back end payment” of 50 percent of the joint venture's profits.

A second high-profile case named the co-founder of Pacific Consolidated Industries. It is based on alleged violations of the FCPA's anti-bribery provisions and includes charges of money laundering and tax offenses. The charges are based on the alleged payment of \$300,000 to the U.S. Ministry of Defense for the award of Royal Air

Force contracts. With 100 open FCPA investigations at year end 2007 and with enforcement officials focusing on the FCPA, there is little doubt that more investigations will be opened and more cases will be brought in 2008.

What is the Impact on Business?

In view of increased enforcement emphasis on the FCPA, a proactive approach in this area is necessary — particularly in view of the allegation in *Lucent* about neglecting FCPA training for employees. The following steps can reduce the risk of liability:

- **Effective compliance procedures consistently applied.** If a company does not have compliance procedures and programs in place, now is the time to establish them. They should address the anti-bribery provisions of the FCPA and the accounting procedures that need to be in place for the books and records and internal control provisions. Companies with such procedures already in place should review them periodically. Once a set of procedures are in place, it is critical that they be consistently updated and enforced.
- **Periodic education of employees.** In view of *Lucent*, employee education is a priority. Periodic and repeated emphasis on FCPA compliance is critical to ensure that employees understand that compliance is a management priority. This is particularly true in view of everyday occurrences, such as employee turnover, promotions, and changes in position.
- **Careful assessment of “country risk.”** It is prudent to carefully assess each country in which the company does business. The environment and history in some countries may create a difficult venue for compliance. This “country risk” should be analyzed with an eye toward instituting additional procedures and protections where necessary.
- **Thorough due diligence when hiring agents and completing mergers.** Many cases involving the anti-bribery provisions involve payments made through agents. *Baker Hughes* is just one high-profile and recent example. Others involve mergers or the acquisition of a subsidiary. This requires companies to conduct due diligence when retaining agents to act in foreign countries and to ensure that those arrangements are periodically reviewed. Similarly, a key part of any merger due diligence should involve a complete FCPA review.

Although SEC officials and DOJ prosecutors have a new enforcement focus on the FCPA, a prudent, proactive approach should aid in compliance and avoiding future difficulties.

This Law Alert is prepared for the general information of clients and friends and should not be relied upon as specific legal advice. If you would like more information or have questions, please contact the following:

Thomas O. Gorman
Chair, Securities Litigation Practice Group
1919 Pennsylvania Avenue, NW, Suite 500
Washington, D.C. 20006-3434
202-778-3004 tgorman@porterwright.com

Robert J. Tannous
Chair, Corporate Finance & Securities Practice Group
41 South High Street
Columbus, OH 43215-6194
614-227-1953 rtannous@porterwright.com

William P. McGrath Jr.
1919 Pennsylvania Avenue, NW, Suite 500
Washington, D.C. 20006-3434
202-778-3005 wmcgrath@porterwright.com

Please visit www.porterwright.com/publications to read this and our other publications on the Web.

Porter, Wright, Morris & Arthur LLP Office Locations

Cincinnati, Ohio
(800) 582-5813

Cleveland, Ohio
(800) 824-1980

Columbus, Ohio
(800) 533-2794

Dayton, Ohio
(800) 533-4434

Naples, Florida
(800) 876-7962

Washington, D.C.
(800) 456-7962

www.porterwright.com

© 2008 Porter Wright Morris & Arthur LLP. All rights reserved.