CORPORATE FINANCE & ACCOUNTING

Overview of the Foreign Corrupt Practices Act

By **Martin T. Biegelman**
and **Daniel R. Biegelman**

A **Wiley Global Finance Executive Selection**
derived from Chapter 2 of
Foreign Corrupt Practices Act Compliance Guidebook: Protecting Your Organization from Bribery and Corruption

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This extract is from Chapter 2 in *Foreign Corrupt Practices Act Compliance Guidebook,* by Martin T. Biegelman and Daniel R. Biegelman. The focus is on an understanding of the Foreign Corrupt Practices Act (FCPA) statute, its enforcement policies and penalties, as well as important case law and the role of government. It is not just large, multinational companies that are violating the FCPA; it is also smaller, private companies and individuals who are employing questionable practices. This chapter provides an overview of the statute and how it is applied to best ensure compliance.

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CHAPTER 2

Overview of the Foreign Corrupt Practices Act

This chapter focuses on an understanding of the Foreign Corrupt Practices Act (FCPA) statute itself, as well as covering important case law and the role of government, specifically its enforcement policies and penalties. This chapter also covers the changes in the law over the years and important trends to be aware of in the FCPA arena. It is not just large, multinational companies that are violating the FCPA; it is also smaller, private companies and individuals who are employing the same corrupt practices. The best way to ensure anti-corruption compliance is to fully understand the FCPA statute and how it is applied.

FCPA PROVISIONS

The FCPA has two main parts: the antibribery provision and the accounting provision. The FCPA mandates that corporate records contain accurate statements concerning the true purpose of all payments made by the company. The law makes it a crime for American companies, domestic concerns, or foreign nationals doing business in the United States, as well

as individuals and organizations acting on their behalf, to bribe any foreign government official in return for assistance in:

- Obtaining or retaining business, or directing business to any particular person
- Influencing a foreign government official to do or to omit an act in violation of his duty
- Influencing a foreign government official to affect an act or decision by a foreign government[1]

The FCPA not only makes it a crime to pay bribes to foreign officials, it also makes it a crime for publicly traded U.S. companies to make payments of any kind that are not on the books. Bribes are almost always disguised on the books as some other business expense rather than the true nature of the payments. This reduces the government's evidentiary burden because the very evidence the government will need in prosecutions can be found in the internal books and records. Government prosecutors do not have to prove a bribe, only that a payment was made and not recorded properly on the company's books.

In short, the FCPA makes it a crime for a company in the United States, for U.S. citizens, or their agents to obtain business by bribery of a government official of another country (or even conspire to do so from the United States), or for a publicly traded U.S. company to fail to record such a payment on its books. While the Department of Justice (DOJ) is responsible for bribery violations of the FCPA, the Securities and Exchange Commission (SEC) handles accounting violations of the FCPA. It is interesting to note that it is not a crime under the FCPA for an American company to pay bribes in a country where bribes are not illegal.

There are also specific exceptions granted in a 1988 amendment to the FCPA. American companies can pay facilitation fees to expedite permits, licenses, papers, visas, mail, and phone service, and to expedite the movement of perishable cargo. Further, it is not considered a bribe to reasonably reimburse public officials for expenses such as meals, travel, and lodging while the company is promoting, or demonstrating a product, or executing a contract. These expenses must not be excessive and must reflect bona fide charges. However, it must be kept in mind that these actions still may be illegal in the country where they occur.

The penalties for violating the FCPA can be severe. Enterprises can be fined $2 million for each violation, and individuals face five years in

prison and a $250,000 fine. In addition, the company can be forced to abandon the business won by bribery through business debarments, face disgorgement of the profits obtained through bribery, be denied export licenses, or be disqualified from any U.S. government contracts.

U.S. companies can protect themselves with a compliance program that ensures all employees are specifically aware of which actions are prohibited by the FCPA. Companies can also protect themselves by including special clauses in their contracts whereby local agents and partners confirm that they will not violate the FCPA, as well as other anti-corruption laws. Many companies have tried to circumvent the FCPA by having local joint venture partners commit bribery while the U.S. companies are willfully blind. This use of third parties will not prevent an FCPA prosecution. The DOJ and the SEC expect U.S. companies and their foreign subsidiaries to comply with the FCPA.

LEVELING THE PLAYING FIELD

In the years after the FCPA's passage, Congress grew concerned that American companies faced a competitive disadvantage versus foreign companies who routinely paid bribes and were even allowed in some cases to deduct the cost of bribes as business expenses. This inequity spurred Congress to push forward on initiatives that encouraged other countries to follow the United States's lead in fighting corruption.

> *Accordingly, in 1988, the Congress directed the Executive Branch to commence negotiations in the Organisation for Economic Co-operation and Development (OECD) to obtain the agreement of the United States' major trading partners to enact legislation similar to the FCPA. In 1997, almost ten years later, the United States and thirty-three other countries signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The United States ratified this Convention and enacted implementing legislation in 1998.*[2]

ANTIBRIBERY PROVISIONS

The FCPA prohibits individuals and companies from "corruptly making use of the mails or any means or instrumentality of interstate commerce in furtherance of an offer, promise, authorization, or payment of money or anything of value to a foreign official for the purpose of obtaining or

retaining business for, or directing business to, any person or securing any improper advantage."[3] Furthermore, the FCPA also requires "issuers not only to refrain from making corrupt payments to foreign government officials, but also to implement policies and practices that reduce the risk that employees and agents will engage in bribery."[4] The Act has been amended and expanded over the years: "Since 1998, [the provisions] also apply to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the United States."[5]

The law has several elements, which must be met in order for it to apply. While it may be complicated, in practice the application is somewhat straightforward, since corrupt payments to foreign government officials will be broadly construed. In general, if a similar action would be illegal in America there is a very good chance it would be illegal under the FCPA. "Bribery" encompasses offers, payments, promises to pay, authorizations of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value.

Section 78dd-1 of the FCPA covers "issuers" or companies that have registered with the SEC (i.e., companies with stock that is publicly traded in the U.S., and prohibits particular foreign trade practices). "An issuer is a corporation that has issued securities that have been registered in the United States or who is required to file periodic reports with the SEC."[6] The section affects the company as well as its directors, officers, employees, or any agents or third parties acting on behalf of the company.[7]

Section 78dd-2 covers domestic concerns and their officers, directors, employees, and agents. The definition of "domestic concern" encompasses an individual who is a citizen, national, or resident of the United States, as well as any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship that either has its principal place of business in the U.S. or is organized under the laws of the U.S. or its territories.[8]

Section 78dd-3 prohibits foreign nationals from using the mails or any instrumentality of interstate commerce, while in the territory of the U.S., in furtherance of an FCPA violation. This section also covers foreign companies not registered with the SEC or that principally do business overseas.[9] All sections prohibit the same behavior and only differ in to whom they apply.

The law also applies when a bribe is offered to any foreign official, candidate for foreign political office, foreign political party, or anyone acting on behalf of one of the above categories. According to the statute's

definition, "foreign official" means "any officer or employee of a foreign government or any department, agency or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of such government or department, agency, or instrumentality, or for or on behalf of any such public international organization."[10] In practice, "foreign officials" encompasses all government employees and employees of state-owned businesses. Recent cases have concluded that doctors in state-owned hospitals and journalists working for state-owned media fall under the definition. For purposes of this chapter, "foreign official" will refer to all foreign individuals covered under the statute.

It can be difficult to determine whether one is dealing with a foreign official, whether they are employed by a foreign government or a state-owned enterprise. Companies need to be aware of the business ownership structure of the country in which they are doing business, such as what industries are state-owned or under the control of the government. In countries with royal families, members can be highly influential and heavily involved in government agencies, even if the country is not a monarchy.

The law also applies when the bribe giver knows that the recipient will give at least part of the bribe to a foreign government official, even if they are not working for them.[11] It is common for bribes paid to government officials to be routed through family members, business associates, or designated businesses. In short, the law covers nearly anyone associated with government or politics, whether they are an elected official, a political party leader, or merely an employee of a state-run business. Subject to the statute's exceptions, it is difficult to envision a scenario where something of value is given to a person associated with a foreign government in connection to business where it would not fall under the FCPA's purview.

The person making the corrupt payment or instructing that it be made must have corrupt intent and the payment itself must be made for the purpose of causing the bribe recipient to abuse his or her position of authority within the government and to provide some type of commercial benefit to the bribe payer or the entity on whose behalf the bribe is being paid. A bribe does not have to be paid in order for there to have been a violation of the FCPA. There simply needs to have been an offer or promise to make a corrupt payment to a foreign official as an inducement to influence an official decision. For example, former Congressman William Jefferson faced FCPA charges for accepting bribe money which he intended to give to a foreign official, though he never did.

To violate the FCPA, one must "knowingly" do the corrupt act. This knowing requirement comes up most frequently in situations where the money is given to an intermediary. The government must prove that the bribe giver knew the money was for a bribe. To do so, the government can prove actual knowledge or knowledge that the outcome is substantially certain to occur.[12] Alternatively, "when knowledge of the existence of a particular circumstance is required for an offense, such knowledge is established if a person is aware of a high probability of the existence of such circumstances, unless the person actually believes such circumstance does not exist."[13] This second definition prevents the ostrich defense, where a person pleads ignorance after they have willfully ignored the facts and circumstances. Willful blindness in the face of a high probability of bribery will lead to an FCPA violation and conviction. Courts are strict when a defendant pleads ignorance.

The statute lists two different purposes for bribery; either one will satisfy the requirement. The bribe must be given with the intent of influencing an act or decision of a foreign official, or causing such foreign official to do or omit to do any act in violation of his or her lawful duty, or to secure an improper advantage. Otherwise, it must be given to induce such foreign official to use his influence to affect or influence an official decision, in order to assist in obtaining or retaining business, or directing business to any person. This later requirement must be tied to a business purpose in some manner.[14]

The bribe given to the government official must be connected with his official duty in some way. Hiring a government employee to sabotage a competitor's equipment, even though it is beneficial to the company, would likely not violate the antibribery provisions, as the act is not connected to the employee's official duties. However, this illegal payment would implicate the accounting provisions, which are discussed ahead.

Courts will interpret the "business purpose" requirement extremely broadly. While the FCPA originally applied mostly to obtaining and retaining government contracts, it has since been broadened. Even an indirect advantage will suffice; paying off customs officials to reduce taxes and duties on imported products is considered an FCPA violation. Furthermore, the bribe need not be tied to a specific contract. In the seminal case *United States v. Kay*, the court's theory was that the import taxes provided a competitive disadvantage for the company's products versus domestic competitors, and that reducing the cost disparities positively benefited the company's business, even if the competitive benefit

was indirect.[15] "Congress intended for the FCPA to apply broadly to payments intended to assist the payor, either directly or indirectly, in obtaining or retaining business for some person."[16]

Note that the statute of limitations for the FCPA is five years from the date the offense was allegedly committed. This period can be extended for up to three years upon request by a prosecutor and a finding by a court that additional time is needed to gather evidence located abroad.[17]

Jurisdiction

Jurisdiction to prosecute a domestic concern or issuer can be established on the basis of nationality or territoriality. Acts that occur on U.S. soil such as the use of the mails, interstate communications, or travel are territorial and establish prosecutorial jurisdiction in the United States. In addition, acts that occur entirely outside of the U.S. but are committed by or on behalf of domestic concerns or issuers can also be prosecuted in the United States by virtue of their nationality.

Until the 1998 amendments to the FCPA, foreign nationals, with the exception of issuers, were not subject to the FCPA. The amendments asserted "extraterritorial jurisdiction" over foreign nationals and entities. A foreign company or individual is subject to the FCPA if they directly or indirectly cause an act in the U.S. or its territories in the furtherance of a corrupt payment to a foreign official. U.S. parent companies of foreign subsidiaries can also be held liable under the FCPA if they are found to have directed the unlawful activities of their foreign subsidiaries.[18]

Facilitating Payments

The FCPA does present some exceptions and affirmative defenses to bribery. The Act expressly excludes what are known as "facilitating payments" or "expediting payments." They are also euphemistically called "grease payments." These are payments to officials to expedite or to secure the performance of routine and common government services and functions.[19] For a payment to be considered a facilitating payment, it must be something that is paid regularly to obtain a regular service. Typical examples include licensing fees, document processing fees, and government services such as police protection and customs inspections.

Generally, they are small payments made to low-level government officials, for simple actions. Note that these payments must be legal under the country's laws to qualify. The decision to award new business or to

continue business with a particular entity does not qualify as "routine governmental action." This exception will be narrowly construed; if the payments are solely intended to influence government action even if they otherwise meet the qualifications, they will fall outside this exception. Even though facilitating payments are allowed by statute, the trend is to not authorize them as a business practice. Many companies have instituted rules prohibiting their payments. Some countries, such as the United Kingdom, have banned them completely.

Affirmative Defenses

The Act provides affirmative defenses for those accused of FCPA violations. If the payment, gift, or offer was lawful under the foreign country's laws and regulations, it would be considered appropriate. These payments must be properly recorded by the company. It is not a defense to state the payment of bribes is a common and accepted practice in the country. Even in countries where bribes are expected they are usually against the law, even if the law is not enforced.

The statute also allows for reasonable and bona fide travel and lodging expenses incurred by or on behalf of foreign officials, provided they were directly related to the promotion, demonstration, or explanation of products or services, or the execution or performance of a contract with a foreign government or agency thereof.[20] If the expenses were not reasonable, a company will be on the hook. This situation happened to a Boston-based engineering firm while entertaining Egyptian officials. The expenses were determined to be unreasonable, the company was found guilty of FCPA violations, and was forced to implement a substantial FCPA compliance program. This company is profiled in Compliance Insight 2.1.

FCPA Elements Summary

The FCPA prohibits directors, officers, employees, or agents of registered companies or stockholders thereof, domestic concerns, or foreign nationals in the United States paying, or offering, or promising any payment, gift, or anything of value to any foreign official, or any foreign political party, or official thereof, or any candidate for foreign political office, or any person acting at least in part on their behalf, for purposes of:

- Influencing any act or decision of the official, party, or candidate, in his official capacity

- Inducing that person or entity to do or omit to do anything in violation of his lawful duty, or to secure an improper advantage
- Getting the recipient to use his influence with a foreign government or instrumentality to affect or influence any act or decision of such government or instrumentality, in order to assist the issuer in obtaining or retaining business for or with, or directing business to, any person

COMPLIANCE INSIGHT 2.1: METCALF AND EDDY CIVIL FCPA SETTLEMENT

Metcalf & Eddy International Inc., a Massachusetts-based environmental engineering firm, was convicted in 1999 of violating the FCPA for unlawfully providing travel and entertainment expenses to an Egyptian public official. The official was the chairman of a committee that was involved in contract negotiations for a sewage upgrade project in Egypt that Metcalf & Eddy wanted to secure. The official received, along with his family, trips to the United States and a per diem that amounted to 150 percent above the rate allowed by law. Metcalf & Eddy paid for the flights, including first-class upgrades, and almost all the travel and entertainment expenses, even though the official had already received the funds to pay for his expenses. Furthermore, Metcalf & Eddy failed to accurately record these transactions, furthering the prosecution's case that the company knowingly violated the law.[21]

The civil settlement in this case required Metcalf & Eddy to institute an FCPA compliance program. This case set the standard for what the government expects in such a program, and has been repeatedly followed in other cases. The standards laid out establish the minimum requirements that should be met when creating an FCPA compliance program.[22]

At minimum, an effective FCPA compliance program includes the following elements:

- Clear FCPA policy, establishing compliance standards and practices to be followed by employees, consultants, and agents. These standards and practices must be reasonably capable of reducing violations and ensuring compliance.

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(*continued*)

- Assignment of one or more senior officials to be responsible for oversight of the compliance program. The official shall have the authority and responsibility to implement and utilize monitoring and auditing systems to detect criminal conduct, and when necessary, bring in outside counsel and independent auditors to conduct investigations and audits. The officials should make any necessary modifications to the program to respond to detected violations and to prevent further similar violations.
- Creating and maintaining a committee to review the hiring of agents, consultants, or other representatives to do business in a foreign country, and the related contracts. The committee will also review all prospective joint venture partners, to ensure FCPA compliance, and the due diligence done in selecting the prospective partner. The committee has a continuing responsibility to ensure subsequent due diligence in retaining other agents and consultants by the joint venture. This committee should be independent and not be influenced by the company officials involved in the transactions at issue.
- Clear corporate policies to make sure that the company does not delegate substantial discretionary authority to individuals that the company knows or should know are likely to engage in illegal activities.
- Clear corporate procedures to assure that the necessary precautions are taken to make sure the company only does business with reputable and qualified individuals. The policy must require that evidence of the due diligence performed be maintained in the company's files.
- Communicating FCPA policies, standards, and procedures to employees; requiring regular training on the FCPA and other applicable foreign bribery laws to officers and employees involved in foreign projects. Agents and consultants hired in connection with foreign business should also be given appropriate training, as soon as is practicable.
- Implementation of appropriate discipline measures, including as necessary, discipline of individuals who fail to detect violations of the law or of the company's compliance policies.

- Establishing a reporting system whereby suspected criminal conduct may be reported, without fear of retribution, and without having to report directly to immediate superiors.
- Including in all foreign business contracts provisions banning foreign bribery. No payment of money or anything of value will be promised, offered, or paid, directly or indirectly to any foreign official, politician, political candidate, or similar individual, to induce them to use their influence or to obtain an improper advantage in a business deal. All contracts must include a provision that all prospective agents agree not to retain any subagents or representatives without prior written consent of a senior company official; any breach of this provision terminates the contract.

Furthermore, an effective FCPA compliance program should also include:

- Periodic review, at least once every five years, of corporate policies and the FCPA compliance program, to be conducted by independent legal and auditing firms retained for such purpose.
- Prompt investigation and/or reporting of any alleged violations of the FCPA or other applicable foreign bribery laws by the company, its officers, agents, or other personnel, and of any joint venture in which the company is a participant.

Case law has added an additional requirement:[23]

- The company, using objective measures, must determine the regions or countries in which it does business that pose higher risks of corruption, and then on a periodic basis, conduct rigorous FCPA audits of its operations in such areas. The audits shall include detailed audits of the operating unit's books and records, audits of selected agents, consultants, and joint venture partners, as well as interviews with relevant employees, consultants, agents, and so on.

BOOKS, RECORDS, AND INTERNAL CONTROLS PROVISION

The books and records provision of the FCPA requires certain corporations to create and maintain books, records, and accounts that fairly and accurately reflect company transactions. The knowing falsification of company records is also prohibited. Furthermore, the provision mandates a strong system of internal controls.[24] According to the DOJ:

> *The FCPA also requires companies whose securities are listed in the United States to meet its accounting provisions. . . . These accounting provisions, which were designed to operate in tandem with the antibribery provisions of the FCPA, require corporations covered by the provisions to make and keep books and records that accurately and fairly reflect the transactions of the corporation and to devise and maintain an adequate system of internal accounting controls.*[25]

While the antibribery provisions apply to a broad group, the books and records provision only applies to issuers. This is logical, as the financial records of individuals and private businesses are not subject to the same kind of scrutiny as public companies' are. This is similar to the Section 404 requirements of Sarbanes-Oxley (SOX). Note that violating the books and records provisions could also result in SOX violations. Covered companies must make and keep books and records that accurately and fairly reflect their transactions. Corporations must also devise and maintain an adequate system of internal accounting controls.

The statute lists several requirements for internal controls. These include:

- Companies must ensure that transactions are only executed in accordance with management's general or specific authorization.
- Transactions must be recorded in accordance with generally accepted accounting principles (GAAP).
- Access to assets must be limited to those with authorization.
- Internal audits must be done at reasonable intervals, comparing the records with the actual assets.

The requirement of limiting access to assets is to prevent the use of slush funds and off-the-books accounts, which are often used to facilitate bribery. The audits help to make sure that the books accurately reflect assets; for instance, a company must make sure that a sales contract with a company is that and is not a cover for questionable payments.

The accounting provisions are also broader in another way, as they cover all questionable payments, not just those made to foreign officials. Commercial bribery payments must also be recorded in a company's records or else it will be in violation. Of course, to do so would admit to violating the laws of the country in which the bribery occurred.

The purpose of the books and records provision is to put teeth into the statute. Logic tells us that companies probably will not accurately record bribe payments to foreign government officials but if they do, the evidence is there for the government to obtain. If companies omit or falsify transactions to hide the bribe payments, they also face legal peril. The strength of the FCPA gives great leverage to the government in investigating and prosecuting bribery and corruption schemes. Violators are damned if they do and damned if they don't. The best way to avoid punishment is not to do the crime in the first place.

Books and Records Elements Summary

Every issuer of stock publicly traded in the United States shall:

- Make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer
- Devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:
  - Transactions are executed in accordance with management's general or specific authorization
  - Transactions are recorded as necessary (i) to permit preparation of financial statements in conformity with GAAP and (ii) to maintain accountability for assets
  - Access to assets are permitted only in accordance with management's general or specific authorization
  - The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences

SARBANES-OXLEY AND THE FCPA

The enactment of SOX changed the course of governance by spotlighting and mandating the importance of compliance and ethics. SOX

strengthened corporate accountability and governance of public companies through rules covering conflicts of interest, financial disclosures, board oversight, and certification of financial statements and disclosures.[26] Like few laws in modern times, SOX required public companies to comply with its many requirements and implement heightened compliance. The focus on SOX soon brought renewed attention to the FCPA and anti-corruption compliance. The fact is that the FCPA should be understood and analyzed in conjunction with SOX and its disclosure requirements. Unlawful payments and the falsification of records are independently outlawed. Falsification of company records to cover up a bribe violates both the FCPA and SOX and can cause a company to quickly run afoul of the DOJ and SEC.

OPINION PROCEDURE

Under the DOJ Opinion Procedure, a company or individual can request an opinion on a proposed business transaction or conduct before undertaking it. This is a useful procedure whereby a company can ask the government to analyze a prospective course of action to see whether it would lead to any FCPA violations. "The Department of Justice has established a Foreign Corrupt Practices Act Opinion Procedure by which any U.S. company or national may request a statement of the Justice Department's present enforcement intentions under the antibribery provisions of the FCPA regarding any proposed business conduct."[27] Thirty days after receiving the request and related material information, the Justice Department shall issue an opinion. Failure to fully disclose material and relevant information will nullify the opinion and the requestor will be unable to rely on its contents as a defense.

Business conduct in conformity with an issued opinion will be granted a presumption of conformity with the FCPA. The request for or issuance of an FCPA opinion does not affect a company's responsibility to comply with the accounting procedures in any way. An FCPA opinion only binds the DOJ and does not affect any other agency or any entity not involved in the request.[28] That being said, issued opinions provide an excellent resource for FCPA compliance. (Please see the Appendix for more information and summaries of important DOJ Opinion Procedure Releases.)

When the DOJ issues the opinion, the conduct or transaction is presumed to be FCPA-compliant. "Over the years," former Assistant Attorney General Alice Fisher noted, "the FCPA opinion procedure has generally been underutilized, with only a handful of opinions being

requested each year. But as Assistant Attorney General, I want the FCPA opinion procedure to be something that is useful as a guide to business."[29]

The opinion procedure may also be useful in the context of joint ventures, mergers, and acquisitions, "when the FCPA due diligence turns up potential problems with the foreign counterpart. Transactional due diligence in the FCPA context is good for business."[30]

PENALTIES

Violations of the FCPA can lead to major criminal and civil penalties and fines. Individuals can face jail time, while the company can be forced to pay millions, if not billions. Furthermore, a company can be forced to install costly new internal controls and business practices or even bring in an outside monitor as per agreement with the government. Monitors in particular can be very costly and intrusive to a company. A company also runs the risk of lawsuits from shareholders when FCPA violations are made public. The FCPA itself provides no private cause of action, but shareholders can use the underlying illegal activities as the basis for a derivative suit against the company.

The penalties for violations of the FCPA can be very severe and can include monetary fines of up to $25 million per violation against entities and $5 million per violation against individuals. Prison sentences can be for periods of up to 20 years. Other punishments can include:

- *Debarment:* The prohibition from doing business with or contracting with any agency of the U.S. government. Depending upon the industry and the defendant company's reliance on government contracts, debarment could result in a significant reduction in revenues.
- *Loss of export privileges:* Like debarment, loss of export privileges can be financially devastating for any company that manufactures goods for export.
- *Injunctive relief:* Companies may be barred from participating in a particular business or from engaging in certain practices by means of an injunction.
- *Appointment of a Monitor:* A conviction of an FCPA violation can cause a company to be subject to the court's continued oversight for many years. One way of enforcing the court's continued authority is the appointment of an independent monitor. Monitors typically have broad powers to oversee the company's continued operation and implementation of required changes to its compliance program, and can test to

ensure that required changes are being followed. Monitors are typically law firms who also engage the services of forensic accounting and investigative firms to assist them in carrying out their duties, which often span several years. Monsanto had an independent monitor assigned for three years as part of its settlement with the DOJ for its FCPA violation. In addition to the monetary penalties of an FCPA violation, defendant companies must pay for the monitor's professional fees and travel expenses. Monitorships often cost many hundreds of thousands, or even millions, of dollars.

- *Loss of goodwill and reputational damage:* A company's reputation has intrinsic value. Companies who have been the focal point of negative news stories resulting from FCPA enforcement can sustain long-term damage to their reputations, sometimes resulting in a significant reduction of market capitalization when shareholder confidence results in large selloffs.
- *Other Potential Criminal and Civil Liabilities:* The facts that support an FCPA case may also be the basis for Mail/Wire Fraud, Securities Fraud, Money Laundering, Tax Evasion, Conspiracy, False Claims, Travel Act, and other criminal violations and civil liability.

FCPA violations "may also give rise to a private cause of action for treble damages under the Racketeer Influenced and Corrupt Organizations Act (RICO), or to actions under other federal or state laws. For example, an action might be brought under RICO by a competitor who alleges that the bribery caused the defendant to win a foreign contract."[31]

Another law, the Travel Act, is also used in conjunction with the FCPA to prosecute offenders. The Travel Act prohibits interstate or foreign travel or use of the mail, with the intent to distribute the proceeds of any unlawful activity, commit any crime of violence to further any unlawful activity, or otherwise promote or facilitate the promotion of any unlawful activity.[32] The statute's definition of "unlawful activity" specifically includes bribery.[33] Thus bribery, which does not violate the FCPA but otherwise violates applicable state law, can be prosecuted under this Act.

THIRD-PARTY AND SUCCESSOR LIABILITY

Companies need to be aware that if they purchase or merge with a company that has committed an FCPA violation, the successor or purchasing company can be liable for the prior violation. The rules also apply to the use of third parties. Due diligence is of paramount importance here.

Actions by foreign subsidiaries of American companies or the third parties they hire can also result in liability, even if the company is not aware of the actions or did not authorize them.

A number of legal theories support this vicarious liability. When the foreign subsidiary is majority or wholly owned by the parent company, the parent will be responsible for the actions of the subsidiary, under the theory that they are effectively the same entity. A parent company can also be found liable if it approves or ratifies the conduct at issue, meaning that it either directly approves of the actions or learns about them and fails to take appropriate action. A company should ensure that its compliance program also applies to its subsidiaries and third parties. Through agency principles, companies are vicariously responsible for the actions of agents that have been hired, whether they are independent contractors or foreign subsidiaries.

This liability is why the use of third parties is so fraught with potential risk. This liability is also not restricted to those parties that the company has formally engaged. Courts will look at the totality of the circumstances surrounding the involvement of the party in question to determine whether the company should be liable for the unlawful actions. The company's internal designation of whom it considers agents or not is not dispositive. This is particularly important in situations where the companies had knowledge of unlawful payments; the company's classification of the agent and its level of control will not matter. Companies must look into the behavior of third parties if it has reason to believe illegal payments are being made.

The internal controls provision has been used to impose responsibility for the conduct of distributors. Though companies do not generally maintain strict control over the actions of the entities responsible for distributing their products abroad, the SEC's position is that companies must be aware of their actions and exercise proper supervision.

Joint ventures present liability risks since the company shares responsibility for the actions taken by the other company or companies involved in the venture insofar as it is related to the joint venture. FCPA violations also often come to light during the due diligence phase of mergers and acquisitions. By exercising appropriate due diligence and taking appropriate action for discovered violations, the company need not face any sanctions for the actions of the acquiring company. However, it must make sure it has discovered the violations and dealt with them appropriately. It must ensure that the behavior has ended and will not continue after the merger.

COMPLIANCE INSIGHT 2.2: SELF-DISCLOSURE FOLLOWS M&A ACTIVITY

On May 7, 2009, Sun Microsystems filed an SEC Form 10-Q that caught the investing public's attention. Under the risk factors section of the form, the company disclosed the following potentially serious FCPA violation:

> *We have identified potential violations of the Foreign Corrupt Practices Act, the resolution of which could possibly have a material effect on our business. During fiscal year 2009, we identified activities in a certain foreign country that may have violated the Foreign Corrupt Practices Act. We initiated an independent investigation with the assistance of outside counsel and took remedial action. We recently made a voluntary disclosure with respect to this and other matters to the Department of Justice (DOJ), Securities and Exchange Commission (SEC) and the applicable governmental agencies in certain foreign countries regarding the results of our investigations to date. We are cooperating with the DOJ and SEC in connection with their review of these matters and the outcome of these, or any future matters, cannot be predicted. The FCPA and related statutes and regulations provide for potential monetary penalties, criminal sanctions and in some cases debarment from doing business with the U.S. federal government in connection with FCPA violations, any of which could have a material effect on our business.*[34]

The disclosure by Sun closely follows the April 20, 2009 announcement that Oracle Corporation had agreed to purchase Sun for $7.4 billion. Shortly after Sun's disclosure, Oracle acknowledged that it was aware of the potential violations and that it had been disclosed to them prior to both companies agreeing to the acquisition. There is strong speculation that the FCPA disclosure by Sun may have come about from the enhanced due diligence that often accompanies the acquisition process.[35] With the government spotlight on FCPA violations, robust vetting and self-disclosure are absolutely critical in protecting an organization.

Sun's self-disclosure of a potential FCPA violation may result in the government focusing more attention on the software, telecom, and information technology sectors. These typically are growing

businesses that have interactions with the public sectors. Much of their business is in emerging markets that are high risk. Some companies have immature compliance programs and are focused on sales and marketing without factoring in the inherent risks.

The information technology sector on the West Coast of the United States may very well be an area of focus. There are several reasons for this:

- There is a large concentration of IT companies there, especially in Northern California.
- Many of these firms are start-ups and private entities.
- These companies may have less sophisticated compliance programs than older, more established companies in other industries.
- These companies are growth-oriented and may be willing to take risks to obtain and retain business.

WHY CORRUPTION MATTERS

Many mentions have been made thus far of the evil of corruption. It is what spurred Congress to enact the FCPA and it is that harm the Act intends to remedy. The harm of corruption seems self-evident; that it is bad is taken for granted. Corruption, bribery, and the like inspire a negative gut reaction. Yet, to understand the FCPA, it is necessary to better understand the harm that results from corruption. Transparency International defines corruption as "the misuse of entrusted power for private gain." This is further broken down into two types, "according to the rule" corruption and "against the rule" corruption. The former is the payment of a bribe to receive preferential treatment for something the recipient is required to do by law while the latter is a bribe paid to obtain services the receiver is prohibited from providing.[36] For example, paying a government official to curry favor during a bidding process would be "according to the rule" while paying a government official to ignore safety violations would be "against the rule."

Transparency International is a leading international nongovernmental organization fighting corruption. They have identified four costs of corruption:

1. *Political:* Corruption delegitimizes democratic institutions and presents a major obstacle to the rule of law. Institutional accountability cannot develop.
2. *Economic:* Corruption depletes national wealth. It transfers scarce public resources into projects that benefit only a small group of people while ignoring fundamental infrastructure. It distorts market forces and prevents competition while at the same time discouraging outside investment.
3. *Social:* Corruption undermines public trust, in leaders and government as a whole. Leaders ignore the needs of the many and focus solely on self-enrichment. Bribery and graft become the norm.
4. *Environmental:* Corrupt leaders ignore environmental harm caused, often by foreign businesses, since they directly benefit from the projects and are not accountable to the regions harmed. No heed is paid to long-term negative consequences as only short-term benefits matter to the leadership.[37]

For a deeper analysis into corruption's harm, Afghanistan serves as a useful case study.

COMPLIANCE INSIGHT 2.3: AFGHANISTAN: A CASE STUDY IN CORRUPTION

The Taliban emerged as the rulers of Afghanistan after its war against the Soviet Union in the 1980s. They were subsequently toppled by the American military following the government's refusal to hand over Osama Bin Laden and other al-Qaeda forces responsible for the terrorist attacks of September 11, 2001. The United States installed a democratic government in the war-torn country with former exile Hamid Karzai as president. Many had great optimism for the development of Afghanistan following the removal of the oppressive Taliban regime. The country had suffered tremendously from near constant tribal warfare and the devastation of the Russian invasion, and in the wake of Operation Enduring Freedom, there was hope that the country's disparate tribes could unify into a coherent state. This hope would be short-lived.

Despite great promise after dismantling the Taliban, Afghanistan has become one of the most corrupt countries on earth. Even though many developing nations struggle with corruption, its scale and scope is unlike anything Afghanistan has ever seen before. Its rank in the Transparency International index has fallen from 117 out of 180 countries in 2005 to 179 in 2009. "Kept afloat by billions of dollars in American and other foreign aid, the government of Afghanistan is shot through with corruption and graft. From the lowliest traffic policeman to the family of President Hamid Karzai himself, the state built on the ruins of the Taliban government . . . now often seems to exist for little more than the enrichment of those who run it."[38]

Everything, no matter how mundane, requires a bribe: driving a truck, settling a lawsuit, resolving a property dispute, receiving an official job, and so forth. This has taken money out of the pockets of the poor and given it to the rich and powerful and deprived the country of money that could be used for improvements. The Afghan government is weak, focusing on selfish benefit rather than building the country; this has contributed to letting the Taliban reestablish a foothold. Despite their religious extremism and brutal repression, the Taliban represents an alternative to the overly corrupt government. Unlike the Afghan government, the Taliban takes fighting corruption seriously. It runs its own courts, which dispense justice quickly without the need for bribes, and has set up committees to give Afghanis a platform to complain about injustices.[39]

The failures of the Afghani government and growth of opium trafficking as a major money source has created tremendous instability in the region, leading to a reoccurrence of the conditions that allowed al-Qaeda to flourish there in the first place. President Barack Obama has pledged more troops and greater resources to combat this growing extremism and terrorism threat.

For example, police officials routinely steal funds from their departments and sell their equipment and supplies. These officials often do this to deliberately weaken police authority, to prevent an interference with their own corruption. This leaves the police dangerously underfunded and lacking needed items like ammunition or body armor. Judges and prosecutors ignore the law in favor of their own interests.[40] With no rule of law or an adequate body to police the area, the results have been predictable.

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An American intelligence report, which casts serious doubt on the Afghan government's ability to restrain the Taliban, found that "the breakdown in central authority in Afghanistan has been accelerated by rampant corruption within the government of President Hamid Karzai and by an increase in violence by militants who have launched sophisticated attacks from havens in Pakistan."[41]

The public has lost faith in their government. Even President Karzai has publicly acknowledged the overwhelming corruption and the immense harm it has wreaked upon the country.[42] Even Karzai's family has been linked to opium smugglers. According to a former Afghan finance minister, "the government has lost the capacity to govern" and is completely in thrall to drug traffickers.[43]

Though it remains as one of their most pressing issues, the Afghani people have come to accept corruption as part of their daily lives. One contractor described "how the government is corrupt from A to Z: [t]he pressure . . . begins with 'suggestions' that he hire officials' relatives and friends and rent vehicles only from certain providers; it ends with the officials telling him exactly how big a cut of his profits they'll take to let the project continue."[44] In a province with an extremely high illiteracy rate, the local economy minister pushed to build a new university. Why? A big project like a university allows for plenty of opportunities for graft.[45]

Corruption was a major issue in the August 2009 Afghani election both as an election issue and in the campaign itself. It ranked as one of the major issues for voters and was addressed frequently by candidates. Widespread reports of voting fraud for Karzai overshadowed the election and drew negative attention worldwide. Though Karzai was eventually declared the winner, the fraud further tarnished his image and did little to inspire hope for Afghanistan's future.

INCREASED ENFORCEMENT

The increase in FCPA enforcement levels detailed throughout this book stems from corporate scandals of the early 2000s and the resulting corporate reform efforts. It has coincided with efforts from countries around the globe to fight bribery and corruption. This cumulative push has placed greater scrutiny on shady business practices and forced businesses to evaluate their practices and confront possible consequences.

Companies have also uncovered more illegal payments as part of SOX-related financial reviews. Greater scrutiny on company record-keeping has helped to bring these issues to the forefront. Since penalties can be so high, many companies have voluntarily disclosed their violations to the government in a bid for leniency.

"Mark F. Mendelsohn, deputy chief of the DOJ's fraud section, says pursuing anti-corruption cases has become a 'significant priority in recent years.' He says: 'U.S. companies that are paying bribes to foreign officials are undermining government institutions around the world. It is a hugely destabilizing force.' "[46] Mendelsohn summarizes the government's effort against corruption and its global importance:

> *I do think that the global economic crisis that we're in presents a grave challenge in the fight against foreign bribery. I think it is very tempting for companies to divert resources, which are scarce, away from compliance. It is tempting for salespeople in the field who are trying to generate business, generate revenue, save their jobs, to cross the line and pay bribes. I think that companies need to be especially vigilant in this economic climate to not cut back. Our law enforcement efforts are not going to be scaled back, and so it would be, I think, a grave mistake for a company to take that path.*[47]

Noting the ever-increasing amount of fines leveled, one school of thought has it that the enormous fines reflect the government's view of the FCPA as a profit center. The government can recover enormous sums of money from companies who have committed violations and are then resolved with a deferred prosecution agreement. This has led to a view of the government bullying companies who disclosed minor violations into paying large fines, for fear if they do not disclose, the punishment would be even worse.

Companies worry that paying for meals or the giving of seasonal gifts, common in many countries, could lead to serious trouble. Companies' overseas behaviors are dramatically changing. "For years, taking business associates to lavish dinners and giving them expensive holiday gifts, and even outright cash, was expected and done in many countries."[48] These practices have been reevaluated and many companies have banned activities that are in the gray area of FCPA enforcement or could possibly be construed as illegal payments. They have hired consultants and have come forward with voluntary disclosures to the DOJ.

The government has responded to the increased FCPA focus by making enhancements to improve enforcement. The SEC plans to create dedicated

divisions to focus exclusively on particularly specialized and complex areas of securities law. Of note, it will establish a new FCPA Unit. The unit will be proactive in its approach to identifying FCPA violations and will work closely with foreign counterparts for an even greater global approach.[49]

The year 2010 had barely begun before we had more evidence of the government's aggressive enforcement agenda. The DOJ announced on January 19, 2010 that it had arrested and indicted 22 individuals in Las Vegas and Miami as part of a major undercover FCPA sting. Using tactics more commonly associated with cases against drug cartels or the Mafia, FBI agents posed as representatives of an African country's Defense Ministry. They solicited a 20 percent ''commission'' as the fee to win a 15 million dollar contract to outfit the country's presidential guard. The defendants are 22 top-level executives from the arms industry. This case marked this first time the government has used an undercover operation to ferret out FCPA offenders, and it likely will not be the last.[50]

NOTES

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3. Title 15, United States Code, Section 78dd-1-3.
4. *U.S. v. SSI International Far East, Ltd*. Defendant, criminal information unsealed on October 16, 2006, (Dist. OR 2006), 24.
5. DOJ, "Lay-Person's Guide to the FCPA."
6. Ibid.
7. Title 15, United States Code, Section 78dd-1.
8. Title 15, United States Code, Section 78dd-2(h)(1).
9. Title 15, United States Code, Section 78dd-3(a).
10. Title 15, United States Code, Section 78dd-2(h)(2)(A).
11. Title 15, United States Code, Section 78dd-1.
12. Title 15, United States Code, Section 78dd-1(f)(2)(A).
13. Title 15, United States Code, Section 78dd-1(f)(2)(B).
14. Title 15, United States Code, Section 78dd-1(a)(1).
15. *U.S. v. Kay* 359 F.3d 738, 756 (5th Cir. 2004). This broad interpretation of "business purpose" does not negate the intent requirement of the statute. An intent to do the corrupt act must still exist.
16. Ibid., 748.

17. Title 18, United States Code, Section 3292(a).
18. Title 15, United States Code, Section 78dd-3.
19. Title 15, United States Code, Section 78dd-1(b).
20. Title 15, United States Code, Section 78dd-1(c).
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27. DOJ, "Lay-Person's Guide to the FCPA."
28. Title 15, United States Code, Section 78dd-1(e)(1).
29. Alice S. Fisher (assistant attorney general, United States Department of Justice), speech at the American Bar Association's National Institute on the Foreign Corrupt Practices Act, Omni Shoreham Hotel, Washington, DC, October 16, 2006, www.justice.gov/criminal/fraud/docs/reports/speech/2006/10-16-06AAGFCPASpeech.pdf.
30. Ibid.
31. DOJ, "Lay-Person's Guide to the FCPA."
32. Title 18, United States Code, Section 1952(a).
33. Title 18, United States Code, Section 1952(b).
34. SEC Form 10-Q, Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, filed by Sun Microsystems, Inc., May 8, 2009, 39, http://sec.gov/Archives/edgar/data/709519/000119312509103902/d10q.htm.
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