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2014 Mid-Year Update: Foreign Corrupt Practices Act

A Special Report by:
The Jackson Lewis Corporate Governance &
Internal Investigations Practice Group

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I. Introduction

The U.S. Foreign Corrupt Practices Act (“FCPA”) continues to be a major focus for U.S. regulators including the Department of Justice (“DOJ”) and the U.S. Securities & Exchange Commission (“SEC”). The first half of 2014 has included notable settlements totaling close to \$500 million. At the same time, the Eleventh Circuit’s ruling in *United States v. Esquenazi* has adopted the broad interpretation set forth by the DOJ and SEC regarding what constitutes an “instrumentality” of a foreign government.

These developments signal that government enforcement agencies do hold organizations accountable to the advice and standards set forth in the DOJ/SEC 2012 publication, [A Resource Guide to the U.S. Foreign Corrupt Practices Act](#) (“FCPA Guidance”). As noted in our prior report, the FCPA Guidance explains that, in the wake of an established FCPA violation and a pending determination of whether to take action against the organization, the DOJ and SEC take a “common-sense and pragmatic approach” to evaluating an organization’s compliance program by asking three fairly simple, albeit broad, questions: (1) Is the Company’s compliance program well-designed?; (2) Is it being applied in good faith?; and (3) Does it work?

More recently, in November 2013, the World Bank and its partners released the [Anti-Corruption Ethics and Compliance Handbook for Business](#) (the “Handbook”), which was developed “by companies for companies” to address the concern that “a myriad of existing international principles for business can be confusing, especially for small and medium-sized enterprises with limited resources.” The Handbook attempts to define, from the perspective of companies, best practices in anti-corruption compliance. While each case, transaction and resolution has its own set of circumstances, both the FCPA Guidance and the Handbook make clear that the strength of an organization’s compliance program is a key factor in determining whether an organization will be subject to prosecution and/or regulatory fines or whether the organization will be shielded from responsibility.

In this **2014 Mid-Year Special Report**, we provide a basic overview of the FCPA and a brief summary of the salient points of notable recent developments. We also outline best practices for minimizing liability based on these developments. We hope you will find this Special Report useful in developing your organization’s compliance program and in minimizing your FCPA and related risks in today’s global business environment. We are here to assist your organization with effectively managing these workplace threats.

II. Overview of the Foreign Corrupt Practices Act

The FCPA, at its core, prohibits individuals and organizations from bribing foreign government officials in order to benefit the business interests of the organization. The key elements are discussed below, followed by a summary of the FCPA’s accounting-related provisions.

A. FCPA Elements

1. Bribery Prohibitions

The anti-bribery portions of the FCPA prohibit U.S. companies, public and private, individuals and foreign subsidiaries of U.S. companies, and others, including the officers, directors, employees, agents and shareholders of U.S. companies (or foreign companies doing business in the United States), from bribing foreign officials in return for business. Specifically, the FCPA prohibits the offer or authorization of anything of value, directly or indirectly, with a corrupt intent, to a foreign official, political party or candidate, knowing

that some or all of the payment or value will go to the foreign official for the purpose of influencing any official act or to obtain or retain business.

A brief list of other conduct triggering potential FCPA violations includes: winning a contract through bribe payments; influencing a procurement process; paying bribes to customs officials; and making payments to obtain favorable tax treatment. The FCPA's broad prohibitions on bribery can be difficult to track.

2. Domestic and Global Application

The FCPA's anti-bribery provisions apply to conduct inside and outside the United States, and prosecution by the U.S. DOJ may result from a bribe provided through the use of mail, telephone, email, text, fax or any communication that touches interstate commerce. Companies or their agents may be prosecuted under the FCPA if they engage in *any* act in furtherance of a corrupt payment regardless of whether the agent was in the United States. Thus, as an example, the FCPA Guidance explains that FCPA liability attaches to both a U.S. company that provides payments and its European intermediary that funnels such funds to a foreign country official for the purpose of advancing the U.S. company's ability to procure a contract. This is an FCPA violation for both, notwithstanding that the intermediary never set foot in the United States.

3. Key Elements of an FCPA Claim

As referenced above, the FCPA prohibits bribery of foreign officials. Essentially the FCPA prohibits an "issuer" – a U.S. company that issues securities – or any of its officers, directors, employees, agents or stockholders from:

- (1) making use of interstate commerce (mail or any means or instrumentality of interstate commerce);
- (2) corruptly;
- (3) in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value;
- (4) to a foreign official – directly or indirectly;
- (5) for the purpose of influencing that foreign official.

Thus, the FCPA prohibits a payment made "corruptly." This means with an intent or desire to wrongly influence the recipient and, therefore, an intent to induce the recipient to misuse his/her official position. The FCPA does not require that a corrupt act succeed in its purpose. Indeed, for purposes of an FCPA violation, the recipient of a "corrupt" payment need not have received it, accepted it or solicited it — it is enough that there was an intent to make a corrupt payment. Thus, an executive who directs a manager to "pay whoever you need to" in a foreign government will have violated the FCPA even if no payment was ever offered or made.

Government enforcement agencies have issued broad interpretations of the FCPA's elements, complicating the efforts of U.S. companies to comply with the Act. For example, the FCPA prohibition on giving foreign officials "anything of value" in return for business raises many enforcement issues. First, enforcement agencies will give minimal, if any, regard to the fact that a U.S. parent company is unaware of conduct by its foreign-based subsidiary that is violative of the FCPA. Moreover, a "foreign official" as defined by the FCPA includes any employee of a foreign government or instrumentality, even one who is perhaps merely employed by any state-owned enterprise. Finally, "anything of value" goes well beyond cash payments and has been interpreted by regulators to include vacations, airfare, gifts, personal favors, disproportionate entertainment expenses, and compensation for disproportionate amounts of time spent on non-business matters.

The FCPA does not contain a minimum threshold amount for corrupt gifts or payments; however, as noted in the FCPA Guidance, neither the DOJ nor the SEC have investigated conduct such as providing a cup of coffee, taxi fare or company promotional items of “nominal value.” When such actions are part of a systemic pattern or course of conduct, however, the DOJ and/or SEC may become interested. Some of the more obvious forms of gifts or payments to foreign officials include: cash (the most common), sports cars, fur coats, country club membership fees, household maintenance expenses, payment of cell phone bills, expensive dinners, travel disguised as training trips for employees, payment of a relative’s educational expenses, or the use of charitable contributions as a way to funnel bribes to government officials.

4. Affirmative Defenses to Liability

Companies faced with FCPA liability can avail themselves of two affirmative defenses if applicable: (1) the payment was lawful under the local written laws of the country in which it was made (the so-called “local law defense”); or (2) the payment was made due to a contractual obligation or demonstration of a product, *i.e.*, a “bona fide business expenditure.”

As to the first defense, the mere fact that the alleged bribery does not rise to the level necessary for prosecution under the foreign country’s local laws is insufficient to establish the defense. The burden is on the company to establish that the payment was in fact lawful under the *written* laws of the country, which is rarely, if ever, the case.

With respect to the second defense, while travel costs for the promotion, explanation or demonstration of a company’s product are legitimate *bona fide* business expenses, payments for trips for personal entertainment purposes or trips mischaracterized on company reports are not, and no affirmative defense will be available for such payments. Additionally, the FCPA Guidance offers a non-exhaustive list of preemptive actions companies can employ to assure the availability of the *bona fide* business expenditure defense. These include: paying all costs directly to travel and lodging vendors and reimbursing upon presentation of a receipt only; not advancing any funds for reimbursements in cash; ensuring that costs and expenditures are transparent; obtaining written confirmation that the payment of expenses is not contrary to local law; and ensuring that costs and expenses on behalf of foreign officials are accurately recorded in company books.

Exempted from the FCPA are facilitating payments made to further “routine governmental action” that involves non-discretionary acts such as the processing of immigration visas, and the processing or supplying of utilities such as phone, mail or power. Routine government action does not include a decision to award business or any acts where a decision on the part of the foreign official is to be made. The FCPA Guidance recommends, however, that companies do not permit or make facilitating payments (even those that result in routine government action) because of the vagueness of how such payments are recorded and the potential for violation of local law. In addition, the anti-bribery laws of virtually every other country (*e.g.*, the UK Bribery Act) do not contain an exception for “facilitating payments” and are instead considered a form of bribery.

5. Corporate Liability

Corporate liability under the FCPA can arise through parent-subsidary relationships under traditional agency theories of liability prefaced on parental control of the subsidiary’s action. Liability can further arise through successor liability in the case of mergers and acquisitions. The DOJ and the SEC recommend that acquiring corporations employ strict due diligence and compliance review of the target organization. Indeed, both agencies have declined to enforce the FCPA against corporations that have voluntarily disclosed and remediated conduct in the pre-acquisition phase of mergers, thus emphasizing the importance of conducting meaningful due diligence in the context of a merger, acquisition or other applicable corporate transaction.

Corporate and individual liability can also be triggered through the aiding and abetting of, or conspiracy to commit, FCPA violations. Those who aid or abet are as guilty as direct violators. Those who agree to commit

an FCPA violation can also be held liable for conspiracy, which, due to the extraterritorial jurisdiction of United States conspiracy laws, may implicate foreign companies.

The FCPA does not contain a statute of limitations. Therefore, the general United States Code five-year limitation period for DOJ criminal actions applies. This period can be extended in cases of conspiracy. There is a similar five-year statute of limitations that applies to SEC civil enforcement actions.

B. FCPA Accounting Provisions

The FCPA's accounting provisions apply to issuers that have a class of securities registered under Section 12 of the Exchange Act or that are required to file annual or other periodic reports. These provisions include foreign corporations that trade on U.S. exchanges through American Depositary Receipts. The DOJ and SEC take the position that these provisions extend to subsidiaries or affiliates under the control of the public corporation, including joint venture partners and foreign subsidiaries.

The accounting provisions of the FCPA include two primary components. First, under the **books and records provisions**, accounting records must accurately reflect transactions and disposition of assets. Second, under the **internal control provisions**, companies are obligated to "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"; "access to assets is permitted only in accordance with management's general or specific authorization"; and "transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles." Failure to comply with these obligations can subject a company (and potentially its executives) to criminal and civil liability.

The accounting provisions of the FCPA are often used as the basis for enforcement actions by the SEC even in the absence of traditional FCPA issues. However, the Congressional intent behind the FCPA's internal controls and books and records provisions was to focus on the use of inaccurate accounting as a means of hiding international bribery. Importantly, there is no "materiality threshold" under the accounting provisions and companies may be criminally or civilly liable regardless of whether the international or interstate elements of the anti-bribery provisions are met. The fact is that it is easier for DOJ and the SEC to prove violations of the FCPA's requirements pertaining to internal controls and/or books and records than the anti-bribery provisions. This reality in turn has prompted many organizations facing potential FCPA enforcement actions to admit only to the accounting-related violations.

Similar to the FCPA's bribery elements, companies and individuals may also face civil liability based on theories of aiding and abetting or causing a violation of the accounting provisions. Additionally, willful violations of the FCPA's accounting provisions can subject companies and individuals to criminal liability.

III. Key 2014 FCPA Enforcement Developments

A. Eleventh Circuit Defers to SEC/DOJ Broad Interpretation of What Constitutes an "Instrumentality" of a Foreign Government

On May 16, 2014, the U.S. Court of Appeals for the Eleventh Circuit held that "[a]n 'instrumentality' under...the FCPA is an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own." *United States v. Esquenazi*, Case No. 11-15331 (11th Cir. May 16, 2014). In so holding, the Court

delineated a two-part test for determining whether an entity is state controlled: (1) whether there is government control; and (2) whether a state-owned entity performs a public function.

The 11th Circuit noted that in assessing government control, relevant factors include:

- (1) the foreign government's formal designation of the entity;
- (2) whether the government has a majority ownership interest;
- (3) the government's authority to appoint and remove the entity's principals;
- (4) the extent to which the entity's profits are returned to the public treasury;
- (5) whether the government supports an entity that is otherwise performing at a loss; and
- (6) the length of time the above factors existed.

In assessing "public function," relevant factors mentioned by the 11th Circuit include whether:

- (1) the entity has a monopoly over its functions;
- (2) the government subsidizes the entity;
- (3) the entity performs services for the public at large; and
- (4) the public and the government generally perceive the entity to be performing a governmental function.

After applying the two-part test and examining the relevant factors, the 11th Circuit affirmed the FCPA convictions of two defendants for bribing officials of Haiti Telco, the sole provider of landline telephone service in Haiti. Although Haiti Telco is not designated by statute or any law as a government entity, the National Bank of Haiti (which later became the Banque de la Republique d'Haiti) is owned by the Haitian government and has a 97% ownership of Haiti Telco.

This opinion illustrates that doing business even with non-governmental entities can create risk, requiring due diligence as to the ownership of such entities before entering into relationships in high-risk regions of the world.

B. Large Penalties Paid for Acts of Foreign Subsidiaries

On January 9, 2014, the subsidiary of a global aluminum company (which was a majority-owned and controlled aluminum sales company) pleaded guilty to violating the FCPA and agreed to pay \$223 million to the DOJ to resolve charges it paid millions of dollars in bribes through an international middleman in London to Bahrain government officials. According to the charges, the subsidiary concealed the bribes by laundering payments through offshore shell companies and bank accounts, including accounts held under aliases in Guernsey, Luxembourg, Liechtenstein and Switzerland, and by utilizing a sham distributorship to mark up the price of alumina to cover the payment of the bribes.

Notably, the Settlement Agreement with the DOJ required the parent company to maintain and implement an enhanced global anti-corruption compliance program, even though there was no indication (at least in the Settlement Agreement) that it had any knowledge of, or involvement in, the corrupt conduct. In its press release, the DOJ noted that "[t]he law does not permit companies to avoid responsibility for foreign corruption by outsourcing bribery to their agents, and, as today's prosecution demonstrates, neither will the Department of Justice."

In a parallel action, the company settled with the SEC and agreed to pay an additional \$161 million in disgorgement, resulting in total penalties of \$384 million. According to the SEC, the parent company lacked sufficient internal controls to prevent and detect the bribes, which were improperly recorded in its books and records as legitimate commissions or sales to a distributor. In its press release, the SEC noted that “extractive industries have historically been exposed to a high risk of corruption” and commented: “As the beneficiary of a long-running bribery scheme perpetrated by a closely controlled subsidiary, [the parent company] is liable and must be held responsible . . . It is critical that companies assess their supply chains and determine that their business relationships have legitimate purposes.”

In another proceeding, on April 9, 2014, the Russian subsidiary of a global high-tech company agreed to plead guilty to felony violations of the FCPA and admit its role in bribing Russian government officials to secure a large technology contract with the Office of the Prosecutor General of the Russian Federation. In addition, the government entered into criminal resolutions with the parent company’s subsidiaries in Poland and Mexico relating to contracts with Poland’s national police agency and Mexico’s state-owned petroleum company, respectively. In total, the three entities were required to pay almost \$77 million in criminal penalties and forfeiture.

In announcing the settlement, DOJ commented: “[The company’s] subsidiaries, co-conspirators or intermediaries created a slush fund for bribe payments, set up an intricate web of shell companies and bank accounts to launder money, employed two sets of books to track bribe recipients, and used anonymous email accounts and prepaid mobile telephones to arrange covert meetings to hand over bags of cash . . . Even as the tradecraft of corruption becomes more sophisticated, the department is staying a step ahead of those who choose to violate our laws, thanks to the diligent efforts of U.S. prosecutors and agents and our colleagues at the SEC, as well as the tremendous cooperation of our law enforcement partners in Germany, Poland and Mexico.”

In the parallel SEC proceeding, the company consented to the SEC’s Order, which found that it had violated the FCPA’s internal controls and books and records provisions, and agreed to over \$31 million in disgorgement and prejudgment interest, resulting in total penalties paid to the government of over \$108 million. In its press release, the SEC noted that the parent company “lacked the internal controls to stop a pattern of illegal payments to win business in Mexico and Eastern Europe. The company’s books and records reflected the payments as legitimate commissions and expenses.” The SEC further emphasized that “[c]ompanies have a fundamental obligation to ensure that their internal controls are both reasonably designed and appropriately implemented across their entire business operations, and they should take a hard look at the agents conducting business on their behalf.”

IV. Analysis & Observations for Employers

The three recent noteworthy FCPA cases discussed above illustrate the following law enforcement trends:

- Corruption prosecutions are now global in scope with U.S. regulators gaining greater and more expeditious cooperation from their foreign counterparts;
- Industry-wide investigations remain the norm with U.S. regulators recognizing that if one company in a particular industry is paying bribes, their competitors may be as well;

- There is a continuing and renewed focus (in view of the 11th Circuit opinion) on bribes paid by companies and/or their agents and third-parties to state-owned enterprises, which is broadly construed; and
- Regulators with increasing frequency are holding parent companies responsible for bribes paid by their foreign subsidiaries (even where no parent company employees either participated in, or had knowledge of, the corrupt acts), where the parent company lacks adequate internal controls to detect the bribes and prevent their occurrence.

What does this mean for multinational companies? First, such organizations face ever-increasing scrutiny and risk under the FCPA and other global anti-corruption laws (*e.g.*, the UK Bribery Act, Canada's Corruption of Foreign Public Officials Act, and Brazil's Law to Combat Corruption), particularly if they (or their subsidiaries) are operating in a high-risk industry in high-risk countries.

Second, particularly given the 11th Circuit's decision that bribes paid to state-owned entities violate the FCPA, it is risky behavior for companies to treat "commercial bribery" (which is not covered by the FCPA, but still illegal under *other* U.S. laws and most foreign anti-corruption laws) differently from bribery of foreign officials.

Third, as illustrated by the recent DOJ/SEC settlements, companies must have adequate internal controls in place with their foreign subsidiaries to detect any corrupt acts by those subsidiaries, and to ensure that all financial transactions involving those subsidiaries are recorded properly on their books and records.

To minimize risk, multinational companies should have a zero tolerance policy when it comes to paying bribes (whether directly to a foreign official or not) and adequate internal controls in place to prevent and detect such corrupt activity (including by its subsidiaries). In addition, such companies should conduct periodic risk assessments of its anti-corruption compliance programs, enhance its anti-corruption policies, processes and controls as needed (*e.g.*, when entering new foreign markets or acquiring other companies), and conduct anti-corruption training for its global workforce, including its subsidiaries.

V. Conclusion

FCPA and, more broadly, bribery and corruption, are increasingly a focus of regulators on a global scale. Global companies have been put on notice of what is an adequate compliance program, what are the regulatory expectations in the context of an internal investigation, and how an organization should implement corrective action with self-reporting. Those organizations that adhere to regulatory expectations and industry best practices as illustrated by the Resource Guide and the Handbook, respectively, minimize risk and likely will avoid serious consequences should an issue arise involving corrupt conduct. Conversely, those companies that do not take proactive steps to implement an effective compliance program face significant risk of a government investigation, penalties, bad publicity and potential downstream litigation by third-parties, including whistleblower claims and shareholder derivative lawsuits.

For company directors, officers, executives and senior managers, we suggest that the directive to take action is clear. Jackson Lewis is pleased to provide this Special Report and stands ready to assist your organization with assessing risk and developing the appropriate action plan in view of that risk.

VI. Our FCPA Expertise

The **Jackson Lewis Corporate Governance and Internal Investigations Practice Group**, led by partners Rich Cino (Morristown, NJ) and David Jimenez (Hartford, CT), conducts risk assessments; provides advice and counsel on the development, design, and implementation of organizational and corporate compliance programs and components thereof, including codes of conduct, anti-corruption policies, internal reporting mechanisms, internal controls, and third-party due diligence processes; conducts anti-corruption training; and conducts corporate investigations that correspond to Foreign Corrupt Practices Act, U.K. Bribery Act and other applicable international anti-bribery requirements. Should litigation ensue, we also defend employers on all types of related civil litigation including whistleblower claims arising from the Sarbanes-Oxley Act, the False Claims Act and the Dodd-Frank Act of 2010. Additionally, we advise and defend organizations faced with high-stakes regulatory investigations and enforcement actions. The firm's **White Collar and Government Investigations Practice Group** led by practice group leader, Paul Kelly, also advises employers faced with potential criminal liability under the FCPA.

In cross-border investigations and other matters, the **International Employment Issues Group** is co-led by John Sander, who brings substantial in-house experience for major global employers managing workplace and compliance issues in more than 70 countries. To the extent local labor/employment law matters arise outside the U.S., we work in tandem with [L&E Global](#), a global alliance comprised of international labor and employment law firms, as well as other top law practices throughout the world.

The firm's Corporate Governance and Internal Investigations Practice Group and the White Collar and Government Investigations Practice Group have a team of experts with substantive experience handling FCPA matters from their inception through final conclusion. Our team includes FCPA compliance experts with prior *Fortune* 100 company experience, former federal prosecutors and white collar crime practitioners, experienced trial attorneys and international employment law experts.

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