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FCPA DUE DILIGENCE IN ACQUISITIONS

The due diligence essential to protect American companies engaged in foreign acquisitions from inheriting or creating FCPA violations has many aspects, including investigation of consultants, limits on travel expenditures for foreign officials, and contract provisions to provide post-acquisition protection. Recent Department of Justice cases and Opinion Releases provide some guidance for judgment calls on permitted payments.

By Rebekah J. Poston, David A. Saltzman, and Gregory W. Bates *

If you are in the banking, securities, or commodities business, you are all too familiar with the anti-money laundering provisions of the USA PATRIOT Act and the "Know Your Customer" due diligence requirements of the Bank Secrecy Act. But just how familiar are you with the Foreign Corrupt Practices Act ("FCPA") and its rigorous due diligence requirements? Does the FCPA even apply to you? You may be asking, are you not covered already if you have an anti-money laundering ("AML") program and perform know your customer ("KYC") due diligence? The answer is: If the FCPA applies to you or your company, your standard AML program and KYC due diligence just will not cut it – the FCPA demands a lot more in the due diligence department.

This article takes a real life scenario (the names have been changed to protect the innocent) and demonstrates the lengths to which a U.S. publicly traded company must go in performing FCPA due diligence when it decides to acquire an enterprise in another country known for its corruption.

RECENT ENFORCEMENT INITIATIVES

FCPA due diligence has taken on added importance in the mergers and acquisitions area as a result of the increased enforcement and prosecutions of FCPA violators, both corporations and individuals, by the Department of Justice and the Securities and Exchange Commission. These two agencies enforce the anti-bribery provisions, and the books and records and internal controls provisions of the FCPA. They work in tandem and have legitimate bragging rights based on their prosecutorial accomplishments these past few years.

Since 2005, the DOJ has brought 58 cases – more than the total number of prosecutions brought in the more than 30 years since the statute's enactment in 1977.[1] In 2008, 33 enforcement actions were brought by

[1] Lanny A. Breuer, Assistant Attorney General, U.S. Department of Justice, Criminal Division, Prepared Address to The 22nd National Forum in the Foreign Corrupt Practices Act (Nov. 17, 2009).

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the DOJ and SEC combined.[2] Monetary penalties in 2008 exceeded the total penalties assessed in the previous 31 years of the statute's history.[3] The DOJ represents it collected record corporate fines, including $450 million in penalties in the Siemens matter and $402 million in penalties in Halliburton/KBR.[4] In addition, as Assistant Attorney General Lanny Breuer stated, "The recent FCPA trials of Frederick Bourke, Congressman William Jefferson, and Gerald and Patricia Green resulted in convictions in all three trials for violations of and/or conspiracy to violate the FCPA, along with other crimes, further adding to the DOJ's conviction rate."

In the early history of the statute, very few individuals were prosecuted. In 2008, 60% of the prosecutions brought were against individuals. As Mark Mendelsohn, Deputy Chief of the DOJ's Criminal Division, Fraud Section, in charge of all FCPA prosecutions by the DOJ, told *The Wall Street Journal*:

> To really achieve the kind of deterrent effect we're shooting for, you have to prosecute individuals. If the only sanctions out there are monetary, penalties against companies could be interpreted as the cost of doing business. But when people's liberty is at stake, it resonates in new ways.[5]

Settlements without trial are the usual resolution of FCPA investigations and prosecutions. Settlements typically include civil penalties, disgorgement of profits, prison terms for individuals, placement of FCPA monitors, asset seizures, and federal contract debarment. FCPA prosecutions almost always spawn lawsuits against a company's officers and directors by its angry shareholders.

Perhaps most revealing about how seriously these two enforcement agencies are taking their FCPA enforcement efforts is the fact that the SEC is utilizing the DOJ's standard criminal covert tactics in its FCPA investigations that include undercover operations, wiretaps, confidential informants, and material witness warrants to collect evidence.

As if this were not enough, the DOJ and SEC are cooperating with their counterparts in non-U.S. jurisdictions to help bring prosecutions abroad, in tandem with, and sometimes as an alternative to, prosecutions in the United States. The DOJ has announced that it is providing evidence and technical forensic training, and placing FCPA-trained attorneys abroad, to assist prosecutors in other countries with their local bribery prosecutions.

The year 2008 was indeed a year for coordination between the DOJ and anti-corruption authorities in other countries. In 2008, 45 letters rogatory were issued by the DOJ under Mutual Legal Assistance Treaties, and prosecutors took at least 16 international trips for FCPA investigations to Greece, Hungary, Panama, Romania, and the United Kingdom.[6] As of January 2009, the DOJ was involved in at least 23 multi-jurisdictional investigations in the Czech Republic, Finland, Germany, Greece, Japan, Norway, Sweden, Switzerland, and the United Kingdom.[7]

In 2008, the SEC made a record 594 requests to non-U.S. regulators for assistance with investigations and cooperated with 414 incoming requests from other governments.[8] One of the ways the SEC shares investigative data with securities regulators around the world, including bank and brokerage records, is via a Memorandum of Understanding ("MOU") with the

[2] In 2009, as of December 7, the DOJ and SEC have resolved 30 enforcement actions against corporate entities and individuals combined.

[3] *Supra* note 1.

[4] *Id.*

[5] *Now It's Personal: The DOJ Targets Individuals in Prosecuting Bribery,* The Wall Street Journal, October 8, 2009, http://www.wsj.com.

[6] Robert C. Blume, Esq., and Ryan V. Caughley, Esq., *The FCPA: Overview, Enforcement Trends and Best Practices, in* CORPORATE OFFICERS & DIRECTORS LIABILITY, Volume 25, Issue 9 (2009).

[7] *Id*.

[8] Sheri Qualters, *As Enforcement Goes Global, So Do White Collar Crime Lawyers*, INTERNATIONALnews, ALM Media Properties LLC, April 28, 2009.

International Organization of Securities Commission. The MOU was signed by the SEC in 2003. It was the first global information-sharing arrangement among securities regulators. It provides for the exchange of basic information pertinent to cross-border violations. Information produced under the auspices of the MOU can be used to enforce compliance with securities and derivatives laws and regulations, including through civil and criminal prosecutions.[9]

In August 2009, Robert Khuzami, the Director of the SEC's Enforcement Division, announced in a speech to the New York Bar Association that the SEC has created "national specialized units dedicated to particular highly specialized and complex areas of securities law."[10] By doing so, SEC Chairman Mary Schapiro explained, the SEC's Enforcement Division has "redeploy[ed] dozens of superbly qualified attorneys back to the front lines" and enabled them to "concentrate their expertise in a particular area of law."[11] One of these specialized units is an FCPA Unit. Its focus, according to Khuzami, is "on new and proactive approaches to identifying violations of the FCPA."[12] Khuzami further stated that while the SEC had been active in this area, "more needs to be done, including being more proactive in investigations, working more closely with our foreign counterparts, and taking a more global approach to these violations."[13]

Confronted by these aggressive enforcement efforts, companies must take vigorous prophylactic measures to avoid FCPA liabilities. This is perhaps most important in the context of acquisitions and mergers. We turn now to essential FCPA due diligence in that context.

HYPOTHETICAL MERGER AND ACQUISITION

- A publicly traded U.S. bank named Deposits Bank wants to purchase a bank named Overseasia Bank, located in Overseasia, a country known for its corruption.

- The stock of Deposits Bank is listed on a national securities exchange in the United States.

- Overseasia received a score of 3.5 on the most recent Transparency International Corruption Perception Index ("CPI").[14]

- Stockholders of Overseasia Bank include: (i) the Overseasia government, (ii) a non-U.S., non-Overseasia sovereign wealth fund ("SWF"); and (iii) numerous individual non-U.S. stockholders.

- Deposits Bank would like to retain a third-party consultant to assist it with securing the proper licenses and dealing with government officials and regulators in Overseasia.

- The third-party consultant wants Deposits Bank to sign a "Deed of Facilitation" for its services instead of a contract resembling that which Deposits Bank usually enters into with its consultants. The consultant wants its consulting fee wired to a Gibraltar bank account in the name of its affiliate company.

- The Overseasia Superintendent of Banks is responsible for approving the acquisition and granting the license to Deposits Bank, a prerequisite to Deposits Bank being able to do business in Overseasia.

- Deposits Bank extends an informal invitation to a representative of the Banking Superintendent's office, to visit Deposits Bank's headquarters in Palm Beach, Florida. The visit will include a tour of Deposits Bank's headquarters and involve several business meetings designed to provide the Superintendent of Banks with a better understanding of Deposits Bank's banking products and services.

- The Superintendent informs Deposits Bank he will be the one coming to the meetings, and he makes the following requests of Deposits Bank. He wants: to bring his wife; to fly first class; to stay at The Ritz-Carlton in Palm Beach; all expenses related to his

[9] SEC Rel. No. 2003-145 (2003).

[10] Robert Khuzami, Remarks to the New York City Bar Association (Aug. 5, 2009).

[11] Mary Schapiro, Address to the Practicing Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009).

[12] *Supra* note 10.

[13] *Id*.

[14] Transparency International is a global watchdog of corruption. Every year, it releases an updated CPI, ranking countries by perceived levels of corruption, as determined by expert assessments and opinion surveys. A country's CPI score indicates the perceived level of public-sector corruption in that country. The lower the score, the more that corruption is perceived to be prevalent in that country. Of the 180 countries ranked in 2009, New Zealand ranked the highest (perceived as least corrupt) at 9.4 and Somalia ranked the lowest (perceived as most corrupt) at 1.1. Extra due diligence should be performed in this merger and acquisition where Deposits Bank is on notice Overseasia scores low on the CPI.

travel and stay in Florida (hotel business center services, telephone, laundry, mini-bar, spa, golf green fees, etc.) to be paid by Deposits Bank; a daily stipend while in Florida; to be taken with his wife on a tour of the Kennedy Space Center during his trip to Deposits Bank's headquarters; and to stay the weekend following the conclusion of the business meetings to play golf.

- Deposits Bank's outside auditors discover, in the course of conducting financial due diligence of the Overseasia Bank, unusually high expenditures for entertainment and gifts to Overseasia government officials.

- Deposits Bank's outside auditors also discover that Overseasia Bank has been making small, but regular, monthly payments to a low-level, administrative Overseasia government official.

- The above expenses have been recorded in Overseasia Bank's books and records as "miscellaneous" expenses.

Deposits Bank now wonders if the acquisition of Overseasia Bank is too risky. How can Deposits Bank acquire Overseasia Bank while protecting itself from actual and potential violations of the FCPA?

ISSUES REGARDING OWNERSHIP OF OVERSEASIA BANK

It is important to note that people ostensibly working in private industry might be considered foreign officials under the FCPA. It is not always easy to determine if someone is a foreign official, so Deposits Bank should gather enough information about Overseasia Bank early on to determine whether Overseasia Bank would be considered a foreign government instrumentality such that its personnel would be considered foreign officials. Even though Overseasia Bank might appear to be a private person, it might have attributes that would make it a state-owned entity ("SOE"). Personnel of SOEs often are considered foreign officials, and then even the simplest of favors for such personnel, such as paying for dinner during business negotiations, can inadvertently violate the FCPA.

Many factors should be considered when determining whether an entity is an SOE, including:

- the percentage of ownership by the non-U.S. government;

- the degree of control exercised over the entity by the non-U.S. government;

- the non-U.S. government's voting rights in the entity;

- whether the entity's employees hold governmental roles or have the rights and privileges of government positions;

- whether the entity's employees are capable of exerting influence in other parts of the government;

- the resident country's own characterization of the entity and its employees;

- whether the resident country prohibits and prosecutes bribery of the entity's employees as public corruption; and

- the purpose of the entity (*e.g.*, is a primary purpose to serve the public good?).

The above list is not exhaustive, and the DOJ may consider other attributes that it deems relevant to the analysis.

Here, Deposits Bank has learned that stockholders of Overseasia Bank include: (i) the Overseasia government, (ii) a non-U.S., non-Overseasia SWF, and (iii) numerous individual non-U.S. stockholders.

The mere fact that the Overseasia government is one of the stockholders of an entity does not necessarily mean that Overseasia Bank should automatically be considered a non-U.S. government instrumentality. The amount of such ownership should be considered, as well as the other factors identified above. In this case, the Overseasia government owns less than 0.5% of the outstanding stock of Overseasia Bank. That is so small an amount as to be immaterial. But what if, despite holding such little stock, Overseasia Bank is entitled to designate 1/3 of the members of Overseasia Bank's board of directors? Clearly, that would provide the Overseasia government a large amount of control over the bank, enough so that the bank should be considered a foreign government instrumentality and its personnel, foreign officials. As it turns out, the Overseasia government is no longer entitled to designate any directors, having lost the right when it previously sold most of its stock. After considering the other factors, including the fact that Overseasia Bank's personnel have no other affiliation with the government, its primary purpose is to generate profits for its stockholders and it is not considered by the Overseasia government to be a government instrumentality, Deposits Bank comfortably concludes that Overseasia Bank is not an SOE.

But what about the other stockholders? What is the SWF's involvement with Overseasia Bank? SWFs are state-owned investment funds, essentially venture capital funds of a government. Some SWFs are managed by government officials, and some are managed by private fund managers. Regardless of who manages the fund, an SWF's ownership of Overseasia Bank stock presents the same issues as ownership by the Overseasia government itself. In this case, the SWF is owned by a country in the Middle East. The SWF owns more than 35% of the Overseasia Bank's outstanding stock, giving it the ability to elect 1/3 of the bank's directors. Thus, the SWF exercises enough control over Overseasia Bank to make the bank a non-U.S. government instrumentality. Now, Deposits Bank knows that Overseasia Bank's personnel may be considered foreign officials. Deposits Bank must be careful during negotiations with Overseasia Bank personnel not to give such personnel anything of value that could be construed as trying to corruptly influence such personnel to do this deal, because doing so would violate the FCPA.[15]

USE OF THIRD-PARTY AGENTS

Deposits Bank has decided to retain a consultant to assist with securing the proper licenses and dealing with government officials and regulators in Overseasia. Companies commonly retain consultants to assist with overcoming regulatory hurdles in other countries. The right consultant will have extensive knowledge of that country's laws, awareness of current events that affect their clients' industries in such country, a history of successfully assisting clients to secure the necessary licenses and, in many cases, personal experience in dealing with the relevant government officials and regulators. Retaining the right consultant can be the difference between success and failure.

But retaining the *wrong* consultant can be worse than not hiring any consultant at all. This is because a principal can potentially be held liable for violations of the FCPA committed by a third-party agent. For example, in 2009, the SEC filed a settled civil action that alleged that ITT Corporation, a publicly traded Indiana corporation based in New York, violated the FCPA as a result of, among other things, improper payments to Chinese officials by third-party agents of a wholly owned Chinese subsidiary of ITT.[16] Without admitting or denying the SEC's allegations, ITT consented to the entry of a final judgment permanently enjoining it from future violations and agreed to disgorge $1,041,112 in profits and pay a $250,000 civil penalty. Similarly, in 2008, Christian Sapsizian, a French executive of an Alcatel CIT ("Alcatel") subsidiary working in Costa Rica, pled guilty to bribing and conspiring to bribe Costa Rican government officials through the use of a third-party agent.[17] He was sentenced to 30 months in prison, ordered to forfeit $261,500, and sentenced to three years of supervised release.

In this case, Deposits Bank can potentially be held liable for violations of the FCPA by its consultant in Overseasia, so Deposits Bank has to be careful when selecting a consultant and monitoring its activities.

Due Diligence on the Consultant

Deposits Bank's first step, after determining the consultant it would like to hire based on business-related criteria, is to perform due diligence on the consultant. This entails providing written questions to the

[15] Similarly, Deposits Bank should be wary of giving gifts to employees of the SWF itself. Steve Tyrrell, Chief of the Fraud Section in the DOJ's Criminal Division, indicated that the DOJ may treat employees of SWFs as government officials for purposes of the FCPA and that securities firms should do likewise. http://www.compliancebuilding.com.

[16] According to the SEC's complaint, employees and agents of the subsidiary, Nanjing Goulds Pumps Ltd. ("NGP"), paid officials of Chinese SOEs to influence the design of infrastructure projects so as to require the use of NGP pumps. NGP employees also used third-party agents to facilitate payments to foreign officials. When NGP used a third-party agent, NGP paid inflated commissions to the agents after NGP received payment from the SOE for the pumps. NGP understood that the third-party agent would then pay the foreign official that recommended NGP pumps or directly pay employees of the SOE that purchased the pumps. These illicit payments totaled approximately $200,000 and generated over $4 million in improper NGP sales.

[17] The DOJ alleged that in order to influence the Costa Rican state-owned telecommunications authority to award a contract to Alcatel, Sapsizian, among other things, transferred $14 million from a U.S. bank account to a Costa Rican account of a consultant, from which $2.5 million was subsequently used by the consultant to bribe the Costa Rican officials. As a result of the bribes, Alcatel was awarded a mobile telephone contract valued at more than $149 million. The case is also illustrative of the far reach of the FCPA. The bribery took place entirely in Costa Rica. Sapsizian was a French national working in Costa Rica. Alcatel is a French company and has no operations in the United States. However, Alcatel has American Depositary Receipts listed on the New York Stock Exchange, and a U.S. bank account was used to wire funds to a Costa Rican account for subsequent payment to the foreign officials. U.S. authorities reportedly arrested Sapsizian as he changed planes at Miami International Airport.

consultant, interviewing the consultant's management and possibly the personnel who would work with Deposits Bank, reviewing public resources for information about the consultant, and maybe even using an investigator who specializes in performing FCPA due diligence on potential business partners. It may seem odd to conduct due diligence not only on Overseasia Bank, but also on the consultant, but the latter is just as important as the former in ensuring compliance with the FCPA.

Everyone reading this article is probably familiar with the basic practice of conducting due diligence through the use of a written due diligence request list. The list is submitted to the potential business partner, asking for certain information and requesting copies of certain documents. Here, Deposits Bank should make sure that the list it submits to the consultant includes questions designed to elicit information about the consultant's understanding of, and compliance with, the FCPA and anti-bribery laws of the consultant's own country.

In addition to questions regarding the consultant's licensing credentials, among other things, Deposits Bank should inquire about the consultant's owners/principals, its officers who have responsibilities for selling to or interacting with governmental authorities, and its employees who will be working on Deposits Bank's transaction. Deposits Bank should research such persons to check whether they have ever been convicted or accused of bribery or have other similar black marks on their record. Obviously, any such marks would be a red flag, putting Deposits Bank on notice that the consultant may engage in practices that violate the FCPA – practices for which Deposits Bank itself could be held liable if repeated in the course of the agent's assistance to Deposits Bank.

The due diligence request list should ask about relationships the consultant or its personnel may have, or have had, with governmental authorities, government-owned and government-controlled entities, public international organizations, and political parties and candidates for political office. The consultant's responses to these questions should assist Deposits Bank in determining whether the consultant itself has such characteristics that the consultant or any of its personnel would be considered a foreign official, such that paying the consultant to assist Deposits Bank under the wrong circumstances could violate the FCPA.

The request list should inquire about the consultant's representation of other U.S. persons, whether the consultant has its own "code of conduct" and internal controls, how it typically is paid by clients and how it pays its own personnel, and what kinds of payments it typically makes and to whom, including grease payments.[18] The answers to such questions will provide a window into what type of awareness the consultant has with the FCPA and whether its compensation structure is aligned with, or potentially violative of, the FCPA. If the consultant is typically paid a "success fee," or its personnel are eligible for bonuses or higher salaries, for obtaining governmental approvals, there is a greater incentive for the consultant and its personnel to cut corners if they think it will help culminate in a successful result for the client.

The questions described above are only some of the questions that should be included in a due diligence request list. Each situation is different, depending on industry, location, the proposed transaction and other factors, and each due diligence request list should be customized accordingly.

After reviewing the consultant's answers to the due diligence request list, Deposits Bank should interview the consultant's management and possibly the personnel who would work with Deposits Bank. This will enable Deposits Bank to ask follow-up questions to, and get more details about, the consultant's written answers to the due diligence request list. Deposits Bank can ask questions that require lengthier answers and more detailed explanations than could reasonably be provided in writing, such as "What type of FCPA training do you and your personnel receive?", "How familiar are you with anti-bribery and corruption laws in Overseasia?", and "Do you utilize third-party agents yourself and, if so, how do you select and monitor them?" In-person interviews also require the interviewee to be spontaneous with his answers, giving him less of a chance to devise an answer that he thinks will simply satisfy the interviewer. Inconsistencies between the written answers to the due diligence request list and the verbal answers at the interview may enable Deposits Bank to detect falsehoods.

As part of its due diligence, Deposits Bank should review public resources for information about the consultant. Convictions, scandals, service in public office – information about all of these can be found in newspapers, magazines, and on the Internet. The consultant might not admit any such things to Deposits Bank in its written or verbal answers, but cannot hide such things if they are public information.

Deposits Bank should also consider retaining an investigator that specializes in performing FCPA due

[18] Grease payments are discussed later under Facilitation Payment Concerns.

diligence. Several companies have developed a profitable expertise in investigating potential business partners for FCPA compliance issues in other countries. Services they provide can range from the simple, such as merely checking lists to see if any individuals have governmental affiliations, to the in-depth, such as a full-scale investigation. These investigative companies use their understanding of non-U.S. markets, their knowledge of various countries' information databases, and their awareness of FCPA issues to provide an extra level of fact-checking to companies such as Deposits Bank. It is not enough to simply rely on the consultant's own answers to questions and Deposits Bank's limited understanding of how to check public information about the consultant. The DOJ will expect Deposits Bank to verify its due diligence through independent sources as well. This is another reason it may be a good idea for Deposits Bank to rely on an investigative company's expertise.

Deposits Bank should maintain a complete record of the information it obtains about the consultant in the course of its due diligence. If an investigation by the DOJ or SEC were to occur, it would benefit Deposits Bank to be able to demonstrate that it was very meticulous in its due diligence and that it made a serious effort to confirm that the consultant was law-abiding before it was retained. The DOJ and SEC frown upon the failure to have sufficient written evidence of proper due diligence.[19]

The Contract

Let's assume that Deposits Bank is satisfied with the results of its due diligence on the consultant and has decided to proceed with retaining the consultant. Thanks to the advice of its counsel and compliance officer, Deposits Bank knows that it needs to continue assuring itself throughout the engagement that the consultant is complying with the FCPA. How can it do that?

The best method for Deposits Bank to ensure the consultant's continued compliance with the FCPA is through the written contract Deposits Bank uses to retain the consultant. The contract should contain, among other things:

- representations and warranties by the consultant that affirm its awareness of the FCPA, its past and present compliance with the FCPA, and facts establishing that the consultant itself is not a foreign official;
- the consultant's obligations in the event it discovers a potential violation of the FCPA (which should include providing immediate notice to Deposits Bank);
- the right of Deposits Bank to audit the books and records of the consultant at any time, so Deposits Bank can ensure the propriety of payments by the consultant;
- the right of Deposits Bank to withhold payments to the consultant and to terminate the contract upon a violation of any of the FCPA-related provisions in the contract; and
- an indemnity by the consultant in the event of a violation by the consultant of the FCPA.

The consultant has demonstrated an acceptable understanding of the FCPA and local anti-bribery laws in Overseasia – Deposits Bank would not retain it otherwise – but Deposits Bank can insist in the contract that the consultant maintain its current amount of internal training or even specify ways that the training should be increased. Deposits Bank can even require in the contract that Deposits Bank's own compliance team be permitted to provide mandatory training to the consultant's personnel.

Even if Deposits Bank does not believe that additional training is necessary, the consultant's contract should still contain representations and warranties that the consultant has read and understands the FCPA. Further, the contract should require the consultant to execute and deliver a certification to Deposits Bank every year to the effect that the consultant has not made or authorized any unlawful payments to induce a foreign official to act, or omit to act, in violation of applicable law, or to obtain or retain business for Deposits Bank. The exact language of the certification should be detailed and track the language of the statute, complete with statutory definitions. By having the certification track the language of the statute, Deposits Bank will have further documentary proof that it is attempting to

[19] DOJ Opinion Releases 08-02, June 13, 2008, and 08-01, January 15, 2008; *U.S. v. Latin Node, Inc.*, No.1:09-CR-2039 (S.D. Fla. 2009). In the absence of a significant amount of case law, DOJ Opinion Releases provide guidance concerning the DOJ's FCPA enforcement intentions regarding conduct described by the requesting party. If the requestor receives an Opinion Release wherein the DOJ states that it believes the proposed conduct conforms to current DOJ FCPA enforcement policy and the DOJ nevertheless brings an enforcement action, the company is entitled to a rebuttable presumption that it complied with the FCPA. An Opinion Release does not have any binding application to anyone other than the requestor.

require full compliance by the consultant with the FCPA, and the detailed language in the certification will also serve as a further reminder to the consultant of the exact prohibitions of the FCPA, not to mention Deposits Bank's insistence on compliance with the provisions of the FCPA.

The certification should also contain language re-affirming the accuracy of the consultant's FCPA-related representations and warranties and its compliance with the FCPA-related covenants set forth in the contract. Further, the certification should contain an acknowledgement that the consultant has received, reviewed and understood, and agrees to comply with, Deposits Bank's code of conduct and/or related policies and procedures pertaining to anti-corruption. By having such language in the certification, the consultant would be estopped from claiming later that Deposits Bank never provided a copy of its code of conduct or policies and procedures.

If the consultant does not execute and deliver the certification when required, the contract should permit Deposits Bank to terminate the contract. Further, if the contract otherwise provides for automatic extensions after the initial term, the contract should provide that it shall not be renewed if the consultant has not executed and delivered the certification when required.

Unusual Payment Obligations

But what if the consultant does not want to enter into a typical contract and instead insists that the parties enter into a "Deed of Facilitation" pursuant to which Deposits Bank would be required to wire the consultant's fee to a Gibraltar bank account in the name of the consultant's affiliate? After Deposits Bank manages to turn off the alarm bells ringing in its collective consciousness, it should explain to the consultant that Deposits Bank will not retain the consultant if the two parties are not able to enter into a written contract containing the FCPA-related provisions described above. If the consultant refuses to enter into such a contract, Deposits Bank should terminate discussions with the consultant because such refusal by the consultant would be a huge red flag, signaling an inability or unwillingness by the consultant to comply with the FCPA.

If the consultant's request that the parties enter into an unusual contract was not enough to trigger alarm bells for Deposits Bank, its request that payment be made to a different jurisdiction in the name of a different person should have done it. The use of third parties with no contractual relationship with Deposits Bank to receive fees and payments in unrelated jurisdictions suggest an intent by the consultant to conceal payments. This opens a whole new can of worms. Just as Deposits Bank should not enter into a relationship with the consultant without a contract containing the necessary FCPA-related provisions, it should not make payments to any person or entity other than the consultant itself. Who knows what kind of scheme Deposits Bank would be getting mixed up in if it were to agree to such an unusual arrangement – does money laundering sound familiar?

Further, by participating in such an arrangement, Deposits Bank would not be able to complete the paper trail that demonstrates its full compliance with applicable law. It would have documentary evidence regarding thorough due diligence and a written contract ensuring the consultant's compliance with the FCPA, but the trail would stop there as there would be no adequate basis for payments to the affiliate, no reasonable purpose for inserting the affiliate into the relationship between Deposits Bank and the consultant, and no assurance that the payments to this unknown third person would not be used to evade laws applicable to the consultant. Of course, there are practical implications as well, such as the consultant not having the funds necessary to meet its indemnification obligations should they be triggered.

Deposits Bank should insist that payments be made directly to the consultant. That is the only way to ensure that such payments are tied to the contract and comply with applicable law.

ISSUES REGARDING A FOREIGN OFFICIAL'S TRAVEL REQUESTS

Deposits Bank must consider whether it would be offering or promising anything of value to the Superintendent if it granted any of his requests. Some of the requests might violate the FCPA, but others might fall within one or more of the FCPA's affirmative defenses and, thus, be permissible.[20] A careful analysis is required because Deposits Bank knows that U.S. enforcement authorities frequently consider travel and entertainment expenses as the underlying things of value when bringing FCPA enforcement actions.[21] Moreover,

[20] If charged with violating the FCPA and the defendant desired to plead an affirmative defense, the defendant would be required to demonstrate in the first instance that the payment met the requirements of the affirmative defense. The DOJ would not bear the burden of demonstrating in the first instance that the payment did not constitute a payment permissible under the affirmative defense.

[21] *See*, *e.g.*, *U.S. v. Control Components, Inc.*, No. 09-00162 (C.D. Ca. 2009). In the CCI matter, public documents indicate that

improper recording of travel and entertainment expenses in the books and records of a publicly traded company, such as Deposits Bank, has been the basis for several FCPA enforcement actions.[22]

The next question is whether the Superintendent of Banks of Overseasia is a foreign official. The FCPA defines foreign official in part as "any officer or employee of a foreign government or any department, agency, or instrumentality thereof."[23] There seems to be no doubt but that the Superintendent falls squarely within the FCPA's definition of foreign official.

Next, Deposits Bank needs to analyze if the DOJ would find Deposits Bank was acting with corrupt intent if it meets all the Superintendent's travel demands. FCPA legislative history indicates that Congress considered "corruptly" to mean "to induce the recipient to misuse his official position" and that it "connotes an evil motive or purpose" indicating "an intent or desire to wrongfully influence the recipient."[24] The Eighth Circuit has similarly defined "corrupt intent" to mean "if done voluntarily and intentionally, and with a bad purpose of accomplishing either an unlawful end or result or a lawful end or result by some unlawful method or means."[25]

The enforcement agencies could impute corrupt intent to Deposits Bank if it grants all of the Superintendant's requests because many of his requests bear no relationship to the business nature of the planned meetings. Granting certain of his requests could be interpreted as giving something of value to a foreign official to influence the Superintendent's actions to approve Deposits Bank's merger and license application. If Deposits Bank is viewed by the DOJ as buying the Superintendent's influence, it would be securing an improper advantage through corrupt actions.[26]

Luckily for Deposits Bank, the FCPA provides an affirmative defense for bona fide business expenditures paid to foreign officials if the payments are directly related to "the promotion, demonstration, or explanation of products or services."[27] Deposits Bank must therefore evaluate the business necessity and reasonableness of its proposed meetings in Palm Beach and consider each of the Superintendent's travel requests within the context of this affirmative defense. The business purpose of the trip is to enable Deposits Bank to provide the Superintendent a tour of its headquarters and, while doing so, provide a location for meetings where Deposits Bank's executives and management can make presentations to the Superintendent regarding Deposits Bank's various products and services.

Let us now address each request of the Superintendent under this affirmative defense analysis.

Reservation No. 1: First Class and The Ritz

The Superintendent requested that he travel first class and stay at the Ritz. Deposits Bank's written travel policy allows most senior executives to upgrade to business class on trips where the total travel time exceeds eight hours. The trip from Overseasia to Palm Beach is 12 hours of flight time. Deposits Bank decides it can offer the Superintendent business class, but not

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CCI provided lavish travel and entertainment to holiday destinations under the guise of "training or inspection trips." Criminal Information at p. 8. CCI pled guilty to a three-count criminal information that charged two counts of violating the anti-bribery provisions of the FCPA and one count of conspiracy to violate the FCPA and Travel Act. Plea Agreement at p. 2. CCI was required to pay a criminal fine of $18.2 million; create, implement, and maintain a comprehensive anti-bribery compliance program; retain an independent compliance monitor for three years; serve three years of organizational probation; and continue to cooperate with the DOJ's ongoing investigation. DOJ Press Release *available at* www.justice.gov.

[22] *See, e.g., SEC v. Avery Dennison Corp.*, No. 1:09-cv-5493 (C.D. Cal. 2009). In *Avery Dennison*, the Reflective Division of Avery (China) Co. Ltd., a wholly owned subsidiary of Avery Dennison, provided sightseeing trips to Chinese government officials and failed to accurately record these expenses. The SEC filed a settled civil action against Avery Dennison alleging that it failed to properly record these payments and that Avery Dennison failed to devise and maintain internal controls sufficient to detect and prevent such illegal payments. Complaint at p. 2. In a related administrative proceeding, the SEC ordered Avery Dennison to cease and desist from further violations of the FCPA's books and records and internal controls requirements. *In re Avery Dennison Corp.*, SEC Administrative Proceeding, File No. 3-13564 (July 28, 2009). Avery Dennison will pay $518,470 to resolve the SEC's civil and administrative enforcement actions.

[23] 15 U.S.C. § 78dd-1(f)(1).

[24] H.R. Report 95-640 (1977), at 8; S. Report 95-114 (1977), at 10.

[25] *See U.S. v. Liebo*, 923 F. 2d 1308 (8th cir. 1991).

[26] 15 U.S.C. § 78dd-1(a)(1).

[27] 15 U.S.C. § 78dd-1(c)(2)(A).

first class airfare, and be in compliance with its own written travel policies.

However, Deposits Bank may be able to fly the Superintendent first class under the second affirmative defense in the FCPA, if Deposits Bank wants to try to accommodate this request. A payment to a foreign official that might violate the FCPA could be permissible if Deposits Bank can show there is written law or regulation in Overseasia that requires first class travel for its Superintendent of Banks when he flies a long distance on official business.

This second affirmative defense under the FCPA expressly provides that a payment, gift, offer, or promise of anything of value made pursuant to the written laws and regulations of the foreign official's country is lawful.[28] When Congress amended the FCPA in 1988, adding this affirmative defense, it expressly noted that it wished "to make clear that the absence of written laws in a foreign official's country [expressly prohibiting such payment] would not by itself be sufficient to satisfy" the affirmative defense.[29]

Deposits Bank retains local legal counsel in Overseasia to research this issue. Overseasia counsel informs Deposits Bank's counsel there is a written law in Overseasia requiring the Banking Superintendent to travel first class whenever he flies on official business where the flight lasts more than eight hours. Deposits Bank requests local counsel in Overseasia to prepare a written legal opinion to this effect and attach the applicable law or regulation. With this in hand, Deposits Bank can upgrade the Superintendent's airfare to first class and maintain compliance with the FCPA.

The Superintendent requested to stay at the Ritz. Deposits Bank's travel policy provides that its executives must stay at three-star hotels whenever possible when traveling on company business. The Ritz is a five-star hotel. Three-star hotels are available in Palm Beach during the dates the Superintendent will be attending the business meetings, so Deposits Bank should direct its travel department to make the reservation at a three-star hotel, consistent with Deposits Bank's written travel policy. If Deposits Bank were to pay for a five-star hotel for the Superintendent, that could be considered a violation of the FCPA.

Reservation No. 2: Hotel-associated Costs

The Superintendent's request that Deposits Bank cover all his costs associated with his hotel stay is the type of request that makes interpreting the bona fide business expenditure affirmative defense an art and not a science. Some of these expenses legitimately may be covered under the business expenditure affirmative defense if they are related to the business purpose of the trip. Expenses such as business center and telephone charges may fall within the ambit of this affirmative defense if they are necessary to the Superintendent's duties as they relate to his meetings with Deposits Bank, and if these costs are reasonable. Deposits Bank's written travel policy expressly allows for its company officials to bill the company for these types of expenses, provided back-up receipts are provided. Conversely, Deposits Bank's travel policy does not cover reimbursement for travel expenses of a personal nature, such as mini-bar consumption charges, personal telephone calls, or spa treatments.

Deposits Bank must respectfully decline to accommodate the Superintendent's requests that it pay for the Superintendent's mini-bar, personal phone calls, and spa usage fees. These expenses do not fall within the affirmative defense as they are unnecessary and unrelated to the business purpose of the Superintendent's trip.

Reservation No. 3: A Stipend

Deposits Bank should not accommodate the Superintendent's request for a stipend. Generally, when entities pay for a foreign official's reasonable meals, travel, and lodging expenses connected to such a business trip, a stipend is unnecessary and deemed excessive.[30] Further, Deposits Bank should pay all service providers directly, which has the effect of further reducing the necessity of a stipend. The Superintendent will not incur many, if any, out-of-pocket expenses because Deposits Bank will cover his travel, food, and lodging. In the event that the Superintendent does incur any unanticipated expenses, such as taxi fare, he may, in accordance with Deposits Bank's written travel

[28] 15 U.S.C. § 78dd-1(c)(1).

[29] *See* House Conference Report No. 100-576 (1988), at 922.

[30] In a couple instances, the DOJ has stated that it would not bring an enforcement action against U.S. persons if such persons were to provide stipends to certain foreign officials, but in those situations the U.S. persons did not indicate that they would provide all meals and pay for all necessary travel expenses of the foreign officials, such as Deposits Bank has been asked to do here. *See, e.g.,* DOJ Opinion Releases 08-03, July 11, 2003 (the requestor represented that it would provide stipends to cover meals and local transportation of journalists attending a press event highlighting a new service of the requestor) and 04-04, September 3, 2004 (the requestor represented it would provide a stipend and only occasionally pay for meals).

procedures, seek reimbursement from Deposits Bank by providing an appropriate receipt.[31]

Reservation No. 4: Green Fees

The Superintendent's request that Deposits Bank pay for golf green fees represents a gray area that may or may not be permissible depending on several factors – the number of rounds of golf, the cost, and the time involved. The FCPA, when read in absolute terms, appears to forbid the payment of such green fees. However, practitioners, and even the DOJ, opine that the FCPA should not be read in absolute terms, that some reasonable entertainment is permissible, particularly when it is in conjunction with legitimate business.[32]

Deposits Bank decides that it will break up one of the days of business meetings with an afternoon round of golf. This is probably permissible under the FCPA. Deposits Bank should instruct its executives who will be golfing with the Superintendent to turn in a detailed expense report for the golf outing, with appropriate receipts for food and beverage items, clubs, cart, etc., and the names and titles of all attendees. The key point to remember is that the main purpose of the trip to the United States must be for business. The Superintendent may not be invited to the United States to play golf for several days, with only a short business meeting squeezed in between holes.

Reservation No. 5: Kennedy Space Center

A similar analysis should be applied to the Superintendent's request for a tour of the Kennedy Space Center. The Kennedy Space Center is located approximately three hours by car from Deposits Bank's Palm Beach headquarters. The approximate six-hour round trip, and standard three-hour tour, would consume an entire day. The use of an entire day, particularly if the business meeting itself lasts only one day, is probably not advisable. In addition, permitting the Superintendent's wife to accompany him would likely alter the context of the excursion, further removing it from a business-related side-trip to a tourist experience, with little to no business purpose.[33] A short tour of Palm Beach would be safer under the FCPA.[34]

Reservation No. 6: The Following Weekend

The Superintendent's request that Deposits Bank cover his costs for the weekend that follows the conclusion of the business meetings should be respectfully declined. Such expenses are unnecessary and unrelated to any business purpose. If the Superintendent desires to stay through the weekend, he must do so at his own expense.

Reservation No. 7: The Wife

The Superintendent's request that Deposits Bank cover the expenses for him to bring his wife along on the trip should be respectfully declined. The wife may accompany her husband on this trip—but at the Superintendent's expense. No foreign official's wife, significant other, family member, or friend may be recompensed for their expenses by Deposits Bank if they accompany the Superintendent on this trip. Deposits

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[31] *See, e.g.,* DOJ Opinion Release 07-02, September 11, 2007. In Opinion Release 07-02 the requestor represented that it would reimburse the foreign official a modest amount of daily expenses upon presentation of a written receipt. The DOJ stated that it did not intend to bring an enforcement action against the requestor based on this (and other) representation(s).

[32] *See, e.g.,* DOJ Opinion Releases 83-02, July 26, 1983; 83-03, July 26, 1983; 82-01, January 27, 1982. In Opinion Release 83-02 the requestor represented that it intended to pay for the entertainment, meals, and travel costs associated with a foreign official's visit of facilities operated by the requestor and its parent company. The requestor represented that "the amount expended will not exceed $5,000."

[33] In 2007, the DOJ and SEC resolved enforcement actions brought against Lucent Technologies Inc. concerning a long-running travel boondoggle for senior Chinese government officials that Lucent sponsored and improperly recorded in the company's books and records. According to public records, from at least 2000-2003, Lucent paid for more than 1,000 Chinese government officials to visit the United States. All totaled, Lucent spent more than $10 million on these officials' trips. Public records further indicate that trips were often primarily, and sometimes wholly, for sight-seeing and not for business purposes, and that the destinations included Disneyland, Niagara Falls, the Grand Canyon, and Universal Studios. *SEC v. Lucent Techs. Inc.,* No. 07-cv-02301 (D.D.C. 2007). The DOJ enforcement action was resolved in a non-prosecution agreement. Press Release, DOJ (Dec. 21, 2007), http://www.justice.gov.

[34] In Opinion Release 07-02, September 11, 2007, the DOJ stated that it would not bring an enforcement action against the requestor who represented that it intended to provide "a modest four-hour sightseeing tour" to several foreign officials it would host as part of an educational program. In Opinion Release 81-01, November 25, 1981, the DOJ stated that it did not intend to bring an enforcement action against the requestor when the requestor represented that it would entertain foreign government officials and that the entertainment would not violate the laws of the officials' country and would be "commensurate with the legitimate and generally accepted local custom."

Bank would have no legitimate business purpose in paying for them.

All of the embarrassment of having to decline many of the Superintendent's requests and place restrictions and conditions on others could have been avoided. Deposits Bank should have sent a formal, written invitation to the Overseasia Superintendent of Banks, describing the business purpose of the meetings, with an agenda, the topics to be discussed, and the names of the presenters. Deposits Bank should have addressed the letter to the Superintendent and left the decision of who from the Superintendent's office should attend for the Superintendent to decide.[35] The Superintendent appointing himself as the attendee does not necessarily present FCPA exposure in and of itself.[36]

Attached to the formal letter of invitation should have been a list of expenses Deposits Bank would cover and those it would not. In this way, the conditions and restrictions of travel would have been clear from the beginning and Deposits Bank would have saved itself from the uncomfortable position of having to decline some of the Superintendent's requests.

ISSUES EMERGING FROM FINANCIAL DUE DILIGENCE

Deposits Bank's financial due diligence of the Overseasia Bank uncovered red flags that merit further inquiry. Specifically, due diligence unearthed unusually high expenditures for gifts and entertainment to Overseasia government officials. In addition, some small, regular, monthly payments have been made to a low-level, administrative non-U.S. government official. FCPA enforcement actions have frequently featured gifts and entertainment expenses as violations.[37] In addition, so-called "grease," or facilitation, payments made to administrative government officials also have come under the government's FCPA enforcement radar. The apparent abuse of seemingly lawful facilitation payments has figured prominently in recent enforcement actions.[38]

After learning of the red flags pertaining to gifts and entertainment expenses and facilitation payments, Deposits Bank must not turn a blind eye to such things. Although failure to conduct adequate due diligence is not enough to charge Deposits Bank with knowledge of FCPA violations, taking active steps to avoid the acquisition of knowledge once concerns have been raised *is* enough:

> [K]nowledge may be established if a person is aware of a high probability of its existence and consciously and intentionally avoided confirming that fact. Knowledge may be proven in this manner if, but only if, the person suspects the fact, realized its high probability, *but* refrained from obtaining the final confirmation because he wanted to be able to deny knowledge. On the other hand, knowledge is not established in this manner if the person merely failed to learn the fact through negligence or if the person actually believed that the transaction was legal.[39]

Once Deposits Bank has reason to believe that Overseasia Bank's actions may violate the FCPA, Deposits Bank should investigate these actions further. Deposits Bank may not intentionally avoid information pertinent to such potentially violative actions and later successfully claim ignorance. In a recent high-profile FCPA case, defendant Frederic Bourke, of Dooney & Bourke handbag fame, put forth a defense based on his lack knowledge about the bribes that his joint venture partner, Victor Kozeny, made to foreign officials in Azerbaijan. The defense failed because Bourke was found to have *intentionally* avoided gaining such

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[35] In several DOJ Opinion Releases, the DOJ informed the requesting parties that it did not intend to bring an enforcement action when representations were made by a requesting party that, among other things, the requesting party would not select the government officials who would visit the requestor's facility, even if the foreign officials selected by their government had the authority to issue the licenses and permits necessary for a project the requestor sought to undertake in the other country. *See, e.g.,* Opinion Release 07-01, July 24, 2007, and 85-01, July 16, 1985.

[36] In Opinion Release 85-01, the DOJ advised that it did not intend to bring an enforcement action against the requestor when the requestor represented to the DOJ that senior government officials responsible for issuing licenses and permits necessary for the requestor to undertake its desired project were invited to travel to two locations in the United States to meet with the requestor and to tour a plant belonging to the requestor. ("ARCO intends to invite officials of the French Government Ministry responsible for that Nation's industrial finance and development programs and for the issuance of permits and licenses necessary for the Fos-sur-mer project…. Based on all the facts and circumstances, as represented by the requestor, the Department does not presently intend to take an enforcement action with respect to any of the prospective conduct described in this request.")

[37] *See infra* note 41.

[38] *See infra* note 49.

[39] *United States v. Kozeny and Bourke*, 2009 U.S. Dist. LEXIS 95,233 (S.D.N.Y. Oct 13, 2009), at *52 (emphasis in original).

knowledge. The court found that "Bourke – rather than merely failing to conduct due diligence – had serious concerns that Kozeny was engaging in questionable practices but nevertheless took steps to avoid learning about those practices by declining to join the board of [the joint venture company]."[40] Thus, once Deposits Bank learns that Overseasia Bank has engaged in questionable practices, Deposits Bank should conduct further due diligence into such practices to determine whether they violate the FCPA and then, based on such determination, decide what course of action it should take with respect to the potential acquisition.

Gift and Entertainment Concerns

U.S. authorities often consider gifts and entertainment to be something of value given to a foreign official with corrupt intent for the purpose of influencing the recipient's acts or decisions, or to assist the gift-giver or entertainment provider in securing an improper advantage or otherwise obtaining or retaining business or directing business to someone. While big ticket gifts or entertainment expenditures should be an obvious concern, lately the DOJ has brought FCPA enforcement actions where gifts to individual foreign officials were modestly valued.[41]

The follow-up due diligence must ascertain which foreign officials received gifts and whether these officials have any influence over whether Deposits Bank's acquisition of Overseasia Bank is approved. How frequently are these gifts received? What is the value of the gifts, and what are the circumstances under which the gifts are being given? Some gift-giving is permissible. However, reasonable limitations should control the scale of gift-giving to foreign officials. For example, it may be reasonable to give a gift of relatively little value (such as a company-logoed coffee mug) one time on a special occasion (such as a holiday) to an official before whom Deposits Bank has no pending business. Some companies have a policy setting a gift value to foreign officials of no more than $25. Some companies forbid all gifts of any kind to foreign officials.

Another red flag is the discovery that Overseasia Bank has been paying its third-party consultant for an all-expenses-paid, three-day golfing weekend for each of the past three years. What criteria led the Overseasia Bank to repeatedly award the golf weekend to the consultant? Did the consultant take government officials along? Where are the consultant's expense reports? Some criteria, such as "highest-dollar volume of government sales," would be of greater concern in evaluating the potentially corrupt purpose, than criteria such as "longest consultant tenure." Additional due diligence is needed to more fully understand the rationale for awarding the golfing weekends to the consultant.

In the event that Overseasia Bank's consultant is sharing these benefits or passing them on to Overseasia government officials, corrupt intent may be present. It must be determined if the consultant was acting as an agent of Overseasia Bank at the time he may have shared or transferred his all-expenses-paid golfing weekends benefits. Agents can bind their corporate entities for which they act. The DOJ has brought several actions based on the conduct of consultants and other third-party agents.[42] If Deposits Bank acquires Overseasia Bank, it

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[40] *Id.,* at *50-51.

[41] The Avery Dennison enforcement actions highlighted the fact that even relatively insignificant gifts incorrectly recorded in the company's books and records violate the FCPA. One series of gifts in the Avery Dennison matter concerned four pairs of shoes purchased by an employee of an Avery Dennison Chinese subsidiary. The employee gave one pair of shoes to each of four Chinese government officials. Collectively, the shoes had a total value of $500. *See SEC v. Avery Dennison Corp.* and *In re Avery Dennison Corp.*, *supra* note 22.

[42] Recently, Kellogg Brown & Root LLC ("KBR") pled guilty to one count of conspiring to violate the FCPA's anti-bribery provisions and to four counts of violating the FCPA's anti-bribery provisions related to the payments of $182 million in "consulting fees" to two "cultural advisors" used to make the bribe payments to government officials. KBR admitted that prior to the award of multiple contracts, its former CEO, Albert Stanley, and others met with senior executives in the Nigerian government to request the office holders to designate representatives with whom the joint venture ("JV"), of which KBR was a member, should negotiate government officials' bribes. Stanley and others negotiated bribes with the representatives and agreed to hire two consultants to pay the bribes. The JV paid approximately $132 million to a British consultant that used a Gibraltar corporation to enter into agency contracts with and receive payments from the JV. The JV also paid more than $50 million to a consulting company based in Japan. KBR admitted that it intended for these monies to be used, at least in part, for Nigerian government officials' bribes.

The SEC's complaint charged KBR, Inc., KBR's parent company, with violating the FCPA's anti-bribery, books and records, and internal controls provisions, as well as aiding and abetting Halliburton's (its former parent company) violations of the books and records and internal controls provisions.

The SEC's complaint charged KBR's former parent company, Halliburton, with books and records and internal controls violations of the FCPA. Specifically, the complaint alleged that Halliburton failed to devise adequate internal controls

likely will be acquiring Overseasia Bank's liabilities, and inheriting FCPA third-party liabilities can be devastating.

Facilitation Payment Concerns

Along with gift and entertainment expenses discussed above, the financial due diligence also uncovered small, but regular, monthly payments to a low-level Overseasia administrative government official. These expenditures may be problematic because payments do not need to be material to result in a violation of the FCPA's anti-bribery provisions.[43] In addition, the definition of a foreign official broadly encompasses many government employees, even those at the lower administrative levels. Consequently, this low-level official will be considered a foreign official under the FCPA's definition.[44]

In order to more fully evaluate these payments, Deposits Bank's auditors will need to review the frequency and purpose of the payments. It is one thing to pay a low-level administrative government official a small amount of money to get the mail delivered or the electricity turned on. It is another thing to pay this same official this small amount of money every week, year after year.

These facilitation payments, or grease payments as they are more commonly called, in order not to violate the anti-bribery provisions of the FCPA must be paid only to facilitate, expedite, or secure the performance of a routine governmental action by a foreign official.[45] This is why facilitation payments are considered exceptions to the FCPA anti-bribery provisions. Facilitation payments, if made, must be made only to ensure or expedite the performance of a non-discretionary act that an official is obligated to perform. Only then may such payments qualify for an exception under the FCPA.[46]

The FCPA also expressly states that routine action "does not include any decision by a foreign official whether, or on what terms, to award new business to or to continue business with a particular party, or any action taken by a foreign official involved in the decision-making process to encourage a decision to award new business to or continue business with a particular party."[47]

Determining whether a payment is a facilitation payment is often a highly fact- and circumstance-specific analysis. This is a very gray area of the law. Many companies have eliminated facilitation payments from their FCPA policies entirely because such payments pose too much risk and often constitute bribes under the law of the country in question. In December 2009, the Organisation for Economic Co-operation and Development urged its 38 member countries to encourage companies to discourage the use of facilitation payments. As one FCPA scholar noted, "What may be perceived as a facilitating payment under one set of circumstances may not be similarly perceived under another set of circumstances."[48]

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relating to foreign sales agents and the FCPA, and failed to enforce the internal controls that it had. As a result, Halliburton failed to detect, deter, or prevent violations by its subsidiaries. The SEC represented that numerous books and records of Halliburton and subsidiaries possessed false information relating to bribe payments made by foreign agents. *See U.S. v. Kellogg Brown & Root LLC*, No. 4:09-cr-00071 (S.D. Tex. 2009); *U.S. v. Stanley*, No. 08-cr-597 (S.D. Tex. 2008); *SEC v. Halliburton Co. and KBR, Inc.*, No. 4:09-cv-00399 (S.D. Tex. 2009); and *SEC v. Stanley*, No. 08-cr-697 (S.D. Tex. 2008).

[43] Unlike other instances in securities law, materiality is not an issue when considering the FCPA. Payments of any value may violate the FCPA's anti-bribery provisions. In addition, as discussed below, payments of any size may also violate the books and records and internal controls provisions of the FCPA.

[44] As discussed above, U.S. enforcement authorities aggressively and liberally interpret the definition of foreign official. In apparent contradiction to the posture taken by U.S. enforcement agencies, legislative history concerning the facilitation payment exception expressly indicates that Congress intended to exclude from the definition of foreign official any "government employees whose duties are essentially ministerial or clerical." *See* H.R. Report 95-640 (1977), at 8.

[45] 15 U.S.C. § 78dd-1(b).

[46] With respect to facilitation payments, a House of Representatives committee, when considering the FCPA as a bill, wrote:

> While payments made to assure or to speed the proper performance of a foreign official's duties may be reprehensible in the United States, the committee recognizes that they are not necessarily so viewed elsewhere in the world and that it is not feasible for the United States to attempt unilaterally to eradicate all such payments. As a result, the committee has not attempted to reach such payments.

See H.R. Report 95-640 (1977), at 8.

[47] 15 U.S.C. § 78dd-1(f)(3)(B).

[48] STUART J. DEMMING, THE FOREIGN CORRUPT PRACTICES ACT AND THE NEW INTERNATIONAL NORMS 16 (2005).

One must also consider the facts and circumstances surrounding the payments in the aggregate.[49] What may be a permissible facilitation payment when made infrequently, may, if made regularly over time to the same individual, give rise to the inference of a corrupt and prosecutable payment.[50]

ACCOUNTING CONCERNS

The initial due diligence also identified possible FCPA accounting concerns. As well as being subject to FCPA's anti-bribery provisions, Deposits Bank is also subject to the FCPA's accounting provisions.[51] These provisions require that securities issuers maintain books and records that reasonably reflect the transactions of the corporation, and design and maintain internal controls reasonably sufficient to assure, *inter alia*, that the issuer's assets are used for proper corporate purposes.[52]

Books and Records

Specifically, the books and records provisions require that issuers such as Deposits Bank "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.[53] Regardless of whether the expenditures uncovered in the initial due diligence phase discussed above amount to violations of the FCPA's anti-bribery provisions, a recording of these expenditures in the company's books and records in a manner that fails to provide "reasonable detail" could violate the FCPA. The FCPA defines "reasonable detail" as "such level of detail… as would satisfy prudent officials in the conduct of their own affairs."[54]

The books and records – and all payments expressed therein – should be prepared in accordance with accepted accounting standards and designed to prevent illicit or illegal off-books transactions.[55] It is also important to note that the books and records provisions apply to *all* expenditures, not just those that would be material in traditional accounting parlance or securities law. Several recent FCPA enforcement actions have arisen out of relatively insignificant expenditures that were improperly recorded in companies' books and records.[56]

The expenditures to these foreign officials and consultants have been recorded by Overseasia Bank as "miscellaneous" expenditures. This raises concerns and warrants further investigation to determine whether the payments were recorded in accordance with the FCPA's books and records requirements. Generally, gifts, entertainment, and possible facilitation payments should be set out in separate line items.[57] Separating out such expenses from other line items provides greater transparency to the company's books and records. And the greater the transparency a company's books and records possess, the less likely the payments will be perceived as suspect.

However, if the expenses were relatively small and did not have a relationship to a particular company function, their inclusion in a miscellaneous category may

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[49] The recent Westinghouse Air Brake Technologies Corporation ("Wabtec") enforcement action exemplifies the difficulty in determining whether a payment is a facilitation payment. The DOJ and SEC brought enforcement actions against Wabtec because Pioneer Friction Limited ("Pioneer"), a Wabtec subsidiary, made small payments to government officials, in part to ensure that required inspections would be scheduled and take place and that product delivery certificates would be issued. These payments to obtain routine governmental action arguably fell within the facilitation payment exception. The payments, however, were improperly recorded and Wabtec failed to maintain an effective internal controls system to prevent such payments. Wabtec entered into a three-year, non-prosecution agreement to resolve the DOJ matter. Wabtec also consented to the SEC's filing of settled civil action and, in an administrative proceeding, agreed to cease and desist from further violations of the FCPA. *SEC v. Westinghouse Air Brake Techs. Corp.,* No. 08-cv-706 (E.D. Pa. 2008); *SEC v. Westinghouse Air Brake Techs. Corp.,* SEC Administrative Proceeding File No. 3-12957 (Feb. 14, 2008).

[50] There appears to be a strong trend of companies moving away from permitting facilitation payments. In addition to the risk of possible prosecution under non-U.S. laws, which often do not permit facilitation payments, the current FCPA enforcement environment and the lack of judicial precedence or definitive DOJ guidance on facilitation payments has caused many companies to forbid their employees and agents from making such payments.

[51] 15 U.S.C. § 78m(b)(2)(A) and (B).

[52] *See* S. Report 95-114 (1977), at 8.

[53] 15 U.S.C. § 78m(b)(2)(A).

[54] 15 U.S.C. § 78m(b)(7).

[55] Demming, *supra* note 48, at 22.

[56] In the Wabtec enforcement matter, some of the incorrectly recorded payments were reportedly as small as $31.50/month. *See SEC v. Westinghouse Air Brake Techs. Corp., supra* note 49; *SEC v. Westinghouse Air Brake Techs. Corp.,* SEC Administrative Proceeding *supra* note 49. In the *Avery Dennison* matter some of the improperly recorded payments equaled $10/day. *SEC v. Avery Dennison Corp.* and *In re Avery Dennison Corp.*, *supra* note 22.

[57] Demming, *supra* note 48, at 23.

not be inappropriate.[58] The extent to which these payments were rolled up into larger line items is not necessarily improper as long as the manner in which such payments were incorporated into a larger line item is logical and not for the purpose of concealing questionable transactions.[59]

Further investigation of the gifts, "exorbitant" entertainment expenses by the consultant to Overseasia Bank, and possible facilitation payments, will be required before a determination can be made about whether these payments were recorded in a manner that violated the FCPA. The assistance of forensic accountants, preferably retained by Deposits Bank's outside legal counsel and acting under legal counsel's direction so as to maintain attorney-client privilege, may be needed to properly evaluate the reasonableness of the detail in the books and records.[60]

Internal Controls

The FCPA's internal controls provisions mandate that issuers maintain a system of internal controls that, taken as a whole, provide reasonable assurances that, *inter alia*, the transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or other applicable criteria.[61] Specifically, the statute requires that issuers:

> [D]evise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:
>
> (i) transactions are executed in accordance with management's general or specific authorization;
>
> (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;
>
> (iii) access to assets is permitted only in accordance with management's general or specific authorization; and
>
> (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[62]

The FCPA defines "reasonable assurance" as such level of "degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[63]

The engagement of forensic accountants by outside FCPA counsel under the attorney-client privilege will be necessary. It will be up to them to take the lead in evaluating whether the internal controls were adequate. As one FCPA scholar has noted, "When fraud or other abuses are involved, especially relating to financial transactions, the question will arise as to whether the internal controls were adequate. In such situations, it will be a rare case where internal controls will be found to be adequate."[64] Consistent with this scholar's comments are several recent FCPA enforcement actions where U.S. enforcement agencies alleged that issuers failed to devise or maintain sufficiently adequate internal controls.[65]

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[58] *Id*., at 24.

[59] *Id.*

[60] It is preferable for counsel to employ and direct the forensic accountants so that the accountants' work product and communications are protected under recognized legal privileges. In the absence of an applicable legal privilege, such information could be discoverable in later litigation.

[61] S. Report 95-114 (1977), at 7-8.

[62] 15 U.S.C. § 78m(b)(2)(B).

[63] *See supra* note 54.

[64] Demming, *supra* note 48, at 27.

[65] For example, in 2008, Siemens AG pled guilty to books and records and internal controls charges brought by the DOJ and consented to the SEC's filing of a complaint that charged anti-bribery, books and records, and internal control violations. At least 4,283 corrupt payments, totaling roughly $1.4 billion, were used to bribe officials in return for business in nearly a dozen countries around the world. An additional 1,185 payments to third parties, totaling approximately $391 million, were used, at least in part, for illicit purposes. These widespread and systematic payments were not recorded properly, and Siemens AG failed to devise and maintain an adequate system of internal controls to prevent such payments. Siemens AG allowed the concealment of the corrupt payments and the illegal conduct to flourish. *See U.S. v. Siemens Aktiengesellschaft*, No. 08-CR-367 (D.D.C. 2008) and *SEC v. Siemens Aktiengesellschaft*, No. 08-CV-02167 (D.D.C. 2008). For other examples, *see, e.g., SEC v. ITT Corporation*, 1:09-cv-00272 (D.D.C. 2009), *SEC v. Nature's Sunshine Products, Inc. et al.*, No. 2:09-0672 (D. Utah 2009), or *SEC v. Novo Nordisk A/S*, No. 1:09-cv-00862 (D.D.C. 2009).

Below are some of the factors considered when determining the adequacy of the internal controls:[66]

- whether the board of directors or an independent audit committee of the board of directors oversaw the design and maintenance of the internal controls;
- the existence and quality of written policies and procedures appropriate for the issuer;
- whether those policies and procedures were tested periodically and whether modifications were made to correct for deficiencies identified in the testing;
- whether management received reasonable assurances that the internal controls functioned as designed, either by direct observation, supervision, testing, or appropriate reports;
- whether the internal controls policies and procedures were taken seriously by officers and employees;
- the size of the issuer's operations; and
- the degree of centralization of the issuer's financial and operating management.

Potential Liabilities

Deposits Bank would acquire Overseasia Bank's liabilities in the acquisition. Recently, U.S. authorities have brought several enforcement actions based on the theory of successor liability.[67] In these enforcement actions, the government demonstrated that it will hold acquirers liable for the past acts of the target companies they acquire.[68] This aggressive posture places a greater emphasis on the need for acquirers to conduct robust pre-acquisition due diligence (and in some cases, additional due diligence after the acquisition) of their targets. The standard of what is acceptable FCPA due diligence has risen significantly over the last few years as a result of these successor liability enforcement actions and DOJ Opinion Releases addressing this issue.[69]

GOING FORWARD

If Deposits Bank proceeds with the acquisition, it should consider dramatically changing the way Overseasia Bank operates. Any conduct that may violate the FCPA should cease. In order to stop current violations, and to prevent future violations, Deposits Bank should implement an FCPA compliance program and train all of its employees, executives, officers, and third-party consultants on the relevant aspects of the FCPA. The compliance program, to be deemed effective, must be designed to prevent and detect criminal activity, and to promote an organizational culture that encourages ethical behavior and a commitment to lawful conduct. The compliance program must contain, at a minimum, the seven basic elements embodied in the U.S. Federal Sentencing Guidelines' Effective Compliance and Ethics Program.[70]

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[66] *See supra* note 61, at 8; *see also* Demming, *supra* note 48, at 26.

[67] For example, in 2009, Latin Node, Inc. pled guilty to one count of violating the FCPA's anti-bribery provisions. It appears that eLandia International, Inc., Latinode's new corporate parent, did not undertake any pre-acquisition due diligence and only discovered the illegal conduct during post-acquisition due diligence. Upon discovering the conduct, eLandia promptly conducted an internal investigation, reported the investigation's factual findings to the DOJ, cooperated fully with the DOJ in its investigation, and took remedial action including terminating senior Latinode management involved in or having knowledge of the violations. eLandia subsequently placed Latinode into liquidation and sued the former owners for breach of contract based on their representations that Latinode had not violated the FCPA. *See U.S. v. Latin Node, Inc.*, *supra* note 19, and *eLandia v. Granados and Retail Americas VoIP*, LLC, No. 08-37352 CA20 (Fla. Cir. Ct. 2008). For additional examples of enforcement actions involving mergers and acquisitions, *see SEC v. Avery Dennison Corp.*, *supra* note 22, *In re Avery Dennison Corp.*, *supra* note 22, and the related cases *U.S. v. Ott*, No. 07-cr-608 (D.N.J. 2007), *U.S. v. Young*, No. 07-cr-609

footnote continued from previous column…

(D.N.J. July 2007) and *U.S. v. Amoako*, No. 3:05-cr-01122 (D.N.J. 2006).

[68] Often the government and the defendant entity resolve the enforcement actions without litigating the underlying issues. For example, DOJ enforcement actions premised on theories of successor liability have resulted frequently in guilty pleas or deferred or non-prosecution agreements. In SEC-initiated matters, enforcement actions often are resolved by the filing of a consented to civil complaint. In neither the recent DOJ- nor SEC-initiated enforcement actions have issues of successor liability actually been litigated. Public records simply indicate that the theory is one on which the government proceeded and which the defendant did not contest. Whether the DOJ or SEC would be successful in litigating these theories remains to be tested.

[69] *See supra* note 67 for a discussion of recent FCPA enforcement actions arising out of mergers and acquisitions. *See also* DOJ Opinion Releases 08-02, June 13, 2008, and 08-01, January 15, 2008, detailing extensive proposed due diligence plans.

[70] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2007).

PURCHASE CONTRACT LANGUGE

Let's assume for the sake of this discussion that Deposits Bank has performed satisfactory due diligence. It has decided to proceed with the acquisition of Overseasia Bank. How can it further protect itself if it discovers FCPA violations post-closing? This is where the contract lawyers re-enter the picture to work alongside the FCPA lawyers.

Contract provisions that encompass FCPA representations and warranties are vital to an acquirer being able to protect itself should an FCPA violation rear its ugly head post-closing. Usually, in the merger and acquisition setting, the buyer is in a hurry to close the deal, the FCPA due diligence is on a short time leash, and all the buyer wants to know from its outside counsel and forensic auditors is whether they found anything that could be a deal stopper. Many buyers will instruct their outside counsel and auditors, "We are not asking you to find an FCPA violation; just assess the risk. Is there anything you have found that should make us walk away from this deal?"

Having handled numerous merger and acquisition FCPA due diligence examinations, the authors of this article know that prophylactic language in the contract that can protect the buyer post-closing is essential. In the appendix is some sample language Deposits Bank may want to incorporate into the acquisition agreement if it decides the rewards in buying Overseasia Bank outweigh the risks.

CONCLUSION

With some careful planning and the thoughtful advice from its advisors, Deposits Bank can avoid the FCPA-related problems that often befall companies making an acquisition in a corrupt foreign country. It has determined, among other things:

- how to conduct FCPA due diligence on and contract with a consultant who will safely assist with securing the proper licenses and dealing with government officials and regulators in Overseasia;
- how to conduct pre- and post-acquisition FCPA due diligence on Overseasia Bank, including how to analyze questionable facilitation payments, and gifts and entertainment expenses;
- how to host Overseasia's Superintendent of Banks and accommodate as many of his travel requests as possible without violating the FCPA;
- what types of FCPA-related provisions should be included in the acquisition agreement;
- how to start developing internal controls that will insulate the company from FCPA liability; and
- how to keep itself out of trouble with the FCPA going forward after it completes the acquisition of Overseasia Bank.

The DOJ and SEC have become very aggressive in the last few years, prosecuting companies and individuals at a record pace and obtaining record amounts of penalties. This prosecutorial zeal is expected to continue. Thus, it is important for every company and individual subject to the FCPA to understand its provisions and applications and comply with them. ■

APPENDIX

SAMPLE FCPA CONTRACT LANGUAGE

A. Compliance with Anti-Corruption Laws

1. Overseasia Bank represents and warrants that Overseasia Bank and its owners, officers, directors, employees, and agents thereof:

a. have complied and will comply with: (i) the provisions of the U.S. Foreign Corrupt Practices Act as if its foreign payments provisions were fully applicable to Overseasia Bank and such owners, officers, directors, employees, and agents, and (ii) the provisions of the anti-corruption laws of each jurisdiction in which Overseasia Bank or any agent of Overseasia Bank is conducting or has conducted business;

b. specifically, Overseasia Bank and/or its owners, officers, directors, employees, or agents have not paid, offered or promised to pay, or authorized or ratified the payment directly or indirectly, of any monies or anything of value to any national, provincial, municipal, or other government official or employee or any political party or candidate for political office for the purpose of influencing any act or decision of such official or of the government to obtain or retain business, or direct business to any person or to secure any other improper benefit or advantage (any such payment is a "Prohibited Payment"). For purposes of this provision, an "official or employee" includes any official or employee of any directly or indirectly government-owned or -controlled entity, and any officer or employee of a public international organization, as well as any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization. A Prohibited Payment does not include modest facilitating payments to low-level government employees for the purpose of expediting or securing a routine administrative action ordinarily performed by such employees, provided the recipient of such service or action is entitled to receive such service or action, and the payment is customary and appropriate in the jurisdiction where made; and

c. has made and kept books, records, and accounts that, in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of Overseasia Bank and has devised and maintained a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.