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Driving Business Advantage

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Both History and Recent Trends Indicate that Strong FCPA Enforcement Likely to Continue During Economic Downturn

History teaches us that corruption — and the perception of corruption — rises in times of economic hardship, and this lesson has not been lost on the SEC and the DOJ. Foreign Corrupt Practices Act ("FCPA") investigations and enforcement actions have been on the rise in recent months, continuing a trend that began in the mid-2000s. The government is applying the FCPA in broader contexts, is driving the fines and penalties imposed on violators to new heights, and is looking to prosecute and jail individuals for their roles in the violations. This heightened attention to the FCPA presents ongoing challenges for companies seeking to acquire businesses overseas, as inadequate due diligence can result in the inadvertent acquisition of the substantial costs associated with a future FCPA investigation, to say nothing of the acquisition of potential FCPA liability, and even the efforts to carry out appropriate due diligence can derail potential transactions.

The FCPA was enacted in 1977 to prevent and criminalize bribery of foreign officials. Specifically, the FCPA prohibits U.S. individuals, companies operating in the U.S. (and foreign subsidiaries they control), agents, and intermediaries from making payments to foreign officials in order to secure any favorable business treatment. The act also requires companies to keep accurate books and records, with the view that such transparency will prevent or deter improper payments from being made.

FCPA prosecutions were relatively rare in the first two decades of the act's existence, as the government seemed to make some accommodation to concerns that aggressive enforcement would put U.S. companies at a competitive disadvantage in a world marketplace where other countries did not play by the same rules. This attitude began to change substantially in this decade. In the wake of the passage of the Sarbanes-Oxley Act, widespread allegations of corruption in various international programs (most notably the Iraqi Oil-for-Food program), and with most industrialized countries having passed some form of anti-corruption law, FCPA prosecutions jumped over 200% between the first half of the 2000s and the latter half. There are currently well over 100 pending FCPA investigations.

Fines and Penalties; Disgorgement of Profits

The magnitude of FCPA-related fines and penalties has expanded to previously unheard-of proportions. December 2008 saw the largest fine in FCPA history: $450 million paid by Siemens AG, along with $350 million in disgorgement (on top of hundreds of millions paid to German authorities arising out of the same misconduct). February 2009 saw the

second-largest fine: $402 million paid by Kellogg Brown & Root LLC, along with $177 million in disgorgement paid by its parent companies.

- **Siemens, December 2008:** In what is the biggest allegation of pervasive corruption in the history of FCPA prosecution, Siemens was charged with making over $1.3 billion in illicit payments to government officials in exchange for contracts or other favorable business treatment that the government valued at over $800 million. The alleged bribes were to secure business constructing metro lines in Venezuela, constructing metro lines and signaling devices in China, building power plants in Israel, providing mobile telephone services in Bangladesh, developing a national identification card in Argentina, and various other projects in Vietnam, Russia, Nigeria, and Mexico. Most notably, Siemens AG and several of its subsidiaries were charged with paying kickbacks to Iraqi government officials to procure contracts under the U.N. Oil-for-Food program worth more than $80 million. Siemens agreed to pay $450 million in criminal fines to the DOJ and $350 million in disgorgement of profits to the SEC. In addition, Siemens paid approximately $855 million to German authorities to resolve the investigation there.

- **Kellogg Brown & Root LLC, February 2009:** Kellogg Brown & Root LLC was part of a joint venture to obtain and service contracts to build and expand natural gas facilities at Bonny Island in Nigeria. Over a ten-year period, the joint venture allegedly paid approximately $180 million in bribes to Nigerian government officials to secure four contracts representing over $6 billion of potential business. To conceal the bribes, the joint venture entered into sham agreements with consultants, who were in fact hired simply to facilitate the bribes. Kellogg Brown & Root LLC pleaded guilty to four counts of violating the anti-bribery provisions of the FCPA and agreed to pay a $402 million fine. Additionally, its parent companies paid $177 million in disgorgement of profits.

While these cases involved allegations of particularly pervasive corruption related to the awarding of exceptionally large contracts, the government continues to raise the bar on penalties across the board.

In addition, the government has recently begun to demand and obtain the disgorgement of contract-related profits from companies alleged to have violated only the "books-and-records" provisions of the FCPA. Recent examples of the government seeking disgorgement when charging only books-and-records violations include:

- **Halliburton and KBR Inc., February 2009:** Halliburton was the parent company of KBR, Inc., which itself was the parent company of Kellogg Brown & Root LLC. The SEC alleged that the internal controls of Halliburton failed to detect or prevent the Nigerian-project bribery described above, and that Halliburton records were falsified as a result of the bribery scheme. Halliburton allegedly conducted no due diligence on the agents used by its subsidiaries to facilitate these payments and failed to maintain adequate controls on the use of such agents by its subsidiaries. Halliburton and KBR, Inc. were charged only with violations of the books-and-records provisions of the FCPA. To settle the matter, Halliburton and KBR, Inc. jointly agreed to pay $177 million in disgorgement. As noted earlier, Kellogg Brown & Root LLC paid a $402 million criminal fine.

- **ITT Corporation, February 2009:** ITT Corporation, an engineering and manufacturing company, was charged with books-and-records violations after its wholly-owned Chinese subsidiary, Nanjing Goulds Pumps Ltd. ("NGP"), allegedly made approximately $200,000 in payments to Chinese government officials to influence them to purchase NGP water pumps for infrastructure projects in China. These payments were recorded as "commissions" on NGP's books, which (as NGP was ITT's subsidiary) were incorporated into ITT's SEC filings from 2001-2005. The NGP water pump transactions generated profits of over $1 million. ITT discovered and self-reported the violations, fully cooperated with the SEC's investigation, and instituted remedial measures and enhanced internal controls. In order to settle the matter, ITT agreed to disgorge profits of $1,041,112, together with $387,538 in interest, and to pay a $250,000 civil penalty.

The ever-increasing fines, penalties, and disgorgement orders are intended to eliminate the economic temptation to commit

an FCPA violation in order to obtain business overseas. Disgorgement of profits for violators of the anti-bribery provisions of the FCPA was itself a new trend only a few years ago, with the first ever FCPA-related disgorgement order occurring in 2004. Since 2004, the government has sought disgorgement in virtually every anti-bribery prosecution, and it now appears it will do the same for violators of the books-and-records provisions. While the most substantial recent books-and-records prosecutions have tended to involve conduct which might also have risen to a level meriting substantive prosecution under the anti-bribery provisions, it remains to be seen how far the government will go in seeking disgorgement in cases where there are relatively more "innocent" violations of the books-and-records provisions.

Prosecution of Individuals

Another growing trend is the prosecution of individual employees separately from their companies. Prior to 2007, the number of individuals prosecuted for FCPA violations in a single year had never reached double digits. In just the few years since, however, dozens of individuals have been singled out for prosecution (seventeen charged in 2007, sixteen charged in 2008, more in 2009). In some instances, the government pursues prosecution of individuals and uses information gleaned from those cases to build a case against the company, collecting substantial fines from each new defendant along the way. In other cases, the government has pursued prosecution of individuals based on information provided by companies which have settled with the government under a deferred prosecution agreement requiring ongoing investigation and supplementation. Recent examples of enforcement actions against individuals include:

- **Willbros Group, Inc. and its executives, May 2008:** By the time Willbros settled with the SEC and the DOJ for $32.3 million based on a number of substantive FCPA violations in Bolivia, Ecuador, and Nigeria, four Willbros employees had already been charged. In September 2006, Willbros executive Jim Bob Brown pleaded guilty to FCPA anti-bribery violations stemming from payments to secure oil pipeline construction contracts in Ecuador and Nigeria. By July 2007, Jason Steph was also charged with conspiring to bribe Nigerian government officials with over $6 million, and pleaded guilty in November 2007. Both Steph and Brown cooperated with the government's continued investigation of Willbros, and indictments were returned against another Willbros executive and a Willbros consultant in February 2008. Sentencings for Steph and Brown have been deferred until late September 2009 to allow time for the ongoing cooperation required by their plea agreements. They each face up to five years in prison and fines twice the value they gained by their violations, which was well into the millions.

- **Kellogg Brown & Root LLC executives, February 2009:** By the time Halliburton, KBR, Inc., and Kellogg Brown & Root LLC settled (as discussed earlier), Kellogg Brown & Root LLC CEO Jack Stanley had already pleaded guilty and acknowledged that he engaged in bribery to secure deals in Nigeria. In his plea agreement, Stanley agreed to cooperate with the government's investigation, and it appears he did so. KBR, Inc. and Halliburton settled soon after Stanley's plea, and, since then, at least two other individuals involved in the Halliburton/KBR bribery scheme have been indicted in the U.S., including a London lawyer and an employee of KBR's U.K. subsidiary. These individuals were not in the U.S. at any time relevant to the alleged conduct, but are alleged to have used U.S. bank accounts to make some of the bribes, illustrating the wide jurisdictional reach of the FCPA. The lawyer has been arrested in the U.K., and the DOJ is seeking his extradition. The other individual has an outstanding warrant for his arrest. In the U.S., each individual faces up to 55 years in prison, and the government is seeking forfeiture of over $130 million. As for Stanley, his sentencing has been deferred until August 2009 to allow time for his ongoing cooperation. He faces a potential 70 years in prison and restitution payments of over $10 million.

- **Control Components, Inc. and its executives, April 2009:** In the biggest multi-party indictment of individuals in the history of the FCPA, six executives of Control Components, a California-based company that makes valves used in the energy industry, were charged on April 8, 2009 with numerous counts of making corrupt payments to secure business in China, Malaysia, and the United Arab Emirates for over a decade. For each count, these individuals face

up to five years in prison. They also face fines of the greater of $250,000 or twice the value they gained by their violations. Earlier this year, two other Control Components executives pleaded guilty to violating the FCPA and have been cooperating with the government. Sentencing of these executives has been deferred to allow time for their ongoing cooperation, and so it remains to be seen what sanctions they will face. As of yet, Control Components itself has not been charged.

- **Alcatel executive, September 2008:** Christian Sapsizian, a French citizen, was sentenced to thirty months in prison, three years of supervised release, and forfeiture of $261,500 for bribing employees of the state-owned telecommunications authority in Costa Rica. Sapsizian served as Alcatel's deputy vice president for Latin America. He was charged with wiring $14 million in sham commission payments to a consultant, who then transferred the funds to government officials, all in connection with Alcatel being awarded a $149 million cellular network contract. One other executive was also charged and is currently a fugitive.

- **Bridgestone executive, December 2008:** Misao Hioki pleaded guilty to conspiracy to violate the FCPA by making corrupt payments to various employees of government-owned businesses in Latin America, and was sentenced to two years in prison and fined $80,000. He was also charged with conspiring to rig bids, fix prices, and allocate market shares for industrial rubber products as part of an international cartel. He was arrested following a cartel meeting in Houston. Hioki's prosecution illustrates another trend: charging individuals with FCPA violations in addition to other more substantive charges that may have been the primary reason the individual was being investigated. In April 2009, Shu Quan-Sheng, a Virginia-based executive who bribed Chinese officials in connection with obtaining contracts to provide space launch technology, was sentenced to 51 months in prison in part for FCPA violations. He was also charged with, and was primarily being investigated for, violations of the Arms Export Control Act.

Enhanced International Cooperation and Expanding International Reach

In pursuing cases against foreign-based companies, the DOJ and SEC more often than not make use of the assistance of the foreign country's prosecuting authority. Given that most countries have developed some kind of anti-corruption law, companies operating in multiple countries are facing multi-jurisdictional "piling on" — that is, the company being investigated, prosecuted and sanctioned in a number of countries for what is effectively the same criminal conduct.

- **Siemens, December 2008:** The Siemens situation presents the most notorious example. The DOJ and the SEC noted that they "closely collaborated with the Munich Public Prosecutor's Office in bringing these cases." The high level of cooperation was made possible by the use of the mutual legal assistance provisions of the 1997 Organization for Economic Cooperation and Development Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Thirty-eight countries have adopted the OECD Convention. The success in this case clearly foreshadows more cooperatve efforts.

- **Arafat "Koko" Rahman, January 2009:** The DOJ filed a forfeiture action against financial accounts located in Singapore allegedly containing the proceeds of bribes paid to Arafat "Koko" Rahman, the son of the former prime minister of Bangladesh. According to the DOJ's complaint, the majority of the approximately $3 million held in these accounts is traceable to bribes allegedly paid to Rahman in connection with public works projects awarded by the Bangladeshi government to Siemens, which had already pleaded guilty to FCPA violations in December 2008. Rahman had previously been charged with corruption by the Bangladeshi Anti-Corruption Commission and had $1.6 million of his assets frozen in connection with that investigation. Forfeiture actions have traditionally not been filed in conjunction with FCPA actions, but if any of the funds used in a FCPA violation are paid from a U.S. bank account or flow through U.S. financial institutions, U.S. jurisdiction is triggered. This is also a way for the U.S. government to confiscate the assets of corrupt foreign officials, even if those officials themselves are not subject to FCPA prosecution.

Unique challenges of mergers and acquisitions

This heightened attention to the FCPA presents substantial challenges for US companies which may seek to acquire businesses overseas. Inadequate due diligence can result in the inadvertent acquisition of a very costly future FCPA investigation, and potentially substantial FCPA liability. Even the efforts to carry out appropriate due diligence can derail potential transactions.

- **eLandia International/Latin Node, Inc., April 2009:** An example of the potential liability an acquirer can face is the situation of publicly-traded eLandia International. Soon after eLandia acquired the former privately-held company Latin Node, it discovered that Latin Node's foreign subsidiaries had violated the FCPA by making illicit payments to government officials in Honduras and Yemen. eLandia self-reported the violations, began an internal investigation, and terminated the responsible executives. In April 2009, Latin Node pleaded guilty to violating the anti-bribery provisions and agreed to pay a $2 million fine (which eLandia paid). Furthermore, eLandia disclosed that, when factoring in the cost of the internal investigation and the loss of business that accompanied having to terminate certain executives, its purchase price for Latin Node was approximately $20 million in excess of the fair value.

- **Halliburton/Expro, June 2008:** The challenges surrounding potential acquisitions are also illustrated by a June 2008 advisory opinion from the DOJ concerning Halliburton's attempt to acquire British firm Expro in a competitive bidding process. Expro operated on all continents and had a number of national oil companies as customers, raising FCPA compliance concerns. As a result of certain bidding restrictions imposed by U.K. law, Halliburton had insufficient time and inadequate access to allow it to complete what it believed to be appropriate FCPA due diligence. Expro's board had already recommended that its shareholders accept a bid from Halliburton's competitor, Umbrellastream. Expro took the position that under U.K. bidding law, it was under no legal obligation to provide any information to Halliburton that it had not already given to Umbrellastream. Umbrellastream apparently had not sought significant FCPA compliance-related information. Halliburton did have access to some information concerning Expro, but it had entered into a confidentiality agreement, which prevented it from disclosing certain information to the DOJ.

  Halliburton sought an advisory opinion from the DOJ, and proposed that, in light of the above restrictions, and if it made a successful bid for Expro, it would (1) meet with the DOJ immediately following closing to disclose any FCPA issues learned pre-closing; (2) within ten days of closing, present to the DOJ a comprehensive FCPA due diligence work plan, and present the results of the due diligence efforts to the DOJ within 180 days; (3) complete all remediation efforts to address issues raised during due diligence by no later than a year from the date of closing; (4) require all agents/third parties associated with the target company to sign new contracts that incorporate appropriate FCPA compliance representations as soon as commercially reasonable, and terminate all agents/third parties found during due diligence to have caused FCPA-related problems; and (5) immediately impose Halliburton's own FCPA Code of Conduct upon Expro, including providing FCPA training to all appropriate employees within 90 days. Halliburton also represented that in any acquisition agreement, Expro and all its affiliates would retain their liability for any past violations of the FCPA.

  In response, the DOJ stated that it did not intend to take action against Halliburton for any pre-acquisition conduct disclosed to the DOJ within 180 days of closing, or for any post-acquisition conduct disclosed to the DOJ within 180 days of closing and which did not continue beyond that 180-day period. In granting this relief, the DOJ recognized the legal impediments to robust pre-acquisition due diligence and the magnitude and transparency of the proposed post-acquisition due diligence. The DOJ's position is particularly noteworthy because it provided protection to Halliburton for any FCPA violations that might occur after the acquisition date, but before Halliburton could complete the due diligence that normally would have occurred pre-acquisition. As long as these violations were disclosed and remediated within the appropriate time period, the DOJ did not intend to take action against Halliburton. The DOJ reserved the right to take action against any violations not disclosed within 180

days of closing, any violations committed at any time that a Halliburton employee participated in, and any FCPA issues identified within the 180-day period that were not remediated within one year of closing. The DOJ further reserved the right to take action against Expro itself for any post- or pre-acquisition FCPA violations, though it noted that violations disclosed by Halliburton pursuant to the due diligence work plan would qualify as "voluntary disclosures" and possibly be looked upon more favorably.

Perhaps not surprisingly in the face of all of this, Expro chose not to accept Halliburton's bid, and so these mechanisms were not put into action.

Conclusion

Each of the trends and concerns described in this issue is expected to continue. Companies with substantial government contracts or government-granted licenses, and companies that rely on agents or consultants to conduct their overseas business, have historically been most prone to FCPA violations. There remains no substitute for a corporate culture of compliance, a carefully tailored internal compliance program, implemented by knowledgeable and committed executives, and an active response to any "red flags" when contemplating an acquisition or engaging in overseas business.

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