The October 2012 DOJ FCPA Guidance: Anticipating the Top 10 Principles to be Addressed

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September 14, 2012
Anticipated Topics to be Addressed

Suggested Reforms from Chamber of Commerce
- Adding Compliance Defense
- Limiting Successor Liability
- Adding Willfulness Requirement for Corporate Liability
- Limiting Liability for Acts of Subsidiaries
- Defining “Foreign Official”

DOJ’s Goal:
- Reinforced Scope of the FCPA
- Clarity on Charging Decisions and Scope of Corporate Liability
- Emphasis On Compliance Programs
- Remediation

Likely Additional Topics - Based on Enforcement Activity
- Third-Party Liability
- Clarifying Affirmative Defenses and Exception
- Due Diligence Requirements
- Use of Corporate Monitors
- Cooperation Credit
## Anticipated DOJ Principles

### Reinforced Scope of the FCPA
- Courts and the DOJ define “Foreign Official” Broadly
- *Mens Rea* of the FCPA

### Clarity on Charging Decisions and Scope of Corporate Liability
- Parents Have Broad Responsibility for the Criminal Conduct of Subsidiaries
- Successor Liability: Significant risk of FCPA exposure from the actions of acquired subsidiaries
- Liability for Third Parties: Significant risk of FCPA exposure from the actions of Third Parties
- Both Affirmative Defenses and Exceptions Provide Narrow Grounds for Relief

### Emphasis On Compliance Programs
- The DOJ Credits a Company’s Compliance Program; No Compliance Defense is Necessary
- Enhanced Third Party Due Diligence
- Compliance programs should be risk-based and industry specific

### Remediation
- Corporate Monitors: An Important Tool For Ensuring Ongoing Corporate Compliance
- Cooperation Tools: Voluntary Disclosure and Opinion Procedure Release
Reinforcing the Scope of the FCPA
1. Courts and the DOJ Define “Foreign Official” Broadly

BACKGROUND

– FCPA prohibits payments to “foreign officials”
– Statute defines term to include officers and employees of government agencies and departments.
– Statute also defines term to include officers and employees of government instrumentalities.
– Statute neglects, however, to define term “instrumentalities”
– However, DOJ FCPA Op. releases, FCPA settlement papers, and recent high profile court decisions have all generally construed “instrumentalities” to include state-owned or –operated entities (“SOEs”).
– Employees of SOEs are therefore “foreign officials” for FCPA purposes
1. Courts and the DOJ Define “Foreign Official” Broadly (continued)

FACTORS IN DETERMINING WHETHER ENTITY IS AN SOE

1. Whether provides services to the citizens and inhabitants of foreign country.
2. Whether key officers and directors are government officials or are appointed by government officials.
3. Extent of foreign government’s ownership of entity, including whether owns a majority of entity’s shares or provides financial support such as subsidies, special tax treatment, loans, or revenue fees.
4. Entity’s obligations and privileges under foreign country’s law, including whether entity exercises exclusive or controlling power to administer its designated functions.
5. Whether entity is widely perceived and understood to be performing official or governmental functions.

CITATIONS: Haiti Teleco (S.D. Fla. 2011); Lindsey Mfg. (C.D. Cal. 2011); Control Comp., Inc. (2011)
2. **Mens Rea of the FCPA Includes Willful Blindness for Individuals and Corporations**

   - Definition of “knowledge” for purpose of the anti-bribery (third-party payment) provisions of FCPA has taken on increased importance
     - The defendant must objectively believe that there is a high probability that the fact exists; and
     - The defendant must take deliberate actions to avoid learning the facts
2. *Mens Rea* of the FCPA Includes Willful Blindness for Individuals and Corporations (continued)

- Key element: … while “knowing” that all or a portion of such money or thing of value will be offered, given or promised to any foreign official for a purpose prohibited by the FCPA

- The government takes an expansive view of willful blindness. Under the FCPA, an individual or corporation can be guilty if they ignore red flags suggesting a bribe could be paid. *Global Tech*; *US vs. Bourke*. 
Charging Decisions and Scope of Liability
3. Parents Have Broad Responsibility for the Criminal Conduct of Subsidiaries

- *Anderson v. Abbott* “…limited liability is the rule, not the exception…”

- SEC’s Aggressive Civil Enforcement: Liability for the parent for activities of a subsidiary under an agency theory.

  - *In the Matter of United Industrial Corporation*: the SEC did not allege that UIC had any direct knowledge of the fact that its subsidiary violated the anti-bribery provisions of the FCPA. Nevertheless, UIC was subject to an enforcement action for the acts of its subsidiary.
3. Parent’s Have Broad Responsibility for the Criminal Conduct of Subsidiaries (continued)

- The government has been criticized for blurring the distinction between civil liability and liability of the subsidiary and parent for a crime. General rule that companies are liable for the crimes committed by their employees under respondeat superior principles.

- Expected that DOJ will clarify when a parent is criminally liable:
  - Agency theory where subsidiaries' employees act as sub-agents of the parent and parent exercised control over the criminal conduct
  - Unitary enterprise theory where the parent and subsidiary have intertwined management to such an extent that it becomes a single entity – corporate formalities are not respected
  - Parental participation theory where a parent is found to authorize, control, direct the activities of the subsidiary employees who are committing the criminal acts
4. Successor Liability: Significant Risk of FCPA Exposure from the Actions of Acquired Subsidiaries

– Cases have not been clear regarding DOJ’s position with respect to parental liability. Criticized for appearing to adopt a straight (civil) agency theory that parents are automatically liable for the activities of subsidiaries even without knowledge of those activities. The 2012 Guidance will provide an opportunity to clarify the civil / criminal distinction.

– The Department of Justice argues that it can hold a company criminally liable under the FCPA for the actions of a subsidiary that it acquires, even if the criminal act took place prior to the merger. For example, the acquiring company may assume the criminal mens rea when it keeps pre-acquisition employees in place and receives continuing benefits from the corrupt contract
4. Successor Liability (continued)

– The primary factor common in cases where a successor company avoids liability is the absence of post-acquisition illicit payments
– Despite the Department’s clear emphasis on due diligence, it is still unclear how much due diligence is sufficient.
4. Successor Liability (continued)

- Halliburton Standard for Post-Acquisition Due Diligence:
  - Meet with the DOJ to disclose any FCPA issues learned pre-closing
  - Present the DOJ a comprehensive anti-corruption due diligence plan within 10 business days of closing
  - Report the results of risk-based due diligence to the DOJ within 180 days of closing
  - Complete due diligence and remediation within one year from the date of closing
  - Mandate that the target adopt the requesting entity’s Code of Business Conduct and specific anticorruption policies and procedures
  - Maintain the target as a wholly owned subsidiary for so long as the DOJ was investigating any conduct by the target

* DOJ Opinion Procedure Release 08-02
4. Successor Liability (continued)

– DOJ guidance may include more flexible timeline than the Halliburton standard:
  - Compliance requirements in *Johnson & Johnson, Nordam, Data Systems & Solutions*, and *BizJet* all include more flexible timelines, using terms such as “as quickly as practicable,” “promptly” and “as quickly as possible.”

– Post-Halliburton guidance, there are additional examples of flexibility:
  - *Armor Holdings* (2011) - Non-Prosecution Agreement: BAE voluntarily disclosed the conduct of Armor Holdings in 2007, presumably in pre-acquisition due diligence and self-reported to the DOJ. All of the criminal conduct occurred prior to acquisition.
4. Successor Liability (continued)

- Contrast Armor Holdings with the Latin Node plea agreement in 2009:
  - eLandia acquired Latin Node in 2007, but was forced to shut down operations because of irregularities discovered in pre-acquisition conduct, but were unknown at the time of acquisition. eLandia took a loss on the acquisition and was forced to shut down Latin Node, presumably because of the inadequate due diligence compliance work.
  - DOJ was quoted that Latin Node is a "cautionary tale" of what can happen when an acquirer conducts "little, if any, [FCPA] due diligence."
5. Liability for Third Parties: Significant Risk of FCPA Exposure from the Actions of Third Parties

- “It is unlawful to make a payment to a third party, while knowing that all or a portion of the payment will go directly or indirectly to a foreign official.”
- When confronted with evidence of improper activity, a failure to investigate or address red flags can form the basis of “constructive knowledge” and liability for third party acts.
- The knowledge requirement of the FCPA, and specifically the concept of willful blindness and conscious disregard, feature prominently in establishing liability for the acts of third parties.
5. Liability for Third Parties (continued)

- Liability for the acts of third parties may include:
  - Joint Venture Partners – e.g., Bonny Island cases
  - Agents – e.g., Panalpina Freight Forwarder cases
  - Distributors – e.g., Johnson & Johnson
  - Marketers – e.g., Magyar Telekom
  - Consultants – e.g., Alcatel-Lucent
6. Both Affirmative Defenses and Exceptions Provide Narrow Grounds for Relief

- The FCPA includes two affirmative defenses to its anti-bribery provisions:
  
  1. "the payment, gift, offer or promise of any thing of value that was made, was lawful under the written laws and regulations of the foreign official’s, political party’s, party official’s or candidate’s country;” or
  2. where “the payment, gift, offer, or promise of anything of value that was made, was a reasonable and bona fide expenditure, such as travel and lodging expenses, incurred by or on behalf of a foreign official, party, party official, or candidate and was directly related to – the promotion, demonstration, or explanation of products or services or the execution or performance of a contract with a foreign government or agency thereof.”

- Little guidance to be gleaned from recent DOJ’s pronouncements on the meaning of the local law affirmative defense. Previous guidance has advised consultation with counsel or utilizing the Opinion Procedure process.
6. Both Affirmative Defenses and Exceptions Provide Narrow Grounds for Relief

- Enforcement Actions providing guidance on what would not be “reasonable” and “bona fide”:

  - **Metcalf & Eddy (1999):** Hospitalities, such as excessive travel which included Disney World and Paris as destinations; the upgrading of airline tickets to first class; the payment of 150 percent of an official’s estimated per diem; and the payment of the travel expenses of the official's wife and children.

  - **Lucent Technologies Inc. (2007):** 24 presale trips for government customers, of which at least 12 were mostly sightseeing trips. Between 2000 and 2003 Lucent spent over 1.3 million on at least 65 presale visits that were primarily for entertainment purposes and involved travel to Disneyland and the Grand Canyon.

  - **UTStarcom (UTSI) Inc. (2009):** Travel and other things of value were provided to foreign officials by USTI for the supposed purpose of training oversees were, in actuality, primarily to sightseeing locations such as Hawaii, Las Vegas, and New York City. Most of the trips lasted two weeks and cost $5,000 per customer employee.

  - **International Business Machines Corporation (IBM) (2011):** Gifts to government officials of cash, cameras, computers, and computer equipment as well as overseas trips, entertainment, and gifts. Contracts contained provisions requiring IBM to provide training to customer employees that sometimes required travel.
6. Both Affirmative Defenses and Exceptions Provide Narrow Grounds for Relief (continued)

FACILITATING PAYMENTS EXCEPTION - OVERVIEW

- FCPA anti-bribery provisions exclude “any facilitating payment or expediting payment to a foreign official . . . the purpose of which is to expedite or secure the performance of a routine governmental action.”

- FCPA lists 5 categories of activity that constitute “routine governmental actions” for which such payments are permitted:
  1. Obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country;
  2. Processing governmental papers, such as visas and work orders;
  3. Providing police protection, mail pick up and delivery, or scheduling inspections;
  4. Providing phone service, power and water supply, loading cargo, or protecting goods from deterioration; or
  5. Actions of a similar nature.
6. Both Affirmative Defenses and Exceptions Provide Narrow Grounds for Relief (continued)

- Exception is narrowly construed: Congress made clear its intention to “carv[e] out very limited categories of permissible payments from an otherwise broad statutory prohibition.” *U.S. v. Kay*, 359 F.3d 738, 745 (5th Cir. 2004).
- U.S. authorities have not endorsed any particular set of circumstances in which exception is deemed to apply.
- Discretion on the part of the gov’t official is key.
  - Question is whether payment is intended to win an official’s favor for a decision benefitting a company; OR
  - Simply a “grease” payment provided to expedite a decision that has already been made or to which the payer is entitled, i.e., to “cut through the bureaucratic red tape.
- Companies have been prosecuted for relatively small bribe payments that are cumulative, pervasive, or systematic.
  - These cases indicate that US gov’t perceives small-but-frequent facilitating payments as potentially actionable bribery (sometimes referred to as the “aggregation” theory of enforcement) [examples on next slide].
6. Both Affirmative Defenses and Exceptions Provide Narrow Grounds for Relief (continued)

FACILITATION PAYMENTS EXCEPTION - EXAMPLES

Remarks from Deputy Chiefs of DOJ Fraud Section with Respect to Facilitation Payments Exception:

- “DOJ is not encouraging facilitating payments.”
- The exception . . . is not an approval of corruption but an acknowledgment of business reality . . . [If] a company is not able to conduct its business without the permit (or whatever is at issue), the company should try other channels [before making the facilitation payment] . . . such as going to the U.S. embassy or the chamber of commerce.”
- “[T]he gov’t will not give a bright-line rule about the size of acceptable facilitating payments . . . it’s not the amount, it’s the purpose.”
- “Even payments as small as $20 can be the subject of an enforcement action if a company makes a large number of such payments for what the government determines to be an “improper business advantage”
6. Both Affirmative Defenses and Exceptions Provide Narrow Grounds for Relief (continued)

Companies Prosecuted for Relatively Small, Cumulative Payments (i.e., “Aggregation Theory”):

- *Conway* (2008): Philippine subsidiary made hundreds of small payments to customs totaling $417,000 over three years to store shipments and negotiate fines;
- *Westinghouse* (2008): Indian subsidiary made payments to railway and customs officials as small as $31.50 — totaling $40,000 over one year — to facilitate product inspections and certificates;
- *York Int’l* (2007): Authorized third parties to make hundreds of arguably “routine” payments — many under $1000 — to employees of government customers in several countries;
Compliance Programs
7. The DOJ Already Credits a Company’s Compliance Program; No Compliance Defense is Necessary

– The DOJ is likely to assert that a compliance defense is not necessary because it takes a company’s existing compliance program into account when assessing whether to charge a company.

– For example, in press releases and public comments about its April enforcement action against former Morgan Stanley executive Garth Peterson, DOJ and the SEC highlighted the existence of Morgan Stanley’s pre-existing compliance program as a key factor for the Government’s decision not to prosecute the company.
7. No Compliance Defense Necessary

The decision not to prosecute was based on evidence of:

- Rigorous internal controls
- Regular training and reminders on FCPA policy and compliance
- Internal policies addressing the corruption risks associated with the giving of gifts, business entertainment, travel, lodging, meals, charitable contributions and employment, that were updated regularly to reflect regulatory developments and specific risks
- Compliance program monitoring and auditing
- Extensive pre-retention due diligence on business partners and stringent controls on payments to business partners
7. No Compliance Defense Necessary (continued)

- DOJ FCPA settlements have, in some form, required a company to create a compliance program, or enhance its existing compliance program, to include the following components:
  - A Code of Conduct clearly articulating company policy against violations of the FCPA and other applicable anti-corruption laws.
  - Internal controls to ensure fair and accurate books, records and accounts are kept.
  - Standards and procedures applicable to directors, officers, and employees and, where necessary and appropriate, outside parties acting on behalf of a company in a foreign jurisdiction.
7. No Compliance Defense Necessary (continued)

- Senior corporate official oversight with the authority to report matters directly to the Audit Committee of the Board of Directors.
- Training and other mechanisms to communicate a company’s FCPA and anti-corruption policies and standards and procedures to all directors, officers, employees and, where necessary and appropriate, agents and business partners
- Reporting system for suspected criminal misconduct.
- Disciplinary procedures.
- Third-party pre-retention due diligence and oversight.
7. No Compliance Defense Necessary (*continued*)

- **Standard anti-corruption contract provisions**, where necessary, in agreements, contracts, and renewals with all agents and business partners which may include: (a) anti-corruption *representations and undertakings*; (b) rights to conduct *audits* of their books and records; and (c) rights to *terminate* an agent or business partner as a result of any violation of anti-corruption laws or breach of representations.
- Periodic compliance program testing to evaluate its effectiveness.
7. No Compliance Defense Necessary (continued)

- DOJ’s FCPA enforcement has evolved to provide continuing and dynamic guidance – based on the facts and circumstances of individual matters – on compliance practices it believes will best prevent and detect corruption.

- DOJ may assert that this approach, which provides specific and detailed guidance on how to design a compliance program, makes a compliance defense unnecessary.

- One area where this may be most apparent is with respect to standards and procedures – DOJ’s recent settlements have required that they be developed “on the basis of a risk assessment addressing the individual circumstances” of the company including, but not limited to:
7. No Compliance Defense Necessary (continued)

- Its geographical organization
- Interactions with various types and levels of government officials
- Industrial sectors of operation
- Involvement in joint venture arrangements
- Importance of licenses and permits in the company’s operations,
- Degree of government oversight and inspection, and
- Volume and importance of goods and personnel clearing through customs and immigration
7. No Compliance Defense Necessary (continued)

- DOJ’s approach of providing continuing guidance on its expectations for compliance programs is also reflected in its move to state explicitly that:

  - Standards and procedures include policies governing: gifts; hospitality, entertainment, and expenses; customer travel; political contributions; charitable donations and sponsorships; facilitation payments; and solicitation and extortion; and

  - A review of a company’s compliance program should be conducted annually.
8. Enhanced Third-Party Due Diligence

- DOJ has always required pre-retention due diligence and oversight as well as standard anti-corruption contract provisions with all agents and business partners. However, its settlement requirements have evolved such that DOJ now expects agent and business partner retention due diligence and oversight that includes:

  - “Properly documented risk-based due diligence pertaining to the hiring and appropriate and regular oversight of agents and business partners;”
  - Informing agents and business partners of a company’s commitment to abiding by anti-corruption laws; and
  - Seeking a reciprocal commitment from agents and business partners.
Remediation
9. **Corporate Monitors: Still Considered An Important Tool For Ongoing Compliance**

- Since 2008, more companies agreed in settlements to self-monitor, using their own counsel to submit reports to the DOJ.
- Trend started when the costs of corporate monitors became controversial with Congressional hearings regarding the Ashcroft monitorship and statements made by US District Judge Ellen S. Huvell in an FCPA case involving oil for food program. *Morford Memo.*
9. Corporate Monitors (continued)

– The DOJ has not abandoned monitorships. Of the companies that have entered into deferred or non-prosecution agreements in 2012, three were required to retain compliance monitors. Smith and Nephew, Inc.; Biomet, Inc.; and Marubeni.

– The DOJ will reaffirm the use of monitorships. They will look at the seriousness and pervasiveness of the conduct, whether or not the conduct was voluntarily disclosed, and the quality of the compliance program.
9. Corporate Monitors (continued)

– The guidance will note that factors the DOJ considers in imposing a monitor are the seriousness of the offense, the length and pervasiveness of the misconduct, the nature and size of the company, the quality of the company's compliance program at the time of the misconduct, and its subsequent remediation efforts.

- DOJ claims that it regularly rewards voluntary disclosure by companies that disclose wrongdoing through the use of declinations, deferred prosecution agreements and non-prosecution agreements, as well as significantly reduced monetary penalties.

- FCPA Guidance will likely cite to the multitude of cases that cite voluntary disclosure, however, additional guidance on the tangible effect of disclosure is unlikely to be forthcoming.

– In testimony before the House and Senate in 2011, DOJ officials emphasized the continued importance of the Opinion Procedure Releases and its ongoing significance to the FCPA.

– DOJ considers the advisory opinions to be a unique procedure under the current law. It allows companies to provide facts and information to the department and the DOJ is able to give them an advisory opinion as to specific conduct and whether that conduct violates the FCPA.

– Procedure is unique among the criminal laws.

– Those opinions are published and available to companies to analyze them, to understand where the government is focusing its enforcement, and what specifically violates the law.
Thank You

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