



The FCPA and why it matters

by Michael Osajda

Statement of intent

This paper explores the origins of the US Foreign Corrupt Practices Act (FCPA) and the effects of corporate corruption that led to its enactment. In addition to providing a succinct overview of the FCPA and why it matters, the paper highlights associated risks and the commonalities between ethical business practice and a sound compliance culture.

The Act, which became the global benchmark for antibribery legislation, has had significant implications for corporate business and accounting practices. As more companies target international business contracts and regulation increases, offshore risk management will only gain in priority on the corporate agenda. A deep understanding of the FCPA is the first requirement towards fostering a sound compliance and corporate governance culture.

Understand who you are really doing business with.

www.world-check.com

Contents

1. Executive overview	4
2. Refining and expanding the PEP concept	6
3. Key PEP compliance challenges	18

Background

The year is 1977. The place is Washington, D.C. The forum is the United States Congress. The 94th Congress, which ended its term on January 3, 1977, and the 95th Congress had received information and held hearings that revealed evidence of payments to foreign governmental officials and political parties by United States businesses. These were embarrassing revelations of payments of corporate funds to foreign government officials in excess of \$300 million to secure some type of favorable action by that government or to prompt government functionaries to discharge their administrative or clerical duties. The industrial sectors cited by the legislative history included drugs and health care, oil and gas production and services, food products, aerospace, airlines and air services, and chemicals.¹

These revelations were discussed by the Congress on a number of levels. On the level of international relations, while détente with the Soviet Union had commenced, the Cold War was still a fact of life. There was an active struggle for worldwide influence between the Soviet Union and the United States. The proxy war in Angola between troops from Communist Cuba, supported by the Soviets, and apartheid South Africa, supported by the Americans, was in its second year. The fall of Saigon in 1975 and its concomitant negative effect on US prestige was still felt in Washington. It was by no means certain or even predicted that the Soviet Empire would implode in a dozen or so years. In that context, Congress stated that corporate bribery had foreign policy implications. It was embarrassing not only to the United States but also allied governments. The House Report cited scandals in Japan, the Netherlands and Italy, all as a result of corporate bribery. These scandals lent “credence to the suspicions sown by foreign opponents of the United States that American enterprises exert a corrupting influence on the political processes of their nations.”²

There were also ethical and business levels to the issue. Congress flatly stated the obvious: “The payment of bribes to influence the acts or decisions of foreign officials, foreign political parties or candidates for foreign political office is unethical. It is counter to the moral expectations and values of the American public.”³ These sentiments resonated in Washington in 1977. President Jimmy Carter’s credentials as an economic leader or the Commander in Chief of the Armed Forces may have been questioned, but his role as a proponent of moral and ethical behavior was an important part of his presidency. President Gerald Ford signed the Helsinki Accords on human rights, but Jimmy Carter elevated the principles contained in the Accords in importance during his term.⁴

Finally, on the pure business level, Congress concluded that the corrupt activity that had been presented was bad business. It skewed the economic transaction. Rather than quality, service, salesmanship, price, or other factors being rewarded, corruption was paramount. Exposure of such activity could also have negative consequences for the company involved. It could “damage a company’s image, lead to costly lawsuits, cause the cancellation of contracts, and result in the appropriation of valuable assets overseas.”⁵

With this background, and in the wake of the domestic corruption uncovered in the Watergate scandal that resulted in felony convictions for Presidential advisors and the resignation of a

THE FCPA AND WHY IT MATTERS

sitting President, Congress chose to address the issue of foreign public corruption caused by US persons. Two methodologies were considered by Congress. One proposal would allow companies to continue to make payments to foreign governmental officials but require them to annually disclose such payments. Failure to disclose would be criminalized. The other proposal would criminalize the payments outright. Congress rejected the “name and shame” approach in favor of criminalizing both bribery and concealment.

The Act

The Foreign Corrupt Practices Act (FCPA) 15 U.S.C. §§ 78dd-1, et seq. was enacted in 1977. At the signing, President Carter emphasized his belief that corporate bribery was “ethically repugnant.”⁶

The statutory scheme of the FCPA, as amended, is divided into the antibribery and the accounting provisions. The antibribery provisions of the FCPA make it unlawful for a US person, certain foreign issuers of securities, as well as foreign firms and persons who take any act in furtherance of such a corrupt payment while in the United States, to make a corrupt payment to a foreign official for the purpose of obtaining or retaining business for or with, or directing business to, any person. The accounting provisions require companies whose securities are listed in the United States to make and keep books and records that accurately and fairly reflect the transactions of the corporation and to devise and maintain an adequate system of internal accounting controls.

Antibribery provisions

The Lay–Persons’ Guide to FCPA (The Guide), published by the United States Department of Justice (<http://www.justice.gov/criminal/fraud/docs/dojdocb.html>) sets forth an easily understandable exposition of the antibribery provisions of the FCPA. The Guide lists five elements necessary to constitute a violation of the antibribery provisions. Those elements are: who, corrupt intent, payment, recipient and business purpose test.

Who

Who is covered by the antibribery provisions of the FCPA? The FCPA casts a wide net. It potentially applies to any individual, firm, officer, director, employee or agent of a firm, and any stockholder acting on behalf of a firm. Issuers are covered by the FCPA. An issuer is defined as any entity that has a class of securities registered pursuant to the Securities Exchange Act of 1934 or that is required to file reports under that Act.⁷ This definition includes US publicly traded companies and foreign public companies that may be listed on US stock exchanges through the use of American Depositary Receipts. Domestic concerns are also covered by the FCPA. A domestic concern is not an issuer but any individual who is a citizen, national, or resident of the United States, as well as any corporation, partnership, association, joint-stock company, business trust, unincorporated organization or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws of a State of the United States or a territory, possession, or commonwealth of the United States.⁸ In 1998, the FCPA was amended to broaden the jurisdiction over multinationals. US parent corporations (issuers or domestic concerns) may be held liable for the acts of their foreign subsidiaries if the US parent authorized, directed, or controlled the activity in question, as can US citizens or residents, themselves domestic concerns, who were employed by or acting on behalf of such foreign-incorporated subsidiaries.⁹ The 1998 amendments also expanded the jurisdiction over other foreign companies and nationals. If a foreign company or foreign national takes any action in furtherance of a corrupt payment within the territory of the United States, that person will be subject to the jurisdiction of the FCPA.¹⁰ The Department of Justice has taken an aggressive interpretation of this section to include not only the act itself but any circumstance that causes the act in the territory of the United States to be enough to confer jurisdiction.¹¹ And the jurisdiction also extends to actions in the United States effected

THE FCPA AND WHY IT MATTERS

through the mails or other means of interstate commerce, as well as acts that occur in foreign countries without regard to means of interstate commerce.¹²

Corrupt intent

The act must be performed with a corrupt intent. If the payment is made for the purpose of:

- 1) influencing any act or decision of a foreign official in his official capacity;
- 2) inducing a foreign official to do or omit to do any act in violation of his lawful duty; or
- 3) inducing a foreign official to use his position to affect any decision of the government, the element of corrupt intent is met.¹³

The Department of Justice has taken the position that the FCPA does not require that the corrupt act succeed in influencing the official receiving the payment. The offer or promise of a corrupt payment can constitute a violation.¹⁴

Payment

The FCPA prohibits paying or making an offer or promise to pay money or anything of value.¹⁵ Anything of value may be interpreted broadly to include travel, gratuities, physical gifts and even charitable contributions. The statute does not quantify the value of the payment. There is no statutory de minimus test for the payment.

Recipient

The FCPA prohibits the corrupt payments to a foreign official, foreign political party or official of such party or any candidate for political office, or a third party (such as an agent or joint venture partner) with knowledge that all or a portion of the payment will be given to one of the prohibited persons or parties. Unlike the UK Bribery Act, the FCPA was not intended to prohibit private foreign corruption. The FCPA defines "foreign official" as "any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization."¹⁶ There is no statutory exception to the definition of foreign official based on rank or position. The FCPA applies to any public official. Knowledge does not have to be direct. It may be inferred by all of the facts and circumstances. Willful blindness or reckless disregard is not a shield from the knowledge element.

Business purpose test

The FCPA prohibits payments made in order to assist the payor in obtaining or retaining business with, or directing business to, any person. Although the recipient of the payment may be a foreign official, the business does not have to be with a foreign government to satisfy the business purpose test. The Department of Justice warns that it will interpret "obtaining or retaining business" broadly.¹⁷ There is support for this position in the legislative history of the 1988 Amendments to the FCPA.

[T]he reference to corrupt payments for 'retaining business' in present law is not limited to the renewal of contracts or other business, but also includes a prohibition against corrupt payments related to the execution or performance of contracts or the carrying out of existing business, such as a payment to a foreign official for the purpose of obtaining more favorable tax treatment. The term should not, however, be construed so broadly as to include lobbying or other normal representations to government officials.¹⁸

There are three circumstances in which acts otherwise prohibited by the FCPA will not constitute a punishable violation. A payment otherwise prohibited by the FCPA is permitted if it is a facilitating or expediting payment made to secure the performance of a routine government action by the recipient with regard to the award or continuation of business. This so called "grease payment" exception is limited to non-discretionary acts of the official. The FCPA further limits such a payment to one "which is ordinarily and commonly performed by a foreign official in:

THE FCPA AND WHY IT MATTERS

- (i) obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country;
- (ii) processing governmental papers, such as visas and work orders;
- (iii) providing police protection, mail pick-up and delivery, or scheduling inspections associated with contract performance or inspections related to transit of goods across country;
- (iv) providing phone services, power and water supply, loading and unloading cargo, or protecting perishable products or commodities from deterioration; or
- (v) actions of a similar nature.¹⁹

The two other circumstances are affirmative defenses set forth in the statute. These affirmative defenses will shield the payor if the otherwise illegal payment was 1) lawful under the written laws and regulations of the recipient's country or 2) a reasonable and bona fide expenditure, such as travel and lodging expenses incurred by or on behalf of the recipient and directly related to product promotion, demonstration or explanation or the execution or performance of a contract with a foreign government.²⁰ In other words, there must be a valid business reason for the payment other than to influence the recipient in favoring or awarding business to the payor. The burden of proof for the affirmative defenses is with the person or entity that has been charged with a violation of the FCPA, i.e. that the payment met the requirements of the affirmative defense.

A single violation of the antibribery provisions of the FCPA may place more than one person/entity in criminal and civil jeopardy. The business entity as well as its officers, directors, employees, agents, or shareholders acting on behalf of the entity may be penalized for a violation of the FCPA. Issuers and domestic concerns may be subject to a fine of up to \$2,000,000. Natural persons who willfully violate the FCPA may be subject to a fine of up to \$100,000 and imprisonment for up to 5 years. In addition, both the offending entity and natural persons acting on its behalf may be subject to civil penalties of up to \$10,000 for each violation and be subject to other injunctive relief, such as a cease and desist order.²¹ For violations of the antibribery provisions, issuers are prohibited from indemnifying their natural persons who are subject to criminal or civil fines.²²

Accounting provisions

The accounting provisions of the FCPA are seemingly less expansive than the antibribery provisions but may be more troublesome. The accounting provisions require issuers to maintain certain records and adequate internal controls.²³ The same definition of issuer is applicable to the accounting provisions as to the antibribery provisions, i.e. US publicly traded companies and foreign public companies that may be listed on US stock exchanges through the use of American Depositary Receipts.

The maintenance of certain records required by the FCPA is commonly known as the "books and records" provisions. Each issuer is required to "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."²⁴ This provision makes it more difficult for a company to utilize slush funds or disguise payments to facilitate a violation of the antibribery provisions. There are no exceptions to this provision for materiality or for the facilitating payments exception or the affirmative defenses to the antibribery provisions of the FCPA. Covered companies must decide how to record for their shareholders and the rest of the public payoffs to low level government functionaries, payments to foreign officials that would otherwise be illegal but lawful under the written laws and regulations of the recipient's country, or even private non-governmental bribery. These record keeping issues could be challenging.

Issuers are also required to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

THE FCPA AND WHY IT MATTERS

- (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 the differences.²⁵

This provision appears to be an attempt at statutory prophylaxis. It mandates that management know what is going on the company. Transactions must be approved by responsible authority. Assets can only be accessed with authorization. If proper controls are implemented, illegal payments become more difficult. But a knowing failure to implement such controls could result in liability.

Both of the accounting provisions are applicable to 50% or greater foreign subsidiaries and joint ventures. For foreign subsidiaries and joint ventures in which the issuer has a lesser interest, the issuer must make a "good faith" effort to ensure compliance with the accounting provisions.²⁶

A willful violation of the accounting provisions of the FCPA can result in criminal fine of up to \$25,000,000 for an entity. An individual may face a penalty of a \$5,000,000 fine and imprisonment for up to 20 years.²⁷ On the civil side, a violation of the accounting provisions can result in a civil penalty of up to \$50,000 for entities or up to \$100,000 for individuals as well as accountings, cease and desist orders and disgorgements. Like violations of the antibribery provisions, issuers are prohibited from indemnifying their natural persons who are subject to criminal or civil fines for violations of the accounting provisions.

Why it matters

In this period of globalization, many entities other than recognized multinationals are taking the first steps in doing business overseas. For them, a thorough understanding of not only the FCPA, but also patterns of SEC and DOJ activity, is necessary to navigate the shoals of enforcement. The FCPA does not only apply to publically traded companies. Virtually any US entity doing business overseas, from the privately held small manufacturer to the one man software shop, will be subject to the Act. Foreign companies that are traded in the United States are also subject to the act. If those entities sell directly to foreign governments, they are in the sweet spot of the Act. But it is important to understand that sales need not only be to governments; private sales may also be within enforcement jurisdiction if there is an interface with government for even peripheral reasons. Use of intermediaries, subsidiaries or other business formats may not shield the entity from liability. A misinterpretation of the facilitating payments exemption or the affirmative defenses by operators or finance personnel in the field may give rise to prosecution. The FCPA requires the enactment of certain internal controls and makes a willful failure to do so a violation. This may also expose publicly traded companies to a Sarbanes-Oxley compliance issue.

In short, the FCPA may not be as straightforward as it seems. It casts a wide net and has been enforced with more vigor in the past few years. That trend is likely to continue. As recently as November 12, 2009, Assistant Attorney General Lanny Breuer commented:

"As some of you may know, the Criminal Division has primary enforcement responsibility for the FCPA, and in recent years, FCPA enforcement has been one of our top priorities. Since 2005, we have brought 57 cases – more than the number of prosecutions brought in the almost 30 years between the enactment of the FCPA in 1977 and 2005. As a result, the Fraud Section of the Criminal Division has developed a group of experienced, hard-working and talented prosecutors who specialize in FCPA investigations and prosecutions. In addition, in 2007, the FBI created a squad of dedicated

THE FCPA AND WHY IT MATTERS

FCPA agents in its Washington Field Office. That group of dedicated FCPA agents has grown exponentially, both in size and in expertise, over the last two years – and we hope and expect that growth will continue. Working together with the FBI, and often with our civil counterparts at the SEC, the Department currently is pursuing more than 120 FCPA investigations.”²⁸

The FCPA matters and is relevant for entities and persons who do or propose to do business outside the United States. There are a number of actions that affected entities can take in order to reduce the likelihood of a violation. Among them are adoption of an ethical business culture and adoption and implementation of a comprehensive anticorruption policy.

Doing the right thing may be best way to comply with the FCPA.

References

- 1 H. Rept. 95-640, 95th Cong., 1st Sess., at 1 and 2 (1977)
- 2 H. Rept. 95-640, at 2
- 3 H. Rept. 95-640, at 2.
- 4 President Jimmy Carter, Address at Commencement Exercises at the University of Notre Dame May 22, 1977
- 5 H. Rept. 95-640, at 2
- 6 Foreign Corrupt Practices and Investment Disclosure Bill Statement on Signing S. 305 Into Law December 20, 1977
- 7 15 U.S.C. § 78dd-1(a)
- 8 15 U.S.C. § 78dd-2(h)
- 9 15 U.S.C. § 78dd-1(g)
- 10 15 U.S.C. § 78dd-3
- 11 United States Attorneys' Manual, Title 9, Criminal Resource Manual §1018 "Prohibited Foreign Corrupt Practices" (November 2000)
- 12 15 U.S.C. §§ 78dd-1(a), (g)
- 13 15 U.S.C. §§ 78dd-1(a) (1), 78dd-2(a) (1), 78dd3-1(a) (1)
- 14 United States Attorneys' Manual, Title 9, Criminal Resource Manual §1018 "Prohibited Foreign Corrupt Practices" (November 2000)
- 15 United States Attorneys' Manual, Title 9, Criminal Resource Manual §1018 "Prohibited Foreign Corrupt Practices" (November 2000)
- 16 15 U.S.C. §§ 78dd-1(f) (1), 78dd-2(h) (2), 78dd3-1(f) (2)
- 17 The Lay–Persons' Guide to FCPA, page 4
- 18 H. Conf. Rept. No. 100-576, 100th Cong., 2nd Sess., at 918 and 919 (1988)
- 19 15 U.S.C. §§ 78dd-1 (f) (3) (A), 78dd-2 (h) (4) (A), 78dd-3 (f) (4) (A)
- 20 15 U.S.C. §§ 78dd-1 (c), 78dd-2 (c), 78dd-3 (c)
- 21 15 U.S.C. §§ 78dd-2 (g), 78dd-3 (e)
- 22 15 U.S.C. § 78ff
- 23 15 U.S.C. § 78m(b)
- 24 15 U.S.C. § 78m(b)(2)(A)
- 25 15 U.S.C. § 78m(b)(2)(B)
- 26 15 U.S.C. § 78m(b)(6)
- 27 15 U.S.C. § 78ff(a)
- 28 Lanny A. Breuer, Assistant Attorney General, Criminal Division, U.S. Department of Justice, Prepared Keynote Address to The Tenth Annual Pharmaceutical Regulatory and Compliance Congress and Best Practices Forum, November 12, 2009



WORLD-CHECK™

Understand who you are really doing business with.

www.world-check.com

© Global World-Check. All rights reserved.