

SEC BRINGS FCPA CHARGES BASED ON EXTORTED PAYMENTS

On January 11, 2010, the Securities and Exchange Commission (the “SEC”) filed a settled civil enforcement action against NATCO Group Inc. (“NATCO”). The SEC charged NATCO with violating the books and records and internal controls provisions of the Foreign Corrupt Practice Act (the “FCPA”) in connection with payments to immigration officials in Kazakhstan. Although NATCO agreed to pay a relatively modest civil penalty (\$65,000), the case is noteworthy because the SEC brought charges despite recognizing that the payments were extorted by Kazakh officials by threats of imprisonment and deportation. The case is a stark example of the difficult practical and legal situations in which companies operating in high risk countries sometimes find themselves.

According to the SEC’s complaint, NATCO’s wholly owned U.S.-based subsidiary, TEST Automation & Controls, Inc. (“TEST”), won a contract to provide instrumentation and electrical services in Kazakhstan. During the course of periodic audits of the immigration documentation of TEST’s expatriate employees, Kazakh immigration prosecutors claimed that the TEST workers lacked proper documentation. The officials threatened to fine, jail, or deport the workers if TEST refused to pay cash fines. The workers believed the immigration officials’ threats to be genuine and sought guidance from TEST’s U.S.-based senior management. Senior management authorized the payments and, thereafter, TEST employees used personal funds to make cash payments of \$25,000 and \$20,000 to Kazakh officials. TEST reimbursed the employees using false documentation, indicating in one case that the payment was an advance against an employee bonus and, in the other case, a visa fine.

The complaint also alleged that TEST falsified records related to payments to an immigration consultant in Kazakhstan. Specifically, TEST used fabricated invoices to substantiate two cash payments to a consultant who was known to have close ties to the Kazakh Ministry of Labor. Based on both types of misconduct, the SEC claimed that “NATCO’s system of internal accounting controls failed to ensure that TEST recorded the true purpose of the payments, and NATCO’s consolidated books and records did not accurately reflect these payments.” NATCO settled the charges with the SEC without admitting or denying the allegations in the SEC’s complaint.

The NATCO settlement addresses a concern for companies operating in high risk countries: whether payments made to a foreign official in order to ensure the safety and well-being of company employees faced with extortionate threats can expose the company to FCPA charges. The FCPA does not contain a statutory extortion or duress defense. The common law defense of duress generally requires a showing of a well-grounded apprehension of death or serious bodily injury. Consistent with this, the FCPA’s legislative history rejects the notion that economic coercion may justify making an otherwise improper payment to a foreign official, but recognizes that “true extortion situations would not be covered by [the FCPA’s anti-bribery provisions] since a payment to an official to keep an oil rig from being dynamited should not be held to be

made with the requisite corrupt purposes.”¹ This distinction was recognized in the recent FCPA prosecution of Frederick Bourke. In considering a potential defense of extortion, the court held that if Bourke produced evidence of true extortion at trial, it would instruct the jury that such evidence may be relevant to the issue of whether Bourke acted with the requisite corrupt intent.² Corrupt intent has been defined in the context of the FCPA as “an evil motive or purpose, an intent to wrongfully influence the recipient” to “misuse his official position in order to wrongfully direct business to the payor or his client.”³ Ultimately, the court did not issue a jury instruction regarding true extortion.

The facts as alleged by the SEC suggest that there was a jurisdictional basis for anti-bribery charges: the complaint alleges that the payments to Kazakh officials were authorized by senior management in the United States. That no anti-bribery charges were brought may suggest that evidence of extortion under serious threats, such as being jailed in a foreign country, at least presented difficulties for prosecutors in proving the FCPA’s corrupt intent element. But the NATCO case makes clear that extortionate threats will not forestall FCPA books and records and internal controls charges, at least in the civil context. Such charges do not have an intent requirement. Had NATCO not concealed and falsely recorded the nature of the payments to the Kazakh officials, it might have avoided liability under the FCPA’s books and records and internal controls provisions. But companies are understandably reluctant, whether for legal or safety reasons, to record payments as extortion payments to foreign officials. It is not clear what, short of such a description, might have satisfied the SEC as to the accuracy of the books and records in this instance.

Companies that operate in high risk countries sometimes face very real threats to their employees. They understandably want and need to safeguard the health and safety of their workers. But they need to do so with a full awareness of the potential legal risks arising from complying with a foreign official’s extortionate demand. It is clear that economic coercion will not support an extortion or duress defense. Beyond that, when the physical safety of employees is threatened, whether an otherwise improper payment is defensible as “true extortion” and how any such payment should be recorded in the company’s books and records present nuanced questions of fact and law that must be weighed on a case-by-case basis.

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¹ S. Rep. No. 95-114, at 11 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098, 4108.

² Opinion and Order, *United States v. Kozeny*, 05 Cr. 518 (SAS) (S.D.N.Y. Oct. 21, 2008).

³ S. Rep. No. 95-114, at 10, *reprinted in* 1977 U.S.C.C.A.N. at 4108.

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