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CLIENT MEMORANDUM

DEPARTMENT OF JUSTICE AND SECURITIES AND EXCHANGE COMMISSION ISSUE LONG-AWAITED FCPA GUIDANCE

On November 14, 2012, the U.S. Department of Justice (the "DOJ") and U.S. Securities and Exchange Commission (the "SEC") released long-awaited guidance on the U.S. Foreign Corrupt Practices Act (the "FCPA"). Although 120 pages in length with over 400 footnotes, the "Resource Guide to the U.S. Foreign Corrupt Practices Act" (the "Guide") breaks little or no new ground. Rather, it summarizes the FCPA and its elements and defenses, discusses factors considered by the DOJ and SEC in bringing and resolving FCPA enforcement actions, and provides general guidance about corporate compliance programs.

In areas that have been the focus of recent public debate, legislative activity, and court challenges—such as the definition of "foreign official," the facilitating payment exception, the scope of permissible gifts, travel, and entertainment for foreign officials, and the application of successor liability in the FCPA context—the DOJ and SEC have not altered their past positions. In many instances, in the absence of judicial precedent or other binding authority, the DOJ and SEC simply reiterate positions they have taken in the past, whether in internal prosecution guidelines, DOJ Opinion Procedure Releases, or settled enforcement actions. The Guide also contains hypothetical examples concerning a variety of topics. Although these concrete examples are a welcome addition, in many instances the examples are far enough from "the line" that they may be of limited utility to companies grappling with close compliance questions. Overall, the Guide is a useful compendium of the U.S. regulators' current positions on a variety of FCPA compliance and enforcement topics.

Among the topics addressed in the Guide are (i) gifts, travel, and entertainment, (ii) the scope of the terms "foreign official" and "instrumentality," (iii) third-party payments and due diligence, (iv) FCPA issues in mergers and acquisitions, (v) factors that will affect whether a matter is resolved by criminal or civil charges, a deferred prosecution agreement ("DPA") or non-prosecution agreement ("NPA"), or a declination, and (vi) corporate compliance programs. The Guide's treatment of these topics is discussed below. For a broader perspective on these and many other issues pertaining to the FCPA, see our comprehensive new book on the FCPA: *The Foreign Corrupt Practices Act: Compliance, Investigations, and Enforcement* (Law Journal Press 2012).

Gifts, Travel, and Entertainment

As previous enforcement actions have illustrated, the DOJ and SEC believe that "[i]tems of nominal value, such as cab fare, reasonable meals and entertainment expenses, or company promotional items, are unlikely to improperly influence an official," and thus, without more, do

not violate the FCPA.[1] The larger or more extravagant a gift, however, "the more likely it was given with an improper purpose."[2] Improper gifts could include "single instances of large extravagant gift-giving (such as sports cars, fur coats, and other luxury items) as well as widespread gifts of smaller items as part of a pattern of bribes."[3] In addition, companies could also violate the FCPA "if they give gifts to third parties, like an official's family members, as an indirect way of corruptly influencing a foreign official."[4] Hallmarks of appropriate gift-giving include circumstances "when the gift is given openly and transparently, properly recorded in the giver's books and records, provided only to reflect esteem or gratitude, and permitted under local law."[5] The DOJ and the SEC note that compliance programs should include appropriate gift-giving policies.

The Guide reaffirms the DOJ and SEC's view that "[w]hether any particular payment [for the travel or lodging of a foreign official] is a *bona fide* expenditure [and thus allowable under the FCPA] necessarily requires a fact-specific analysis" of relevant circumstances.[6] Consistent with prior DOJ Opinion Procedure Releases, the Guide provides a non-exhaustive list of safeguards that businesses can implement in connection with providing travel and lodging to foreign officials:

- Do not select the particular officials who will participate in the trip or program or select them based on pre-determined, merit-based criteria;
- Pay all costs directly to travel and lodging vendors and/or reimburse costs only upon presentation of a receipt;
- Do not advance funds or pay for reimbursements in cash;
- Ensure that any stipends are reasonable approximations of costs likely to be incurred and/or that expenses are limited to those that are necessary and reasonable;
- Ensure that expenditures are transparent, both within the company and to the foreign government;
- Do not condition the payment of expenses on any action by the foreign official;
- Obtain written confirmation that payment of the expenses is not contrary to local law;
- Provide no additional compensation, stipends, or spending money beyond what is necessary to pay for actual expenses incurred; and

[1] Guide at 15.

[2] *Id.*

[3] *Id.*

[4] *Id.* at 16.

[5] *Id.* at 15.

[6] *Id.* at 24.

- Ensure that costs and expenses on behalf of the foreign officials will be accurately recorded in the company's books and records.[7]

As part of its guidance on gifts, travel, and entertainment, the Guide also provides several hypotheticals reflecting what the DOJ and SEC consider appropriate and inappropriate under the FCPA. For example, in one hypothetical involving a multi-day international trip for training and inspection purposes, the DOJ and SEC consider "business class airfare," a "moderately priced dinner, a baseball game, and a play" to be reasonable and *bona fide* expenses under the FCPA.[8] In the next hypothetical, however, the DOJ and the SEC make clear that "first-class" travel with spouses for an "all-expenses paid, week-long trip to Las Vegas, where [the company] has no facilities" would be inappropriate under the FCPA.[9] These hypotheticals comport with prior DOJ and SEC guidance on gifts, travel, and entertainment.

The Scope of the Terms "Foreign Official" and "Instrumentality"

The Guide also addresses the scope of the terms "foreign official" and "instrumentality." Under the FCPA, the term "foreign official" includes, *inter alia*, "any officer or employee of a foreign government or any department, agency, or instrumentality thereof . . . ."[10] The FCPA, however, does not define the term "instrumentality," nor can a clear definition be found in the legislative history or case law interpreting the statute. The absence of a clear definition creates substantial ambiguity as to the types of entities whose employees may qualify as foreign officials. For example, although the DOJ and the SEC have taken the position that the term "instrumentality" includes state-owned entities, and thus that the term "foreign official" includes ordinary employees of such entities, the statute does not clearly resolve the issue.

In the Guide, the DOJ and SEC reaffirm that the term "instrumentality" is "broad and can include state-owned or state-controlled entities."[11] The Guide does not identify specific ownership levels that will qualify an entity as state-owned or state-controlled. It notes that "as a practical matter, an entity is unlikely to qualify as an instrumentality if a government does not own or control a majority of shares"; however, "there are circumstances in which an entity would qualify as an instrumentality absent 50% or greater foreign ownership."[12] As an example, the Guide notes a prior enforcement action in which a French issuer's subsidiaries were convicted of bribing employees of a Malaysian telecommunications company that was 43 percent owned by Malaysia's Ministry of Finance. In that case, notwithstanding the Ministry's minority stake, it had the status of "special shareholder," had veto rights over all major expenditures, and

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[7] *Id.*

[8] *Id.* at 18.

[9] *Id.*

[10] 15 U.S.C. §§ 78dd-1(f)(1)(A), 78dd-2(h)(2)(A), 78dd-3(f)(2)(A).

[11] Guide at 20.

[12] *Id.* at 21.

controlled important operational decisions—and most senior company officers were political appointees.[13]

In determining whether an entity is an "instrumentality," the Guide "requires a fact-specific analysis of an entity's ownership, control, status, and function."[14] Relevant factors include: (i) the foreign state's extent of ownership of the entity; (ii) the foreign state's degree of control over the entity (including whether key officers and directors of the entity are, or are appointed by, government officials); (iii) the foreign state's characterization of the entity and its employees; (iv) the circumstances surrounding the entity's creation; (v) the purpose of the entity's activities; (vi) the entity's obligations and privileges under the foreign state's law; (vii) the exclusive or controlling power vested in the entity to administer its designated functions; (viii) the level of financial support by the foreign state (including subsidies, special tax treatment, government-mandated fees, and loans); (ix) the entity's provision of services to the jurisdiction's residents; (x) whether the governmental end or purpose sought to be achieved is expressed in the policies of the foreign government; and (xi) the general perception that the entity is performing official or government functions.[15] The Guide encourages companies to consider these factors in evaluating the risk of FCPA violations and in designing compliance programs.

Third-Party Payments and Due Diligence

The Guide also reaffirms the DOJ and SEC view of liability for third-party payments and third-party due diligence. The FCPA covers both direct and indirect transfers to foreign officials; indirect transfers create liability where a person makes a transfer "while knowing" that all or a portion of such money or thing of value will be offered, given, or promised to a foreign official. Under the FCPA, a person's state of mind is "knowing" if the person:

- Is aware that [he] is engaging in such conduct, that such circumstance exists, or that such result is substantially certain to occur; or
- Has a firm belief that such circumstance exists or that such result is substantially certain to occur.[16]

Under the FCPA, a person has the requisite knowledge if he "is aware of a high probability of the existence of such circumstance, unless [he] actually believes that such circumstance does not exist."[17]

The Guide identifies a number of "red flags" for which companies should be alert when engaging third parties: (i) excessive commissions to third-party agents or consultants; (ii) unreasonably large discounts to third-party distributors; (iii) third-party "consulting agreements"

[13] *Id.*

[14] *Id.* at 20.

[15] *Id.*

[16] 15 U.S.C. §§ 78dd-1(f)(2), 78dd-2(h)(3), 78dd-3(f)(3).

[17] 15 U.S.C. §§ 78dd-1(f)(2), 78dd-2(h)(3), 78dd-3(f)(3).

that include only vaguely described services; (iv) the third-party consultant is in a different line of business than that for which it has been engaged; (v) the third party is related to or closely associated with a foreign official; (vi) the third party became part of the transaction at the express request or insistence of a foreign official; (vii) the third party is merely a shell company incorporated in an offshore jurisdiction; and (viii) the third party requests payment to offshore bank accounts.[18]

The Guide notes that businesses can reduce the FCPA risks associated with third parties by implementing an effective compliance program, including third-party due diligence, which can vary based on industry, country, size, and nature of the transaction, and on historical relationship with the third party. Nevertheless, the Guide makes clear that several principles "always apply."[19] *First*, as part of risk-based due diligence, companies should understand the qualifications and associations of their third-party partners, including their business reputations and relationships, if any, with foreign officials; the degree of scrutiny should increase if red flags surface. *Second*, companies should have an understanding of the business rationale for including the third party in the transaction (including confirming the role and need for the third party; ensuring that the contract terms specifically describe the services to be performed; considering payment terms and how they compare to typical terms in the industry; and confirming that the third party is actually performing the work for which it is being paid and that the compensation is commensurate with the work being provided). *Third*, companies should undertake some form of monitoring for third-party relationships, such as updating due diligence, exercising audit rights, providing periodic training, and/or requesting annual compliance certifications. *Finally*, companies should inform third parties about their compliance programs and, where appropriate, seek assurances through FCPA certifications or otherwise. The Guide provides multiple hypotheticals on "third-party vetting," covering consultants, distributors, and local partners.[20]

Mergers and Acquisitions

The Guide also provides a discussion of FCPA compliance risks in mergers and acquisitions—including practical tips on conducting due diligence to mitigate such risks. The Guide again reaffirms positions taken by the DOJ and SEC in past enforcement proceedings.

The Guide offers both legal and business reasons for companies to conduct pre-acquisition due diligence and to quickly integrate acquired companies into their compliance programs and internal controls systems post-acquisition. Taking these measures helps an acquiring company to value the target company accurately; reduces the risk that any improper payments by the acquired company will continue; allows the acquiring company to handle potential violations in an orderly and efficient manner; and demonstrates a genuine commitment to uncovering and preventing FCPA violations. The Guide notes that "[i]n a significant number of instances, DOJ and SEC have declined to take action against companies that voluntarily disclosed and remediated conduct and cooperated with DOJ and SEC in the merger and acquisition context"—

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[18] Guide at 22-23.

[19] *Id.* at 60.

[20] *Id.* at 63-65.

although it acknowledges that the DOJ and SEC still may pursue an enforcement action against a predecessor company (rather than the acquiring company) in that circumstance.[21]

To reduce FCPA risks in mergers and acquisitions, the DOJ and SEC encourage companies to take various measures, including: (i) conducting thorough risk-based FCPA and anticorruption due diligence on potential new business acquisitions; (ii) ensuring that the acquiring company's code of conduct and compliance policies and procedures regarding the FCPA and other anticorruption laws apply as quickly as practicable to newly acquired businesses or merged entities; (iii) training directors, officers, and employees of the newly acquired business or merged entities, and, where appropriate, training agents and business partners on anticorruption compliance; (iv) conducting an FCPA-specific audit of the newly acquired or merged businesses as quickly as practicable; and (v) disclosing any corrupt payments discovered as part of due diligence of newly acquired entities or merged entities.[22] These measures previously appeared in compliance program requirements imposed in various settled FCPA enforcement actions, including recent cases involving Pfizer, the NORDAM Group, BizJet International, and Data Systems & Solutions.

Factors Affecting Whether a Matter Is Resolved by Criminal or Civil Charges, a DPA, an NPA, or a Declination

The Guide also discusses factors that affect whether a matter is resolved by criminal or civil charges, a DPA, an NPA, or a declination. It includes several anonymized examples of past declinations in enforcement matters. The DOJ and SEC typically do not publicize declinations, but the Guide includes these examples "to provide some insight into the process."[23]

The Guide reiterates that the DOJ's decision on whether to bring charges against a company is governed by the *Principles of Federal Prosecution of Business Organizations*, which requires prosecutors to consider nine separate factors, including the nature and seriousness of the offense, the pervasiveness of wrongdoing within the company, the company's history of similar conduct, the existence and effectiveness of a pre-existing compliance program, and the adequacy of other remedies, such as civil or regulatory enforcement actions. The SEC's decision-making process is governed by the *SEC Enforcement Manual*, which considers, among other factors, the seriousness of the conduct and potential violations, the resources available to SEC staff, the sufficiency and strength of the evidence, the extent of potential investor harm if an action is not commenced, and the age of the conduct underlying the potential violations.

The declination examples cited in the Guide include most or all of the following factors: relatively minimal misconduct (*e.g.*, a low bribe amount); detection of the misconduct by the compliance program or internal controls; a thorough, independent, and prompt internal investigation; remediation, including disciplining culpable employees, terminating corrupt third parties or contracts, training, and compliance program enhancements; and voluntarily self-reporting to the DOJ and SEC and full cooperation with government investigations. Although a

[21] *Id.* at 28-30.

[22] *Id.* at 29.

[23] *Id.* at 77.

declination may be possible in the absence of one or more of these factors, the examples offer a helpful context against which companies can measure their own potential compliance problems and remedial measures.

Corporate Compliance Programs

The Guide likewise provides a discussion of the DOJ's and SEC's views on corporate compliance programs—including the factors that the DOJ and SEC consider to be the "hallmarks of effective compliance programs."[24] The Guide again comports with the regulators' previous positions on the issue.

The Guide states that the DOJ and SEC have "no formulaic requirements regarding compliance programs" but instead "employ a common-sense and pragmatic approach to evaluating compliance programs, making inquiries related to three basic questions":

- Is the company's compliance program well designed?
- Is it being applied in good faith?
- Does it work?[25]

Echoing other sources of guidance on corporate compliance programs, the DOJ and SEC consider the following factors to be hallmarks of an effective compliance program: (i) commitment from senior management and a clearly articulated policy against corruption; (ii) a code of conduct and compliance policies and procedures; (iii) oversight, autonomy, and resources; (iv) risk assessment; (v) training and continuing advice; (vi) incentives and disciplinary measures; (vii) third-party due diligence and compliance policies; (viii) confidential reporting and internal investigation of suspected or actual misconduct; (ix) continuous improvement with periodic testing and review; and (x) pre-acquisition due diligence and post-acquisition integration for mergers and acquisitions.[26]

Conclusion

Although the Guide does not break new ground, it should be a useful resource for companies subject to the FCPA. It provides the DOJ's and SEC's viewpoints on key FCPA compliance and enforcement issues and gathers in one document previously disparate guidance from the regulators.

Those hoping for a sea change in the government's approach to FCPA enforcement undoubtedly will be disappointed by the Guide. But companies that are subject to the FCPA should review the Guide carefully and benchmark their own compliance programs and practices with those endorsed in the Guide. For companies that have been attentive to FCPA developments in recent years, the Guide should portend few, if any, significant changes in their approach to FCPA

[24] *Id.* at 57.

[25] *Id.* at 56.

[26] *Id.* at 57-62.

compliance. Companies with compliance systems that are still evolving should find the Guide a convenient and helpful resource as they consider the DOJ's and SEC's views on FCPA compliance issues.

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