BASICS OF THE FOREIGN CORRUPT PRACTICES ACT

Illinois companies exported $42.1 billion worth of merchandise to 209 foreign countries in 2006.[1] And this number will continue to grow as the U.S. economy draws closer to the economies of our existing NAFTA partners, recently added CAFTA partners, and countries around the world. In addition, the outsourcing craze of the past decade now requires additional infrastructure investments throughout the world that will be fulfilled in significant part by U.S. companies.

Therefore, it is more important than ever to understand the laws and regulations that govern the export of your company's goods. This is particularly true for small and mid-sized companies that must have the sharpest elbows to compete with Fortune 500 companies yet must still meet the same rigorous compliance standards with export laws.

One export law that companies must be aware of is the Foreign Corrupt Practices Act of 1977.[2] (FCPA) In fact, the importance of complying with the FCPA was recently highlighted by the Attorney General, who recently noted that the Department of Justice is increasingly focusing on the FCPA and training foreign law enforcement partners.[3] While the FCPA was enacted to prohibit outright bribery and other questionable payments by U.S. companies to foreign officials, the law goes well beyond clear cut situations of bribery and strictly regulates the payment of anything of value directly or indirectly to foreign officials. In fact, the FCPA applies to many business situations that may appear to be commonly accepted or proper ways of doing business.

The purpose of this article is twofold. First, this article provides companies with an overview of the FCPA, which has two parts: (1) a ban on the payment of bribes to foreign officials to secure a business advantage; and (2) a reporting requirement for publicly traded companies and their subsidiaries. Second, this article provides companies with practical advice to detect and prevent FCPA violations.

I. AN OVERVIEW OF THE FCPA

After multiple revisions to the original FCPA, the law now covers all persons who attempt to violate the Act's anti-bribery or reporting requirements. So what specific acts are prohibited by the FCPA?

1. Prohibition on payments to foreign officials for a business advantage.

Before analyzing the text of the FCPA anti-bribery provisions, it is important to note that the FCPA applies to everyone (domestic and foreign persons) and everywhere

[1] http://www.ita.doc.gov/TD/Industry/OTEA/state_reports/illinois.html (visited July 13, 2007)

[2] Foreign Corrupt Practices Act of 1977, Pub.L.No. 95-23, 91 Stat. 1494 (codified as amended at 15 U.S.C.78m, 78dd-1 to 78dd-2,78ff (1994) as amended by International Anti-bribery and Fair Competition Act of 1998, 15 U.S.C.A. 78dd-1 to 78dd-3,78ff (1999).

[3] http://www.usdoj.gov/ag/speeches/2007/ag_speech_070301.html (visited July 13, 2007)

(acts undertaken in the U.S. and abroad).[4] It is also noteworthy that the FCPA's anti-bribery provisions have been interpreted broadly by the Department of Justice and the courts. Thus, while reviewing the basic elements of statute one must keep in mind that very strict standards are applied to deter the bribery of foreign officials.

All of the following four basic elements must be met to prove a violation of the FCPA's anti-bribery provisions:

- An offer, payment, promise to pay, or authorization of the payment of money or anything of value;

- To (a) any official or employee of a foreign government, (b) any foreign political party or party official, (c) any candidate for foreign political office, (d) any official or employee of a public international organization, or (e) any other person knowing that all or a portion of the payment or promise of future payment shall be passed on to any of the persons previously listed;

- Corruptly for a purpose of influencing any act or decision of that person or party, inducing that person to do or omit to do an act in violation of that person's or party's lawful duty, securing an improper advantage, or inducing that person or party to use his or its influence with a foreign government to affect or influence any act or decision;

- In order to assist the company in obtaining or retaining business or directing business to any person.[5]

As a brief note, there is an interstate commerce requirement in the statute but that prong is so easily met that it will not be discussed any further.[6]

A. What is an improper act?

This provision of the statute is written very broadly to not only include actual payments; instead, it includes offers and promises to pay. Thus, the payment need not be made to the foreign official. In a similar vein, "authorizations" to pay are also criminalized, so an attempt to pay is not necessary if an employee or agent was tasked with bribing a foreign official.

Similarly, the bribe can be "anything of value" and not just a monetary reward. This language parallels the language criminalizing the bribing of a federal official[7] and other statutes for which this terms has been interpreted broadly. In addition, there are no safe harbors governing the amount or cultural business courtesy.

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[4] 15 U.S.C. §§ 78dd-1, 78-dd2, 78dd-3.
[5] 15 U.S.C. §§ 78dd-1, 78-dd2, 78dd-3.
[6] *Id.*
[7] 18 U.S.C. § 201.

B. Who cannot receive anything of value?

In all likelihood, the key decisionmaker the company would like to influence is a sitting foreign official or someone who will foreseeably serve as a foreign official. The actual term "foreign official" is broadly defined in the FCPA, which means that it includes legislators; executive officials; quasi-governmental officials; and employees of state-owned companies.

This means that companies should investigate whether their counterparts are publicly or privately owned, especially when operating in countries that are not known as proponents of the free market. For example, it may be easy to qualify Chinese corporate executives as "foreign officials" even though the company appears to be dealing with a private company.

The FCPA also prohibits the payment of bribes to candidates for office. Where companies can get unto serious trouble under this provision are the acts of their foreign partners, joint ventures, and agents. While the company does not want to infringe on anyone's right to participate in local elections, campaign contributions can result in a FCPA violation if the purpose of the contribution was to benefit the company or its cooperation with its foreign agent. With this in mind, companies often implement blanket policies prohibiting its foreign agents from making any political contributions that in any way relate to any of the company's operations, subsidiaries, partnerships, or joint ventures.

The FCPA does not govern payments made or promised to private entities although foreign laws may prohibit those payments.

C. What is a corrupt purpose?

Yet again, Congress failed to define the term "corruptly" within the FCPA. To fill the breach, two different U.S. Courts of Appeals have offered guidance:

- The Fifth Circuit noted that the legislative history of the FCPA makes the definition clear: "…by only prohibiting payments that induce an official to act 'corruptly', i.e., actions requiring him 'to misuse his official position' and his discretionary authority, not those 'essentially ministerial' actions that 'merely move a particular matter toward an eventual act or decision or which do not involve any discretionary action.'"[8]

- The Eighth Circuit approved a jury instruction in a FCPA case defining corruptly: "[A]n act is 'corruptly' done if done voluntarily [a]nd intentionally, and with a bad purpose of accomplishing either an unlawful end or result, or a lawful end or result by some unlawful method or means."[9]

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8 *United States v. Kay*, 359 F.3d 738, 747 (5th Cir. 2004). (citations omitted)

9 *United States v. Liebo*, 923 F.2d 1008, 1012 (8th Cir. 1991).

Combining the two definitions, a corrupt act under the FCPA is performed with the intent to cause a foreign official to misuse his or her official position as a decisionmaker. However, the FCPA makes it clear that intent can be established through constructive knowledge—so companies cannot choose to consciously disregard or deliberately ignore possible *quid quo pro* payments that they know or have a reason to know are taking place.

D. What is an unlawful business purpose?

At its broadest, the FCPA prohibits the securing of an improper advantage in order to assist the company in obtain or retain business or direct business to any person. Simply put, an improper advantage includes any preferential treatment to which the company is not otherwise entitled.

It is important to note that this aspect of the statute is not restricted to doing business with foreign governments or state-owned entities. Rather, the broad language of the statute makes it clear that bribes to foreign officials that concern purely private relationships or the creation of unfair marketplaces for products are also prohibited.

E. What payments are permitted by the FCPA?

Three basic categories of payments do not generate FCPA liability: (1) "grease payments"; (2) bona fide business expenditures; and (3) payments permitted by local law.

"Grease payments" in the U.S. business vernacular are paid to expediters. These are payments that are made "merely to move a particular matter toward an eventual act of decision."[10] This includes payments to obtain permits, licenses, and similar official documents as well as gaining access to basic services such as water, cargo, mail, and telephones. The theory behind permitting these payments is that they involve ministerial and nondiscretionary "non-governmental actions."[11] Therefore, this exception does not apply to an award or a continuation of a business relationship with a foreign government.

Bona fide business expenditures are another affirmative defense under the FCPA.[12] Specifically, the statute states it "shall be an affirmative defense to action under…this section that 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: (a) the promotion, demonstration, or explanation of products or services; or (b) the execution or performance of a contract with a foreign government or

[10] H.R. Rep. No. 95-640 (1977)(www.usdoj.gov/criminal/fraud/fcpa/history/1977/houseprt.html). See also 15 U.S.C. §§ 78dd-1(b), 78-dd2(b), 78dd-3(b).

[11] 15 U.S.C. §§ 78dd-1(f)(3)(A), 78-dd2(h)(4)(A), 78dd-3(f)(4)(A).

[12] 15 U.S.C. §§ 78dd-1(c)(2), 78-dd2(c)(2), 78dd-3(c)(2).

agency thereof."[13] This means that nominal gestures and common business practices will not result in FCPA liability.

Companies typically face issues regarding the bona fide expenditure defense in conjunction with promotional tours and items related to business travel. It is imperative that business travel is directly related to the commercial relationship (operations, quality control, etc.) between the company and the foreign official. So when a company paid for expense-paid trips—that included tourist destinations—for foreign officials who had no actual decisionmaking authority, the Department of Justice found that this trip was not a bona fide business expenditure.

Finally, payments permitted by local law are exempt from FCPA liability.[14] Of course, this means the codified laws of a country and not whatever the local custom may be. That being said, many countries do not have laws regarding payments to government officials on the books; therefore, local counsel in the foreign country may need to be engaged to review a proposed transaction.

2. Internal reporting requirements and controls

A. Bookkeeping requirements

The FCPA requires issuers to "make and keep books, records, and accounts which, in *reasonable detail*, accurately and fairly reflect the transactions and dispositions of the assets."[15] The term "reasonable detail" means "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[16] The FCPA does not provide any further guidance concerning (1) the procedures businesses must utilize to maintain their books and records nor (2) the specific internal controls necessary to meet the reasonable detail standard.

Therefore, while the test is reasonability—and not materiality—it is still a reasonably prudent official test. And undoubtedly, prudent corporate officials are very interested in knowing whether accurate books are being kept, especially in light of the strict requirements of the Sarbanes Oxley Act of 2002 (commonly known as SOX). On the other hand, any mistakes made within the context of being reasonably prudent do not generate liability.

I. Who can be held liable?

The FCPA's bookkeeping requirements are imposed only on "issuers", which are defined as companies whose securities are registered with the SEC or who are required to file reports with the SEC per the Securities and Exchange Act of 1934.[17] All issuers are

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[13] *Id*.
[14] 15 U.S.C. §§ 78dd-2(c)(1).
[15] 15 U.S.C. § 78m(b)(2)(A). (emphasis added)
[16] 15 U.S.C. § 78m(b)(7).
[17] 15 U.S.C. § 78m(a).

required to follow these requirements regardless of whether they are engaging in foreign commerce.

However, the inquiry does not end with the statutory language because the SEC promulgated two rules under FCPA governing issuers' accounting practices. First, Rule 13b2-1 provides that "[n]o person shall, directly or indirectly, falsify or cause to be falsified, any book, record or account subject to [the FCPA's bookkeeping provisions]."[18] Significantly, the SEC expands the pool of potential violators to "persons" so that the actual person who engaged in the falsification can be held liable and not just the company itself, the issuer.

Second, Rule 13b2-2, prohibits (a) materially false or misleading statements by directors or officers to accountants in connection with audits and SEC reports; and (b) intentional omissions of material facts to accountants regarding FCPA compliance or any other filing with the SEC.[19] [22] Thus, Rule 13b2-2 significantly departs from both the statute and Rule 13b2-1. In contrast with the FCPA itself, Rule 13b2-2 has a materiality requirement that does not exist within the statute. The addition of a materiality requirement makes prosecution more difficult under this rule. With regard to Rule 13b2-1, Rule 13b2-2 affects a narrower class of people. Rule 13b2-2 applies only to directors and officers, whereas Rule 13b2-1 applies to all persons.

II. How do FCPA bookkeeping violations occur?

Interestingly, the most common types of FCPA bookkeeping violations involve the intentional hiding of other improper activities. These acts are both commissions (partial or total misrepresentations in corporate records) and omissions ("off the books" transactions that are never recorded). Because there is no materiality requirement under the FCPA, this means that minor or simple infractions can result in FCPA sanctions.

It is commonly known that employees try to mask their criminal acts. Employees are most likely to try to hide other blatant criminal acts with foreign entities that include smuggling, tax evasions, kickbacks, and customs violations. But other acts that do not appear to be violations need to be accurately described to ensure that that are not violations. For example, "payment to foreign agent X" would not suffice as an accurate description when the purpose of the payment to the foreign agent is known.

III. How has SOX affected these FCPA requirements?

Sarbanes-Oxley or SOX[20] has had a dramatic impact on FCPA compliance, primarily because companies and their executives now fear a greater threat of investigation, prosecution, and liability directly resulting from bookkeeping practices. One major change has been a far greater willingness by companies to "self-report" violations that are uncovered from internal investigations or transactional due diligence.

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[18] 17 C.F.R. § 240.13b2-1.

[19] 17 C.F.R. §240.13b2-2.

[20] The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

Two particular SOX provisions are largely responsible for the increased self-reporting—Sections 302 and 404—because of the heightened penalties for failing to prevent, detect, or respond to fraudulent accounting practices. First, Section 302 mandates that CEOs and CFOs of companies of publicly traded companies to file and to certify reports to the SEC that (1) financial statements filed with the SEC fairly and accurately represent the company's financial condition; (2) within 90 days prior to the certification, the certifying officers have evaluated the company's internal controls and found the controls to be adequate; and (3) the certifying officers reported to the company's auditors and audit committee any internal-controls deficiencies and any fraud involving management that they detected.[21] Section 404 and its underlying regulations require companies to (1) implement and maintain an adequate financial reporting system with internal controls and appropriate procedures; and (2) annually analyze whether those controls and procedures are effective.[22] Of note, unlike the FCPA, Section 404 makes no distinction between majority and minority interests in foreign subsidiaries.

These two SOX provisions place responsibility for combating improper recordkeeping with the company's highest ranking officers. With the certifying officers facing possible personal liability, it is unsurprising that companies have ramped up their internal controls and procedures as well as other anti-fraud measures. This means that the Board of Directors or Audit Committee will either assume direct responsibility for investigating the possible violation or closely supervise management's investigation.

Through SOX compliance initiatives companies are internally discovering a greater number of FCPA violations, which also creates possible criminal liability under Section 906 of SOX. Section 906 is a criminal provision much like Section 302 that states that a manager who willfully certifies a periodic report filed with the SEC that abrogates the requirements of the accounting provisions of the FCPA faces criminal penalties of up to 20 years in prison and/or fines of up to $5 million.[23] Likewise, SOX's increased criminal penalties for obstruction of justice (including document destruction)[24] and whistleblower protection[25] mean that any investigation must be thorough, independent, and unrestricted.

In total, the passage of SOX clearly has added significantly to the array of tools available to the government to investigate and prosecute, civilly and criminally, violations of the FCPA accounting provisions. Moreover, in the wake of the accounting scandals that spawned SOX, regulators are pursuing such investigations and prosecutions more aggressively than ever. Accordingly, it is imperative that organizations and their advisors carefully consider the interrelationship of the new SOX reporting and disclosure provisions with organizations' own FCPA compliance measures.

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[21] 15 U.S.C. §7241.
[22] 15 U.S.C. §7262.
[23] 18 U.S.C. §1350.
[24] 18 U.S.C. §1519-20.
[25] 18 U.S.C. §1348.

II. PROACTIVE MEASURES TO AVOID FCPA VIOLATIONS

Two factors determine the extent to which an FCPA compliance program is needed (1) the size of your business and (2) whether you are publicly traded—factors that are certainly related. For if your company is a smaller one, then it is much easier to drill into the key decisionmakers how to prevent clear violations and questionable factual scenarios. On the other hand, large corporations need integrated FCPA compliance programs and reminders to a sizeable number of employees of *per se* and possible FCPA pitfalls. Likewise, publicly traded companies have Sarbanes-Oxley and other securities law requirements that require internal controls into which FCPA compliance measures can be weaved.

But regardless of the size of the company, there are certain measures that should be taken:

1. Establish and continually evaluate a FCPA policy that is effectively communicated to the relevant employees.

In total, a compliance program should meet the seven criteria set forth by the U.S. Sentencing Commission for establishing an "effective compliance program":

1. The compliance program must be reasonably capable of reducing the prospect of criminal activity. This means that the company must be actually interested in combating fraud.
2. Specific high-level personnel must be responsible for overseeing compliance efforts.
3. The company must employ due care to ensure that that substantial discretionary authority is not delegated to individuals who may, based on background or other factors, have "a propensity to engage in illegal activities."
4. The compliance program's standards and procedures must be effectively disseminated to all employees.
5. Reasonable efforts must be taken to achieve compliance with the compliance program's standards.
6. Violators of the compliance program must be disciplined though an established mechanism.
7. If and when violations are detected, the company must make appropriate modifications to the compliance program to prevent future violations.[26]

Case law and plea agreements provide additional guidance as to the proper creation and implementation of an effective guidance program.[27]

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[26] U.S. Sentencing Guidelines (USSG), ch. 8, Commentary 8C2.5. *See* 56 Fed. Reg. 22,785 (May 16, 1991).

[27] The case most commonly cited as a road map for creating an effective compliance program is *U.S. v, Metcalf & Eddy*, 99 Civ. 12566-NG (D. Mass. Filed Dec. 14, 1999).

Special measures should be taken to enhance the effectiveness of the compliance program. Special FCPA guidance needs to be provided to employees who are responsible for (1) directly interfacing with foreign officials, (2) managing employees who interface with foreign officials, and (3) hiring and/or working with agents who act on behalf of the company. In so doing, companies should initially provide seminars in which employees can ask specific questions about how they can accomplish their jobs without running afoul of the FCPA. This is particularly important for employees and agents engaged in hosting, gift giving, and/or entertaining foreign officials.

From there, companies should use existing reporting mechanisms through which possible FCPA violations could be reported and subsequently investigated. This could be as simple as instructing employees to contact the general counsel's office whenever they need guidance or believe an FCPA violation may be or has been committed. Likewise, it is common practice that companies require pre-clearance from compliance/legal departments before a foreign official may be hosted, given a gift, or entertained.

Additionally, the company should take measures to ensure implementation of the FCPA compliance program's directives with recordkeeping and financial personnel. One effective tool is to mesh FCPA compliance into a company's regular audits to ensure that internal controls and recordkeeping requirements are followed. Other effective tools include (1) reminding relevant employees of FCPA issues through issue alerts; (2) including FCPA advisories in ethics programming; (3) hiring internal auditors with FCPA experience; (4) include FCPA provisions in standard employment agreements; and (5) enlisting the company's human resources department to trigger FCPA training whenever current employees are promoted or reorganized into certain positions. Finally, it is imperative that companies also keep on eye on their subsidiaries—after all, this could result in FCPA liability for the parent company.

2. Investigate all agents the company hires to interface with foreign officials.

As noted earlier, a company can be criminally liable for the acts of its agent. Therefore, it is imperative that a company proactively engage in background checks on all of the agents it hires to interfaces with foreign officials. In fact, it is universally recommended that companies who can afford to run background checks should do so when available. At a minimum, some level of diligence (e.g., reference checks) should be exercised. No matter what the due diligence mechanism used, the company should maintain documentation of its investigatory efforts to mitigate any enforcement action should an agent violate the FCPA post-engagement. The cost of performing a background check is minimal compared to the fallout from failing to do so.

3. Transactional Issues Arising From Purely Private Transactions

Companies can incur FCPA liability through joint ventures, acquisitions, mergers, foreign investments, infrastructure projects and a host of other transactions. Thus, companies must be vigilant even when engaging in purely private transactions. Here are a few recommendations to ensure the engagement of above board business partners:

- Analyze the amount and percentage of business your prospective business partner engages in with foreign governments. From there, analyze which foreign governments your prospective business partner does its largest volumes and percentages of business. This provides the relevant avenues of inquiry if necessary.
- Avenues of inquiry should include: all public sources of information both foreign and domestic, including talking with U.S. government employees; references from companies who do business with the prospective business partner; and direct interviews with the prospective business partner's relevant employees.
- Analyze the text of the agreement to determine whether there are any "loopholes" or exemptions that could generate liability. For example, the creation of funds that can be spent by your prospective business partner that do not require approval by or disclosure to your company.
- Require the prospective business partner to disclose its complete ownership structure and all shareholders, directors, officers, and any other entity with an interest in the success of the company.
- Review any intra-family relationships between the prospective business partner and relevant government officials.
- Ensure the commissions are within the normal standard for such operations. Padded commissions can reflect the anticipated payment of bribes.
- Require that payments will be made only to specified financial institutions that are related to the transaction and specified in the agreement. Do not agree to payments to third parties or unrelated financial institutions—especially one that are located within the foreign country where you will be doing business.
- Require the disclosure of all agents and sub-contractors who will be doing work on your behalf.
- Include a provision that represents, warrants, and covenants that the prospective business partner has not and will not violate the FCPA.
- Require annual certification of FCPA compliance.

Companies need to be particularly wary when they are engaging in transactions in countries with a high corruption index.[28] Corruption indices measure the perceived appearance of corruption is countries around the world. So when a country has the appearance of a high level of corruption, companies should enhance whatever techniques it employs to ensure it is working with the right business partner.

[28] http://www.transparency.org/policy_research/surveys_indices/cpi (visited July 13, 2007)

4. File an inquiry with the U.S. Government

An inquiry with the U.S. government is reserved for special situations when companies have concerns about a transaction and want pre-transactional guidance from the Department of Justice that the FCPA's anti-bribery provisions will not be violated. Responses from the Department of Justice are prompt—an opinion is issued no more than thirty days after the Department of Justice receives all of the information it requests to issue an opinion.[29] Requests must be specific and provide "all relevant and material information bearing on the conduct…and on the circumstances of the prospective conduct."[30]

However, even a "green light" opinion from the Department of Justice is not a complete barrier from future prosecution. A favorable opinion results only in a rebuttable presumption that the conduct described in the inquiry was lawful.[31] When applying the presumption, courts will weigh various factors, although the most important factor is determining whether the approved prospective conduct matches the conduct the company engaged in.

It is important to note that an inquiry governs only the company who requested the inquiry. Therefore, companies who do not join the request for an opinion cannot rely on the opinion as a safe harbor;[32] instead, the opinion can only serve as a non-binding persuasive argument in the event of prosecution.

CONCLUSION

Ultimately, most companies know that successful foreign trade is not dependent on illegal or questionable interactions with foreign officials, but rather on business fundamentals—the quality of the goods, services, and expertise that companies offer their customers. Yet companies, their subsidiaries, and their agents run afoul of the Foreign Corrupt Practices Act even when their motives are pure. Therefore, the best defense is a good offense to ensure adequate internal and external controls exist to avoid exposure to criminal liability. And if the Department of Justice or the Securities and Exchange Commission believes a Foreign Corrupt Practices Act violation may have occurred, then immediately contact an attorney with the relevant experience to minimize the damage to both your company and its reputation.

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[29] 28 C.F.R. §80.7
[30] 28 C.F.R. §80.6
[31] 28 C.F.R. §80.10
[32] 28 C.F.R. §80.5