The FCPA REPORT

www.fcpareport.com Volume 2, Number 5 March 6, 2013

Facilitation Payments

Facilitation Payments, Foreign Officials, Bona Fide Expenditures and More: Actionable Insight from the Authors of "Defending Clients in FCPA Investigations"

By Rebecca Hughes Parker

Mark P. Goodman and Bruce E. Yannett, partners at Debevoise & Plimpton LLP, and Daniel J. Fetterman, a partner at Kasowitz, Benson, Torres & Friedman LLP, are the FCPA experts behind "Defending Clients in Foreign Corrupt Practices Investigations," a chapter in the 2012 treatise "Defending Corporations and Individuals in Government Investigations." Their chapter addresses the hot button issues companies are facing today as the SEC and DOJ continue to increase the pressure on global companies to implement and enforce best of breed FCPA compliance programs.

Goodman and Fetterman recently shared their insight on some of these pressing issues with The FCPA Report. In our interview, they discussed how far the FCPA's jurisdiction reaches in light of recent case law and the FCPA Guidance, including the jurisdictional implications for aiders, abettors and conspirators; details regarding rewards under the new Dodd-Frank whistleblower provisions; who is a foreign official and whether it matters; how companies should handle facilitation payments; advice on reasonable business expenses after the Guidance; the concept of virtual strict liability in accounting violations of the FCPA; how judicial review will impact settlements; the collateral effects of an FCPA settlement; and when to self-report an FCPA violation.

Broad View of Jurisdiction Over Aiders and Abettors Will Be Hotly Contested

FCPAR: Many have characterized the FCPA's jurisdiction as very broad, saying that actions with an insignificant U.S. nexus are prosecuted. Do you agree?

Mark P. Goodman & Daniel J. Fetterman (G & F): Only a few weeks ago, Judge Richard Sullivan of the United States District Court for the Southern District of New York concluded that e-mails which were sent and received from outside of the United States could form the basis for the SEC to assert claims against certain employees of Magyar Telekom based on the "interstate commerce" language of the FCPA. [See "One U.S. District Court in New York Affirms Broad Jurisdictional and Temporal Reach of the FCPA While Another Dismisses FCPA Case for Lack of Contacts," The FCPA Report, Vol. 2, No. 4 (Feb. 20, 2013).]

This ruling follows the DOJ's and SEC's assertion of jurisdiction in similar cases involving e-mails, faxes and packages. Judge Leon of the United States District Court for the District of Columbia had rejected a "package delivery" theory of jurisdiction in 2010, but that case (one of the Africa sting suits) was based on the "in-the-territory" jurisdictional requirement set forth in 15 U.S.C. 78dd-3 for persons and entities that are neither subject to SEC

The FCPA REPORT

www.fcpareport.com Volume 2, Number 5 March 6, 2013

jurisdiction nor are U.S. "domestic concerns." This issue remains hotly contested, and we can expect litigation on this topic to continue.

The 2012 FCPA Guidance obviously is an important document for what it says on this topic, but it is not law – it is only the DOJ's and the SEC's respective views of the law. Perhaps of greatest concern in this respect is the assertion in the FCPA Guidance that alleged aiders and abettors and alleged conspirators might be charged, depending on the conduct of alleged primary violators or alleged co-conspirators, even if they themselves neither committed an act within the territory of the United States nor sent communications, packages, faxes or other items to the United States. While asserting that this theory is supported in some of the settlements entered into in recent years (including, for example, the JGC settlement), this very broad view of the law will be hotly contested. It could lead to broad challenges based on the notion that the wording of the FCPA sharply limits this use of the conspiracy and aiding and abetting statutes, if it does not preempt their use in FCPA prosecutions entirely.

Dodd-Frank Whistleblower Rules' Reach Is Uncertain

FCPAR: Do you think recent court cases have rendered Dodd-Frank's whistleblower provisions inapplicable to FCPA violations by holding that the provisions don't apply to whistleblowers outside of the United States? [See "Five Themes for General Counsel to Monitor With Respect to Dodd-Frank Whistleblowers and the FCPA," The FCPA Report, Vol. 1, No. 9 (Oct. 3, 2012).]

G & F: Even before the key decision on extraterritoriality was handed down in the Southern District of Texas in the General Electric litigation, the *Nollner* decision by a federal district judge in Tennessee had persuasively concluded that the Dodd-Frank whistleblower provisions did not apply to the FCPA's provisions covering domestic concerns and other entities and individuals subject to the FCPA solely by reason of conduct "in the territory" of the United States.

So, even before the first ruling on the extraterritorial issue, the range of FCPA issues that could have been the subject of whistleblower complaints already was limited, albeit only by one district court decision. Judge Atlas's decision in the General Electric litigation on the issue of extraterritoriality was nevertheless an important development and is very persuasive.

In addition to the fact that the decisions are at the district court level, and appellate developments or contrary decisions from other district courts are always possible, the following considerations merit caution: First, the General Electric decision relates to the anti-retaliation provisions of Dodd-Frank and might not necessarily control the SEC's ability to make payments to whistleblowers under the bounty provisions of the law, although those questions will be closely linked and defendants will doubtless argue that the issues are two sides of the same coin. Second, the Supreme Court is likely to provide more guidance in the *Kiobel* case on the matter of the presumption against extraterritoriality and that could affect how courts view this issue going forward.

The FCPA REPORT

www.fcpareport.com Volume 2, Number 5 March 6, 2013

Use of Accounting "Control in Fact" Guidelines to Help Determine State Control

FCPAR: You discuss the foreign official definition currently espoused by the government, and reinforced in the Guidance. Whether the entity at issue's employees are foreign officials depends on the degree to which the entity is controlled by the state, among other things. [See "U.S. Government Counters Foreign Official Challenge in the Eleventh Circuit," The FCPA Report, Vol. 1, No. 7 (Sep. 5, 2012).] That seems like a difficult analysis for an employee of a company to do on the ground. What advice do you have for companies training employees on how to determine if someone is a foreign official? Or does it even matter?

G & F: Many companies continue to express an interest in seeking to understand and categorize counter-party representatives as "public" or "private" for a number of reasons: (1) they perceive the risks of being prosecuted for commercial bribery as lower; (2) the kind of spending that might trigger commercial bribery liability can legitimately be argued to be higher than in the case of spending on government officials; and (3) for general reputational or business reasons.

The distinction is important and matters, particularly for companies that are subject to the FCPA but not to the U.K. Bribery Act, which explicitly prohibits commercial bribery. It also is clear that, in light of the *Schnitzer Steel* prosecution, in which the DOJ used the U.S. wire fraud statute to prosecute commercial bribery, the number of companies to which this distinction matters is decreasing, particularly given the costs in certain sectors (specifically pharmaceuticals and medical devices) and in certain places (particularly China) of determining whether an individual with whom one is dealing is a "foreign official" under U.S. law.

Employees of state-owned enterprises continue to pose recurring problems, and companies can apply the control-in-fact principles set forth in the relevant accounting guidance, including the Emerging Issues Task Force Memorandum 96-16 or FIN 46R, to assess when a parent corporate entity that is an arm of a foreign government is exercising "control-in-fact" over an enterprise. But this addresses only part, albeit the most important aspect, of the U.S. government's test, which is concededly multi-factored. One can hope that the Eleventh Circuit in the *Esquenazi* case will provide better guidance than we have now. Until we receive such guidance, the advice for companies seeking a high degree of confidence that they are on the right side of the law will be to resolve doubts about whether individuals are "foreign officials" in favor of the conclusion that they are.

Adopt a Bright-Line Policy Prohibiting Facilitation Payments

FCPAR: Like the foreign official determination, the analysis of whether a payment is a facilitation payment can also be tricky on the ground for employees. [See "Designing a Facilitation Payments Policy to Minimize Liability and Retain Flexibility (Part One of Two)," The FCPA Report, Vol. 1, No. 4 (Jul. 25, 2012); and Part Two of Two, Vol. 1, No. 5 (Aug. 8, 2012).] What is your advice to companies training employees about facilitation payments, especially given other laws' prohibitions of facilitation payments?

G & F: Companies would be well-advised to ban the use of facilitation or "grease" payments. Given the difficulty in determining what constitutes a facilitation payment under the FCPA, and the complete prohibition against such payments under the U.K. Bribery Act, companies can avoid the risk of liability altogether by adopting a bright-line policy which prohibits facilitation payments.

In the event that such a policy is impractical or the company decides that it is not desirable, a company should provide as many examples and fact patterns regarding facilitation payments as possible as part of its training program. Specifically, the examples should demonstrate what is proper and improper within the highly specific context of the region, industry and product in which the employee conducts business. Furthermore, companies should define what categories of "payments" are permissible, whether they are in-kind or monetary payments, as well as illustrations of what exactly the company considers to be a facilitation payment. Importantly, strict compliance controls should be in place so that prior review and approval of the payment is given by a knowledgeable FCPA lawyer before the payment is made.

In 2008, Westinghouse Air Brake Technologies Corporation paid a $300,000 penalty for payments to railway regulatory officials, several of which were intended to facilitate pre-shipping product inspections and other ministerial actions. While many of these payments qualified under the facilitation payment exception, other payments were found to be for the purpose of obtaining business. The Westinghouse case is a good example of the ambiguity and undefined parameters of the exception. As a result, many sophisticated companies simply ban the use of facilitation payments to entirely avoid the risk of having a payment misconstrued as a bribe.

Connect Expenses to Legitimate Business Purposes

FCPAR: Regarding the reasonable and bona fide expenditure affirmative defense, did anything in the Guidance strike you as useful for companies to know when designing and implementing their compliance programs?

G & F: The Guidance provides a useful collection of hypothetical scenarios concerning business gifts, hospitality and travel expenses, including illustrating the boundaries of the "reasonable and bona fide expenditures" affirmative defense under the FCPA. The gist of this section of the Guidance is that such expenditures run afoul of the FCPA only where there is "corrupt intent" – evidence of which can be discerned from disproportionate and unusually lavish expenses, such as first-class airfare for a foreign official and his wife to travel to Las Vegas for several days of entertainment with little if any connection to legitimate business activity.

By contrast, the Guidance emphasizes that it would be "difficult to envision any scenario in which the provision of cups of coffee, taxi fare or company promotional items of nominal value would ever evidence corrupt intent" – and, in fact, even the payment of business class international airfare could be appropriate for travel by foreign officials for strictly business purposes. In short, the DOJ and SEC, in their Guidance, appear to have told the business community not to waste substantial compliance resources on "small potatoes" issues and to recognize a principle of proportionality: the more closely related an expenditure is to legitimate business needs, the more likely it is to pass muster under the FCPA.

Virtual Strict Liability for Accounting Violations

FCPAR: You discuss in your chapter what you call the FCPA's "virtual strict liability" of an issuer for the accounting provisions. Please explain that concept and how it is useful for companies designing and implementing compliance programs

G & F: An issuer under the Securities Exchange Act of 1934 will face strict civil liability for any inaccuracies in connection with its obligation to comply with the FCPA's books and records and internal control provisions. In other words, irrespective of its directors' or officers' awareness or knowledge of inaccuracies, an issuer is civilly liable for non-compliance with the FCPA's books and records and internal control provisions.

The concept of virtual strict liability ensures that issuers will remain diligent in their record-keeping duties. Therefore, companies would be well-advised to make significant investments in their compliance programs to ensure that their internal controls will consistently and regularly monitor and rectify any inaccuracies in accounting entries. Because the risk of strict liability can exist for any inaccuracy, whether material to the company's financial results or not, issuers are advised to implement controls to monitor and ensure the accuracy of even a minor entry.

Of course, errors in accounting entries and record-keeping may occur easily and without wrongful intent. Thus, incorrect entries are not actionable as long as they are prepared accurately based on GAAP, and the standard of care imposed under the books and records and internal control provisions is one that would satisfy "prudent officials in the conduct of their own affairs." The "prudent official" standard does not require an unrealistic degree of exactitude or precision, but rather is based on reasonableness. Notably, the congressional conference committee report concerning the statute describes the reasonableness requirement as being achieved through a balancing of various factors, including the cost of compliance.

Judicial Review of Settlements May Lead to Increased Individual Fines

FCPAR: In the past, judges have usually approved civil settlements between the SEC and corporate defendants. Recently, however, at least one judge has been pushing back, saying the reporting requirements were not stringent enough. How do you think this will affect settlement agreements with the SEC in the future? [See "Judge's Refusal to Approve Civil FCPA Settlement Raises Concerns for Future FCPA Settlements with the SEC," The FCPA Report, Vol. 2, No. 1 (Jan. 9, 2013).]

G & F: Judge Leon's rejection of the proposed settlement in the *SEC v. IBM* case has been consistent with a growing trend among district court judges who have rejected other civil settlements between the SEC and corporate defendants. While many expect the Second Circuit's review of Judge Rakoff's rejection of a settlement between the SEC and Citigroup (although not specifically an FCPA case) to shed more light on what to expect for future settlements, there are a number of changes that may occur because of courts' stringent review of proposed settlements: (1) more cases may be brought and settled in a forum that does not require court approval, such as administrative proceedings; (2) more settlements may require defendants to admit their guilt or misconduct as part of the settlement; and/or (3) more settlements may require individual officers or directors to pay a portion of the fine.

Collateral Effects of FCPA Violations and Investigations

FCPAR: In the chapter, you discuss indirect effects of an FCPA violation or investigation. Please explain some of the most significant collateral effects a company that does business with the government has to worry about.

G & F: The most significant collateral effects that a company under FCPA scrutiny typically faces are adverse publicity, the risk of debarment from government contracting, scrutiny by enforcement agencies and regulators in other jurisdictions (or even other regulators in the United States) and private civil suits.

While some measure of adverse publicity and scrutiny by other regulators is par for the course for any company facing any sort of government investigation, the risks of debarment and collateral civil litigation are particularly acute, and potentially extremely burdensome. Many companies that fall under FCPA-related scrutiny depend heavily on government contracting as a core line of business, and hence the risk of debarment as a result of a plea or other form of resolution actually can be more problematic than the monetary fine or other terms of the resolution.

Experienced FCPA counsel will address this issue early in settlement discussions and emphasize, in specific and concrete terms, the potential impact of debarment on the company in order to avoid that outcome as part of any negotiated resolution. Collateral civil litigation often cannot be avoided but, in the FCPA realm, has thus far been met with a mixed record in the courts. Here, minimal publicity and a prompt resolution of any FCPA investigation can help to head off the filing of collateral civil claims.

When to Self-Report

FCPAR: Outside counsel disagree about the wisdom of self-reporting to the government, which can open the company up to extensive and costly investigation. [See "When and How Should Companies Self-Report FCPA Violations? (Part One of Two)," The FCPA Report, Vol. 1, No. 1 (Jun. 6, 2012); Part Two of Two, Vol. 1, No. 2 (Jun. 20, 2012).] What kinds of fact patterns do you look for when you advise a company not to self-report and why?

G & F: The typical fact pattern in connection with a decision not to self-report generally exists where (1) the conduct involved is minor; (2) the company has a robust compliance program which uncovered the conduct; (3) the company took appropriate remedial action with respect to the issues and employees involved; and (4) the company strengthened its compliance program and efforts to avoid future misconduct.