

SEC, DOJ Continue to Enforce FCPA Cases Involving China and Joint Ventures

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China's reputation as an emerging world economy has garnered the attention of US law enforcement, including the US Securities and Exchange Commission and the US Department of Justice, which has increased its prosecution of violations of the Foreign Corrupt Practices Act. Conducting proper due diligence and taking meaningful action to correct risk areas can help avoid problems with joint venture partners or third-party agents that could lead to such violations.

In December 2010, the US Securities and Exchange Commission (SEC) filed a settled enforcement action against a San Jose, California-based technology company (the Company), alleging multiple violations of the Foreign Corrupt Practices Act (FCPA) due to the actions of two of its joint venture entities in China. As part of the proposed settlement, the Company agreed to pay approximately US\$1.25 million and comply with certain undertakings regarding its FCPA compliance program. The Company also entered into a non-prosecution agreement with the US Department of Justice (DOJ), in which it agreed to pay a criminal fine of \$1.7 million and implement certain compliance-related measures. The Company is the latest in a growing list of US firms that have run afoul of the FCPA in China, and with regard to alleged misconduct by joint venture partners.

Background

Enforcement of the FCPA is a top programmatic priority of the SEC and DOJ, and the number of FCPA enforcement actions has increased exponentially over the last six years. This more aggressive approach to FCPA enforcement is likely here to stay. Recently, the SEC, the DOJ and the US Federal Bureau of Investigation have all formed teams of personnel solely dedicated to FCPA cases. At a November 2010 FCPA forum held by the American Conference Institute, Assistant Attorney General Lanny A. Breuer stated that the US government collected well over US\$1 billion in FCPA sanctions in 2010, adding that "FCPA enforcement is stronger than it's ever been—and getting stronger."

Recent Case Highlights Two Major Enforcement Priorities

The case against the Company highlights two major trends in FCPA enforcement actions.

The first trend concerns increased FCPA exposure as a result of alleged illicit payments by joint venture partners and third-party agents. In 2010 alone, the SEC brought seven actions (up from an average of two cases per year over the previous five years) against companies charged with FCPA violations based on the activities of a joint venture partner. Additionally, in each of these cases, companies were also cited for using third-party agents as conduits for illicit payments.

The second trend relates to an increased emphasis on China-related enforcement actions. As China's economy continues to gain ever-greater prominence on the world stage, it is not surprising that a corresponding level of US law enforcement attention is being paid to companies with Chinese operations. China is perceived by US authorities as a high-risk country for bribery and corruption. Since 2005 there have been 16 enforcement actions with a substantial Chinese component. To provide some context, in 2004, the US brought only five FCPA actions. Moreover, the SEC recently established a regional unit within its San Francisco office devoted to FCPA enforcement with a focus on Asia, including China. The creation of the San Francisco FCPA unit suggests the SEC will focus on the technology industry (with its significant Silicon Valley presence), as well as other perceived high-risk industries such as energy, health care, defence and telecommunications.

Recent Case Summary

According to the SEC and the DOJ, between 2004 and 2008 two China-based joint ventures of the Company made improper payments of approximately \$400,000 to government officials in order to obtain or retain business. The payments were made either by sales personnel of the joint ventures or a Chinese third-party agent with which one of the joint ventures had entered into agreements to ostensibly provide "technical" or "consulting" services. As a result of the contracts gained from the alleged illicit payments, the SEC determined that profits of US\$1,147,800 had been generated.

It was also alleged the Company was aware of potential red flags concerning one of its Chinese joint venture partners. Prior to the formation of the joint venture in 2004, the Company conducted due diligence on its proposed Chinese joint venture partner (whose former sole owner was the Beijing Academy of Sciences) and determined the joint venture partner's sales personnel would obtain cash advances and use them to bribe government officials. After entering into the joint venture, the Company communicated to the joint venture personnel that such bribery practices were to stop. However, according to the SEC complaint, the Company did not "impose sufficient internal controls or make any changes to the practice of sales personnel obtaining cash advances".

The Company also allegedly failed to prevent similar ongoing practices at its other Chinese joint venture partner after its formation in late 2006. According to the SEC, sales personnel used cash advances to provide government officials with gifts such as “jade, fur coats, kitchen appliances, suits and high-priced liquor” in order to secure contracts. Furthermore, for both joint venture companies, the expenses associated with the cash advances were improperly recorded on their books as “business fees” or “travel and entertainment” expenses.

As a result of the alleged illicit activity of its Chinese joint venture entities, the Company was charged with violating the anti-bribery and books, records and internal controls provisions of the FCPA. In resolution of the SEC case, the Company was ordered to pay US\$1,147,800 in disgorgement as well as US\$109,212 in prejudgment interest and to comply with certain undertakings regarding its FCPA compliance program. In resolution of the parallel DOJ case, the Company paid a criminal fine of US\$1.7 million, agreed to implement certain compliance measures and periodically reports to the DOJ regarding its obligations under the agreement.

Lessons Learned

SEC and DOJ guidance and precedent show that companies should exercise due diligence, and be mindful of potential “red flags” when dealing with joint venture partners and third-party agents, including the following.

- A history of corruption in the country in question
- Perceived, high risk-industries (energy, health care, telecommunications, defence, technology)
- Joint venture partners or third-party agents with:
 - Substantial business with governmental agencies
 - Former government officials as officers or employees
 - No written policies, procedures or codes concerning business ethics, business conduct or the barring of practices prohibited by the FCPA or the anti-bribery laws of the country in question
 - Lax or insufficient books, records, internal and financial controls and internal audits
 - A lack of, or insufficient, internal FCPA/anti-corruption training
 - The presence of unusual payment patterns or financial arrangements, including abnormally high commissions, discounts and/or rebates

Conducting reasonable and appropriately comprehensive due diligence with a focus on potential red flags and taking meaningful remedial actions to correct problems and risk areas identified can go a long way toward avoiding problems with joint venture partners or third-party agents that could lead to FCPA violations.

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