FCPA Update

March 2013

Avoiding (But Not Hiding From) Third-Party Corruption Risks

By Carl H. Loewenson, Jr.

When entering new markets, it is common for companies to seek out and rely on local contacts to help navigate market structures and cultural issues. In some instances it is practically impossible—if not illegal—for a company to enter the foreign market without partnering with a local third party, such as a consultant, agent, broker, distributor, or joint venture. While these relationships are oftentimes entirely legitimate and crucial for successful entry and continued success, they can also expose companies to significant risks under the Foreign Corrupt Practices Act (FCPA), the UK Bribery Act, or other anti-corruption laws. In fact, the vast majority of reported FCPA cases involved third-party intermediaries.

LIABILITY FOR ACTS OF YOUR INTERMEDIARIES

The FCPA prohibits corrupt payments to foreign officials for the purpose of obtaining or retaining business. Under the statute, both direct and indirect payments are unlawful. The FCPA prevents parties from avoiding liability by putting an intermediary in between themselves and the foreign official. As the Department of Justice (DOJ) and the Securities and Exchange Commission's (SEC) recent FCPA Resource Guide makes clear: "The fact that a bribe is paid by a third party does not eliminate the potential for criminal or civil FCPA liability."[1]

The FCPA imposes liability for payments made by a company to a third party while "knowing" that all or a portion of the payment would be improperly passed on to a foreign government official. "Knowing" does not require actual knowledge that the third party is going to make an improper payment. Rather, the requisite knowledge is satisfied when a party is aware of a high probability, or there is substantial certainty, that a bribe will be offered or paid. Under the FCPA, "knowing" can mean consciously disregarding that a prohibited payment will occur. Therefore, ignoring third parties' potential FCPA violations can lead to liability.

IGNORANCE IS NOT A DEFENSE

Frederic Bourke—co-founder of the luxury handbags line Dooney & Bourke—made an $8 million investment in the failed privatization of the Azerbaijani state-owned oil company. The business venture was unsuccessful and Bourke lost his entire investment. That did not, however, stop the DOJ from indicting Bourke for violations of the FCPA.

Bourke was charged for participating in a consortium of investors organized by Viktor Kozeny, an international businessman whose questionable reputation had earned him the nickname, the "Pirate of Prague." The government alleged that Kozeny arranged for payments of tens of millions of dollars to various Azerbaijani officials that were intended to secure the privatization of the state-owned oil company. Although Bourke was not alleged to have himself bribed or directed any act of bribery, the government charged that he invested in an entity that he knew, or should have known, engaged in a scheme to bribe foreign government officials.

[1] A Resource Guide to the U.S. Foreign Corrupt Practices Act, at p. 22 (Nov. 14, 2012), *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.

In 2009, Bourke was convicted after a jury trial of conspiring to violate the FCPA. Throughout the trial, Bourke maintained that he had no knowledge of the bribery scheme. While the government's primary theory was that Bourke in fact did have actual knowledge of the bribery, the government asked the judge to instruct the jury that it could convict Bourke on a "conscious avoidance" theory. That is, the jury could find that Bourke had the requisite knowledge to be found guilty if he was aware of a "high probability" that bribes were being paid, but he "consciously and intentionally avoided confirming that fact." Finding that Bourke consciously avoided learning of the bribery scheme, the jury convicted Bourke, and he was sentenced to a year and a day in prison and fined $1 million.

Bourke appealed the conviction on several grounds, including that the trial court judge improperly instructed the jury on the issue of conscious avoidance. Bourke contended that the government failed to present evidence sufficient to establish such a theory. The U.S. Court of Appeals for the Second Circuit disagreed and cited the evidence at trial that Bourke was aware of the corruption in Azerbaijan and knew of Kozeny's poor reputation. The court also pointed to the fact that Bourke had voiced concerns (in a taped conversation) to another investor and his attorney that Kozeny may have been bribing government officials. The court relied on the fact that another investor declined to participate in the venture after his diligence left him uncomfortable about FCPA compliance. The court held that it was "entirely proper for the government to argue that Bourke refrained from asking his attorney to undertake the same due diligence done by [another investor] because Bourke was consciously avoiding learning about the bribes." [2]

The Court of Appeals rejected Bourke's argument that the conscious avoidance charge had improperly permitted the jury to convict him based on negligence. The court found that there was ample evidence in the record that Bourke had "serious concerns" about the legitimacy of Kozeny's business practices and Bourke "worked to avoid learning exactly what Kozeny was doing."[3]

Bourke's conviction serves as an important lesson that parties take on a high level of risk when they ignore multiple red flags of public corruption. When dealing with third-party intermediaries, ignorance is not bliss. Failure to conduct due diligence will offer no defense to liability.

MITIGATING RISKS

Recognizing that third-party intermediaries are "commonly used to conceal the payment of bribes to foreign officials in international business transactions," the DOJ and SEC underscore the importance of "risk-based due diligence."[4] The simple fact is that parties should know with whom they are doing business. Companies and individuals should take necessary precautions to ensure that they have formed a business relationship with reputable and qualified third parties.

The extent of diligence that should be conducted on a particular third party is a fact-based inquiry that will vary depending on a number of factors, including the industry, the market, the type of transaction, and the historical relationship with the third party.

---

[2] *United States v. Kozeny, et al.*, 667 F.3d 122, 135 (2d Cir. 2011).

[3] *Id.* at 134.

[4] A Resource Guide to the U.S. Foreign Corrupt Practices Act, at p. 60.

At a minimum, companies should understand the "qualifications and associations" of its third- party intermediaries. That is, companies should understand the business rationale for hiring the third party as well as the intermediaries' business reputation and government affiliations. As the DOJ and SEC make clear in the Resource Guide, "the degree of scrutiny should increase as red flags surface."[5] Potential red flags to watch out for include instances where the third party:

- Charges more than the market price for its services
- Is recommended by a foreign government
- Requests success fees
- Has little or no relevant business experience
- Has a poor reputation in the market
- Demands cash payment, or payment in a third country, or other special arrangement
- Provides inconsistent invoicing or over-bills
- Refuses to sign representations not to violate the law
- Refuses to agree to audit rights
- Has no prior relationship and is granted unusual credits
- Has familial relationships with government officials
- Receives or requests unusual bonuses or commissions
- Has large and numerous end-of-year adjustments
- Requests out-sized discount for a particular customer

No DOJ or SEC lawyer would argue that if any of the above red flags are present, a company cannot per se enter into the relationship. But if any red flags are uncovered, a party should endeavor to understand all the facts and circumstances and resolve any issues before proceeding with using the third party. Just how much follow up needs to be done, again, will depend on the particular facts. It may be that an issue can be resolved through a simple inquiry to the third party. Other issues may require more in-depth investigation. The point is that a red flag—and especially an accumulation of red flags—should not be ignored. Once a company has been put on alert, it is clear that the DOJ and SEC expect resolution rather than avoidance.

Once the diligence process is concluded and a party determines that it feels comfortable entering into a relationship with the intermediary, the structure of the relationship becomes important. Companies should ensure that the payment terms agreed to are commensurate with the scope of work being performed. Companies should evaluate how the payment terms compare to similar arrangements in the industry and geographic location.

The intermediary should be asked to sign a written contract memorializing the terms of the agreement. The terms of the contract should include warranties regarding the intermediaries' past anti-corruption compliance and

[5] *Id*.

willingness to comply with applicable laws going forward. If appropriate, the third party should also agree to have the company audit its books, records, and practices. The third party should also be asked to provide annual attestations of compliance with anti-corruption laws.

Finally, once the relationship is in place, companies should undertake some form of ongoing monitoring of the intermediary. The company should monitor the intermediary to ensure it is being paid for work being performed in a compliant manner. This may include, for example, updating due diligence, exercising contractual audit rights, and periodic training of the third party.

CONCLUSION

The use of intermediary third parties is the single most common source of corruption risk. That does not mean that companies cannot work with intermediaries. Access to business in many markets is possible only through local partners. Rather, it means that companies entering into these relationships must take steps to mitigate the risks, including conducting reasonable due diligence.

As the DOJ and SEC have made clear, "businesses may reduce the FCPA risks associated with third-party agents by implementing an effective compliance program, including due diligence of any prospective" third-party intermediaries.[6]

CONTACT

Morrison & Foerster's FCPA + Anti-Corruption Task Force:

Paul T. Friedman
San Francisco
(415) 268-7444
pfriedman@mofo.com

Timothy W. Blakely
Hong Kong
+ 852 2585 0870
tblakely@mofo.com

Randall J. Fons
Denver
(303) 592-2257
rfons@mofo.com

Daniel P. Levison
Tokyo
+ 81 3 3214 6717
dlevison@mofo.com

Carl H. Loewenson, Jr.
New York
(212) 468-8128
cloewenson@mofo.com

Kevin Roberts
London
+ 020 7920 4160
kroberts@mofo.com

Robert A. Salerno
Washington, D.C.
(202) 887-6930
rsalerno@mofo.com

Ruti Smithline
New York
(212) 336-4086
rsmithline@mofo.com

Rick Vacura
Northern Virginia
(703) 760-7764
rvacura@mofo.com

Sherry Yin
Beijing
+ 86 10 5909 3566
syin@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for nine straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

[6] *Id.* at p. 21.

FCPA Update

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.