2009 AND THE FCPA: WATERSHED YEAR FOR COMPLIANCE INVESTIGATIONS AND ENFORCEMENTS

The year 2009 is shaping up to be a watershed year in Foreign Corrupt Practices Act (FCPA) compliance investigations and enforcements. This article will review the current state of FCPA investigations and enforcement actions and provide guidance to Companies to help navigate in this time of heightened FCPA sensitivity.

Enforcement rich environment

Former U.S. Attorney General John D. Ashcroft recently spoke at the American Conference Institute's FCPA and International Anti-Corruption for the Pharmaceutical and Medical Device Industries conference in New York. General Ashcroft presented his views on the current "enforcement rich environment" for FCPA prosecutions.

Mr. Ashcroft cited the following factors to support his argument that the current political climate creates an increased opportunity and momentum for the enforcement of FCPA cases:

- heightened international awareness of the human cost of corruption as evidenced by international treaties addressing corruption and new signatories to these treaties;

- the economic urgency created by the worldwide economic downturn and the possibility of more whistleblower and "disgruntled competitor" reports of misconduct;

- a climate of distrust of the financial services and business community and the associated appetite for uncovering and punishing corporate wrongdoing; and

- the post 9/11 cooperation between governments to control flows of money to terrorist organizations which conditions governments to cooperate in other multinational investigations.

The Numbers

Both the Securities and Exchange Commission (SEC) and Department of Justice (DOJ) have jurisdiction over the FCPA. Generally speaking the SEC prosecutes, through civil and administrative proceedings, the accounting standards portion of the FCPA, SEC enforcements include profit disgorgement. The DOJ prosecutes, through criminal proceedings of both companies and individuals, both the anti-corruption and accounting standards portions of the FCPA. A hint was to what to expect in 2009 was given by In Scott Friestad, SEC Deputy Director of Enforcement, in November, 2008, when he publicly stated, "The dollar amounts in the [FCPA] cases that will be coming within the

next short while will dwarf the disgorgement and penalty amounts that have been obtained in prior cases."

Within the past 6 months, this statement has certainly turned out to by prophetic. The previous FCPA high water mark of a $44 million fine, assessed against BakerHughes in 2007. This amount has now been dwarfed by the penalties levied against (and agreed to by) Siemens and Halliburton. This fine against Siemens, issued in December, 2008, for the violation of the books and records provision of the FCPA included the following components: a $450 million fine to DOJ, $350 million disgorged profits to SEC, $856 million to German officials, for a whopping total amount of ***$1.6 billion***. In February, 2009, Halliburton, which was charged with internal controls failed to detect or prevent the bribery and that its records were falsified to cover up the illegal payments made in Nigeria by its then subsidiary KBR, agreed to a fine of $402 million plus profit disgorgement of $177 million for a total amount of ***$579 million***. These eye-popping penalties are likely to motivate additional FCPA prosecutions and likelihood of even greater enforcement actions of the FCPA in the future.

Supplementing these eye-popping dollar amounts of fines and penalties which have been recently levied, a review of the number of FCPA cases brought annually since 2004 bears out this increase in enforcement efforts. In the three year period, from 2004 through 2006, 29 FCPA enforcement cases were brought. However this three year total was exceeded in each of the next two consecutive years. In 2007, 38 FCPA enforcement cases were brought and in 2008, 33 FCPA enforcement cases were brought. However, the jump in the number of cases brought in the period before 2006 and in the last two years may well turn out to be insignificant when compared to the 100 FCPA investigations reportedly opened to date in 2009.

Tone at the Top

In addition to former U.S. Attorney General Ashcroft's thoughts and the bureaucratic evidence, consider the "tone at the top" coming from President Obama. In 2006, in a speech at the University of Nairobi, then-Senator Obama did not pull any punches. He warned the Nigerian audience that everything they had worked for, including their freedom, is threatened by corruption. Here's some of what he had to say:

> Corruption is not a new problem. It's not just a Kenyan problem, or an African problem. It's a human problem, and it has existed in some form in almost every society. My own city of Chicago has been the home of some of the most corrupt local politics in American history, from patronage machines to questionable elections. In just the last year, our own U.S. Congress has seen a representative resign after taking bribes, and several others fall under investigation for using their public office for private gain.
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> It is painfully obvious that corruption stifles development - it siphons off scarce resources that could improve infrastructure, bolster education systems, and strengthen public health. It stacks the deck so high against entrepreneurs that they cannot get their job-creating ideas off the ground. In fact, one recent survey showed that corruption in Kenya costs local firms 6% of their revenues, the difference between good-paying jobs in Kenya or somewhere else. And corruption also erodes the state from the inside out, sickening the justice system until there is no justice to be found, poisoning the police forces until their presence becomes a source of insecurity rather than comfort. . . .
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> Of course, the best way to reduce bureaucracy and increase pay is to create more private sector jobs. And the way to create good jobs is when the rules of a society are transparent - when there's a clear and advertised set of laws and regulations regarding how to start a business, what it takes to own property, how to go about getting a loan - there is less of a chance that some corrupt bureaucrat will make up his own rules that suit only his interests. Clarifying these rules and focusing resources on building a judicial system that can enforce them and resolve disputes should be a primary goal of any government suffering from corruption.

Arrival of Private Litigation

Generally, private parties have no right of action under the Foreign Corrupt Practices Act. Only the DOJ and SEC can enforce the FCPA. However, private claims asserting facts discovered by or through FCPA investigations have spurred increasingly collateral civil suits. Such claims of conduct which is actionable under the FCPA would violate the anti-bribery provisions are usually based on the Racketeer Influenced and Corrupt Organizations Act (RICO), common-law fraud, breach of fiduciary duty or, breach of contract. Several recent and ongoing civil actions illustrate this development.

In a breach of contract action, Argo-Tech Corp., an U.S. aviation fuel-related equipment manufacturer has filed a lawsuit at a U.S. district court in Cleveland against defense equipment trader Yamada Corp., a Japanese corporation and its U.S. subsidiary, claiming Yamada's involvement in bribery of Japanese governmental officials violated their contract, which therefore should be terminated. In a RICO and fraud action, brought by an arm of a foreign government, the Aluminum Bahrain BSC (ALBA) sued Alcoa for bribing Bahraini governmental officials in exchange for supply contracts. ALBA's suit is based not on the FCPA but on common law fraud and RICO -- the Racketeer Influenced & Corrupt Organizations Act found at 18 U.S.C. §§1961-68. Shareholder derivative actions, the constant nemesis of corporate America, have also used FCPA investigations and enforcement as a basis. Shareholder derivative suits based on allegations of overseas public bribery have been filed against BAE Systems. A similar suit has been brought

against Alcoa, for the same underlying facts as the suit brought by ALBA. These suits signal how leading plaintiffs' securities lawyers are leaping in, signaling that more such suits are on the way.

This final point was illustrated this past week when, on May 14, 2009, the Policemen and Firemen Retirement System of Detroit brought suit against Halliburton and its former subsidiary KBR, in state court in Houston, Harris County, Texas. This shareholder of Halliburton, acting as plaintiff alleged that certain conduct of KBR, which included massive waste and overbilling of services provided to American forces in Iraq; bribery in Nigeria to win government contracts; and multiple instances of fraud, corruption, and misconduct in both its domestic and foreign operations. The plaintiff shareholders go on to allege that Halliburton's board of directors of breached its fiduciary duty to its shareholders in failing to rein in years of shoddy business practices and criminal activity that resulted in massive fines, penalties and settlements paid to the federal government.

The Steps to Take

So what specific policy implementations can a Company make to protect itself in this era of heightened compliance enforcement environment? In a recent speech to the Texas General Counsel Association, former U.S. Deputy Attorney General Paul McNulty provided his perspective on FCPA compliance investigations and DOJ enforcement actions. From his experience as the second highest-ranking official in the Department of Justice and the chairman of the President's Corporate Fraud Task Force, Mr. McNulty opined that there were three general areas of inquiry the DOJ would assess.

- *"What did you do to stay out of trouble?"*
- *"What did you do when you found out?"*
- *"What remedial action did you take?"*

Mr. McNulty went on to further define acceptable responses to these three areas of inquiry. In the first area of inquiry, "*What did you do to stay out of trouble?"*, he indicated that the DOJ would look to what systems a company had in place, a Code of Conduct, policies and procedures to implement a Code of Conduct and a company wide, anonymous Hotline. More than just having the policies and processes in place, Mr. McNulty emphasized that the DOJ will inquire into whether the Company provided training on these policies and processes and were they used actively in business going forward, for instance in the area of due diligence on business partners, agents, distributors and vendors? In the second inquiry, "*What did you do when you found out?"* Mr. McNulty stated that the DOJ's focus would be on a Company's response after an FCPA/compliance issue arose or was discovered. Was there an investigation, if so was it performed by persons involved with the underlying matter or was the investigation

handled by an outside agency or law firm? In the third area of inquiry "*What remedial action did you take?"* Mr. McNulty indicated that the DOJ would be most interested in the actions a Company took after it completed its investigation. For instance, were the persons involved in any FCPA/compliance violations disciplined and most importantly, did the Company voluntarily disclose the matter to the DOJ and did the Company cooperate with the DOJ in any ongoing investigation.

Former Attorney General Ashcroft phrased the above guidance somewhat more succinctly; he ended his remarks by giving advice for companies seeking to compete in an environment of elevated FCPA enforcement activity. He stated, "*Build strong compliance programs, invest in training and diagnostic tools and, if you do discover a problem, "**go to the DOJ before the DOJ comes to you**"."*