

## ***Watts Water: Don't Get Caught on the (FCPA) Slow Boat to China***

Last week, the Securities and Exchange Commission (SEC) instituted a Cease and Desist Order against Watts Water Technologies, Inc. (WWT) and one of its employees, Leesen Chang (Chang). The Order was to obtain certain civil penalties and fines for conduct of WWT and Chang concerning violations of the books and records and internal control provisions of the Foreign Corrupt Practices Act (FCPA) for its China operations. As noted by the FCPA Professor, “The Watts enforcement action is yet another example of an FCPA enforcement action focused on Chinese Design Institutes.” WWT paid a fine of \$200,000, agreed to disgorge profits of \$2,755,815 and paid prejudgment interest of \$820,791. Chang paid a fine of \$25,000.

The violations revolved around the WWT China subsidiary, Watts Valve (Changsha) Co., Ltd. (CWV) which did business in China and purchased another Chinese company Changsha Valve in April 2006. This Chinese company was consolidated in CWV. In 2010, WWT sold CWV to a Hong Kong entity. Chang was the Vice President (VP) for sales of CWV from 2006-2009.

### ***The Violations***

There were two forms of bribery set forth in the Cease and Desist Order. First CWV made payments directly to employees of a Chinese Design Institute. According to the FCPA Professor, Chinese Design Institutes are “typically state-owned enterprises that provided design engineering and technical integration services that can influence contract awards by end-user state-owned customers.” These direct payments were made to influence design institutes to recommend CWV be awarded the sale of products for Chinese state enterprises. The second form of bribery was that CWV paid “sales-related expenses such as travel, meals, entertainment” of the Chinese Design Institute. Lastly, CWV employees made direct payments to Chinese Design Institute for sales made by CWV.

These payments for such sales-related expenses were made by CWV employees out of their sales commissions and hidden on the CWV books and records as employee expenses. The commissions paid directly to the Chinese Design Institute for sales made by CWV employees were also hidden on the books and records of CWV as its employees commissions. Chang knew about these payments and attempted to block the US Company, WWT, from discovering them or correcting the false entries into CWV books and records.

### ***Discovery and Remedial Measures***

The discovery of the above issues began with the WWT General Counsel (GC) becoming aware of an enforcement action against another company for unlawful payments to a Chinese Design Institute. This led to FCPA training for certain CWV management who disclosed some of the above information. WWT instituted an internal investigation and self-disclosed to the SEC.

The Cease and Desist Order listed several remedial measures taken by WWT, one of which included changing the incentive based compensation. There was also the creation of an enhanced compliance program including policies and procedures, specifically including a Travel and Entertainment Expense Reimbursement Policy for the company's Chinese subsidiaries. Additionally there were enhanced due diligence procedures for foreign business partners. WWT conducted a thorough world-wide FCPA anti-corruption audit. Lastly, it was noted that WWT hired a Director of Legal Compliance to head up the company's compliance efforts going forward.

### ***Lessons Learned***

- The primary lesson learned in this enforcement actions is that it does not matter how much of a company's revenue a subsidiary may represent, a FCPA violation is a FCPA violation. Here it was specifically noted in the Cease and Desist Order that the Chinese subsidiary's revenues were "approximately 1% of Watts gross revenues." *A very expensive lesson indeed.*
- The second lesson is that if a VP of Sales, in any region, resists translating company expense accounts into English, do not run but sprint to those areas, **with all possible haste**, to secure the records because that VP is most probably hiding something that can you get in big, big trouble.
- Next is that a company must use several varied resources to continually assess and re-assess its risk profile. The actions which led to the WWT investigation began because the GC saw that another company was involved in an enforcement action involving a Chinese Design Institute. This is not something traditionally listed as an area to be assessed. However, if a competitor is involved in an enforcement action or a company that is using a sales model very similar to that used by your company, you should re-assess the risk to your company accordingly.
- The final lesson I would suggest is the absolute necessity of in-person training for high risk employees or those company employees in high risk countries. It was through the in-person FCPA training that the WWT learned about the violative conduct. If this training had been video or web-based such disclosure may never have happened.

The Watts Water enforcement action provides concrete information for the compliance practitioner to review and re-assess your compliance program and risk profile to determine if your company has any risks which you are not currently seeing.

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