

# Securities Litigation Update

## FCPA Update: Recent Prosecutions and New Enforcement Tools

April 6, 2010

BY SUSAN S. MUCK, CATHERINE KEVANE, EMILY COHEN AND THEIS FINLEY

Fenwick  
FENWICK & WEST LLP

### RECENT PROSECUTIONS

The past thirty days have underscored the redoubled efforts by the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) to investigate and prosecute violations of the Foreign Corrupt Practices Act (FCPA or “Act”). BAE Systems, Innospec, and Daimler AG have each agreed to large settlements following lengthy investigations by U.S. regulators, often with cooperation from governments abroad. The DOJ has announced that the unit responsible for enforcing the FCPA is set to grow by as much as fifty percent over the next few years, and the SEC’s newly-created FCPA Unit is continuing the SEC’s focus on charging individuals and companies for FCPA violations. All of this underscores that U.S. companies who interact with foreign government agencies or do business in high risk locales must take steps to adopt and enforce strict FCPA policies and procedures or risk costly investigations and significant penalties.

#### BAE Systems, PLC

On March 1, the DOJ announced that BAE Systems, PLC (BAE), the largest defense contractor in the United Kingdom and the fifth-largest provider of defense materials to the U.S. Department of Defense, pleaded guilty to conspiring to defraud the United States by making false statements about BAE’s FCPA compliance program. BAE agreed to pay a \$400 million fine, one of the largest ever imposed in an FCPA-related enforcement action.

Enacted in 1977, the FCPA applies to individuals and businesses with securities registered in the United States or a principal place of business in the United States. It prohibits payments, bribes or gifts to foreign government officials to obtain business or other advantages; prohibits concealment or mischaracterization of such payments or gifts in the company’s books and records; and requires companies to adopt internal controls to prevent violations of the Act. The DOJ and SEC share responsibility for enforcement.

Rather than charge BAE with violations of the FCPA itself, the DOJ charged the company with criminal conspiracy based on BAE’s false statements to the government regarding its FCPA compliance program. The DOJ charged that the company’s CEO, John Weston, made misrepresentations in a November 2000 letter to the Department of Defense in which he said

that BAE’s Board of Directors “recently voted to adopt a proposal for all of the Company’s non-U.S. businesses to comply with the anti-bribery provisions of the FCPA . . .” In a subsequent letter sent to the Under Secretary of Defense, BAE represented that the company and its affiliates had complied with the commitments set forth in the November 2000 letter.

The DOJ charged that, contrary to those representations, BAE failed to implement procedures designed to comply with the anti-bribery provisions of the FCPA and in fact made payments that would not pass muster under the FCPA. The DOJ charged that BAE regularly retained “marketing advisors” to whom BAE made improper payments in order to secure sales of aircraft and other equipment in Saudi Arabia, the Czech Republic and Hungary. BAE made the payments through offshore shell companies beneficially owned by BAE and also encouraged the “marketing advisors” to set up their own shell companies to assist BAE in disguising the payments with the intent of circumventing the law in countries that do not allow such relationships.

In addition to the U.S. action, BAE faced charges in the United Kingdom stemming from similar conduct. BAE settled with the U.K.’s Serious Fraud Office (SFO) by agreeing to plead guilty to charges of failing to keep accurate accounting records of commissions paid to marketing consultants in its Tanzanian business and to pay £30 million in fines and charitable payments on behalf of the Tanzanian government.

The BAE case represents the first coordinated bribery settlement between the DOJ and the SFO, and it will not be the last. Addressing the Global Ethics Summit in February, Mark Mendelsohn, Deputy Chief of the DOJ fraud section responsible for FCPA enforcement, said that he expects greater international cooperation in the battle against foreign corruption. For its part, the SFO is awaiting action on an anti-bribery bill, described later in this update, which will add dramatically to enforcement efforts in the United Kingdom.

### **Innospec, Inc.**

On March 18, the SEC and DOJ announced that Innospec, Inc., an international chemical company, agreed to a \$40.2 million global settlement with the SEC, the DOJ, the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC), and the U.K.'s SFO. The settlement stemmed from allegations that Innospec paid or promised more than \$9.2 million in bribes to state-owned refineries and oil companies in Iraq and Indonesia from 2000 to 2007 in exchange for contracts worth \$176 million. Innospec also was alleged to have paid kickbacks to Iraqi officials in order to obtain contracts under the United Nations Oil for Food Program.

Innospec allegedly funneled payments to Iraq by increasing its agent's commissions and artificially inflating its prices in contracts. In addition to cash payments, Innospec allegedly paid lavish travel and entertainment expenses for Iraqi Ministry of Oil officials, including a seven-day honeymoon for one official. Innospec also supplied mobile phone cards and cameras and provided officials with "pocket money." In Indonesia, Innospec allegedly funneled bribes to government officials through an Indonesian agent and through "special commissions" paid to a Swiss account.

Innospec will pay a \$14.1 million criminal fine, \$11.2 million in disgorgement to the SEC, a criminal fine of \$12.7 million to the U.K.'s SFO, and \$2.2 million to the OFAC. In addition to the fines, Innospec will retain an independent monitor for a period of three years. The agent Innospec employed in Iraq has been indicted in the United States and was arrested in Germany on an international arrest warrant. The United States is currently seeking extradition. As Robert Khuzami, Director of the SEC's Division of Enforcement said in the press release announcing the settlement: "Today's action makes clear that law enforcement authorities within the United States and across the globe are working together to aggressively monitor violators of anti-corruption laws."

### **Daimler AG**

On March 22 the DOJ charged Daimler AG and its subsidiaries with violating the FCPA by paying tens of millions of dollars in bribes to foreign government officials in at least 22 countries including China, Croatia, Egypt, Greece, Hungary, Indonesia, Iraq, Ivory Coast, Latvia, Montenegro, Nigeria, Russia, Serbia, Thailand, Turkey, Turkmenistan, Uzbekistan, and Vietnam. The bribery allegedly resulted in over \$50 million in pre-tax profits to the car manufacturer.

The DOJ charged Daimler with one count of conspiracy to violate the FCPA and one count of violating the Act's books

and records provisions. In the 76-page criminal information, the DOJ alleged that Daimler used a variety of mechanisms to make the corrupt payments, including shell companies, offshore bank accounts, corporate ledger accounts known internally as "third-party accounts," deceptive pricing arrangements, and third-party intermediaries. On Daimler's books, the payments were recorded as commissions, special discounts or "nützliche Aufwendungen," which translates to "useful" or "necessary" payment and which employees understood to mean "bribe."

The DOJ alleged Daimler's violations resulted from an inadequate compliance structure; a highly decentralized sales force with no central oversight; a corporate culture that tolerated or even encouraged bribery; and participation by certain executives.

On April 1, 2010, at a hearing before U.S. District Court Judge Richard J. Leon in the District of Columbia, Daimler AG's Russian subsidiary DaimlerChrysler Automotive Russia SAO (DCAR), and its German subsidiary, Export and Trade Finance GmbH (ETF), each pleaded guilty to criminal charges of one count of conspiracy to violate the anti-bribery provisions of the FCPA and one count of violating those provisions. In addition, Daimler AG entered into a deferred prosecution agreement and resolved the civil complaint filed against it by the SEC. Daimler AG's Chinese subsidiary DaimlerChrysler China Ltd. (DCCL) also entered into a deferred prosecution agreement.

In total, Daimler AG and its subsidiaries agreed to pay more than \$180 million in criminal and civil fines, penalties and disgorgement.

## **NEW ENFORCEMENT TOOLS**

### **Individual Prosecutions**

Adding to the pace of FCPA enforcement is the proliferation of cases against individuals. Over 40 people were charged with FCPA-related violations in 2009, more than double the number in each of 2007 and 2008. In January 2010, the DOJ announced the arrest of 22 people stemming from a two-year undercover sting operation in which the defendants were led to believe they were paying bribes in order to win a lucrative arms contract from the defense minister of a country in Africa. The "Catch 22" case demonstrates the government's willingness to use complex sting operations, undercover agents, and wiretaps to pursue FCPA violators. The DOJ also signaled that it will expand its use of industry-wide sweeps and ancillary charges, such as breaches of

export control laws, to buttress its FCPA enforcement efforts. For its part, the SEC's recent adoption of non-prosecution and deferred prosecution agreements – tools used by the DOJ in resolving many recent FCPA cases – should expand the Commission's enforcement capabilities and encourage self-reporting of FCPA violations by both individuals and corporations.

### **U.K. Bribery Bill**

Later this year Parliament is expected to pass the U.K. Bribery Bill, potentially one of the toughest anti-bribery laws in the world and one that would apply to U.S. companies doing any business in the United Kingdom. While the Bill has not yet been enacted, it appears to enjoy broad cross-party support. In its current form, it differs from the FCPA in several important respects:

- The Bill targets private and public-sector corruption by outlawing payments intended to induce or reward a person to corruptly perform “any activity connected with a business.”
- The Bill imposes a presumption of criminal liability on an organization whose employees, agents or consultants engaged in bribery to further the organization's business.
- The Bill contains no exception for “facilitating payments” (payments made to a foreign official ostensibly intended to accelerate an action the official is required to do anyway).
- The Bill contains no affirmative defense for promotional expenses, such as travel or lodging related to marketing or product demonstrations.
- The Bill applies even where the alleged conduct has no connection with the United Kingdom as long as the entity being charged does “any business” in the United Kingdom.
- The Bill contains an important affirmative defense for a company that proves it had in place adequate procedures designed to prevent its employees and agents from engaging in corrupt behavior. If the Bill is passed, the British government is expected to publish a list of principles to which organizations should adhere to protect against criminal liability for acts of employees and agents.

### **OECD Guidance on Internal Controls**

In February 2010, the Organization for Economic Cooperation and Development (OECD), an international organization committed to supporting economic growth and financial stability, released anti-bribery guidelines for international business transactions (<http://www.oecd.org/dataoecd/11/40/44176910.pdf>). The guidelines set forth best practices for companies seeking to establish and ensure the effectiveness of internal controls and compliance programs for preventing bribery in international business transactions. The guidelines specify that companies should maintain a strong, visible commitment to internal controls; a system for reporting matters directly to independent monitoring bodies; and documentation of risk-based due diligence relating to the hiring of agents and other intermediaries. Although the guidelines are directed at helping countries establish robust anti-bribery laws and regulations, businesses are well-served to familiarize themselves with them as they have been endorsed by 38 countries throughout the world.

The upswing in FCPA activity is likely to continue or even accelerate. Cooperation among international regulatory agencies has never been greater. In this new era of world-wide anti-bribery enforcement, U.S. companies are wise to assess the adequacy of their existing FCPA programs, adopt robust compliance policies where needed, and take steps to train employees whose conduct may expose the company or individuals to the risk of liability.

---

Susan S. Muck, Partner  
Securities Litigation Group  
[smuck@fenwick.com](mailto:smuck@fenwick.com), 415.875.2325

Catherine Kevane, Associate  
Litigation Group  
[ckevane@fenwick.com](mailto:ckevane@fenwick.com), 415.875.2392

Emily St. John Cohen, Associate  
Litigation Group,  
[ecohen@fenwick.com](mailto:ecohen@fenwick.com), 415.875.2394

Theis Finlev, Associate  
Litigation Group,  
[tfinlev@fenwick.com](mailto:tfinlev@fenwick.com), 650.335.7634

©2010 Fenwick & West LLP. All Rights Reserved.

THIS UPDATE IS INTENDED BY FENWICK & WEST LLP TO SUMMARIZE RECENT DEVELOPMENTS IN THE LAW. IT IS NOT INTENDED, AND SHOULD NOT BE REGARDED, AS LEGAL ADVICE. READERS WHO HAVE PARTICULAR QUESTIONS ABOUT THESE ISSUES SHOULD SEEK ADVICE OF COUNSEL.