DEBEVOISE & PLIMPTON LLP

FCPA Update

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Welcome

With this issue, Debevoise & Plimpton LLP inaugurates *FCPA Update*, a newsletter analyzing significant developments relevant to companies and individuals subject to the U.S. Foreign Corrupt Practices Act (the "FCPA").[1]

The FCPA, enacted in 1977, and now complemented by an array of anti-bribery measures in other countries following ratification of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions,[2] seeks to prevent public corruption in transnational business by authorizing criminal and civil sanctions for (1) making or offering of corrupt payments or transferring other things of value to "foreign officials,"[3] in order to secure or retain business or improper advantages, as well as (2) breaching of the statute's accounting and internal controls provisions.

The latter provisions require "issuers" under the 1934 U.S. Securities Exchange Act to "maintain a system of internal accounting controls" designed to provide "reasonable assurances" that, among other things, "transactions are executed in accordance with management's general or specific authorization," and are recorded in accordance with generally accepted accounting principles or other relevant accounting criteria, such as IFRS. Inaccurate recording of corrupt payments as legitimate expenses is essentially a strict liability violation of the FCPA books and records provisions, and both such violations and internal controls violations are a recurring source of risk for U.S. exchange registrants doing business outside of the United States.

The appointment of new regulators by the Obama Administration has set the stage for a new round of enforcement in a field in which regulatory activity has already increased dramatically. In a speech on August 5, 2009, SEC Director of Enforcement Robert Khuzami noted his agency's creation of a specialized FCPA enforcement unit, describing its goals as "being more proactive in investigations, working more closely

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1 15 U.S.C. §§ 78m(b)(2)-(3), 78dd-1 to -3, 78ff (2006).

2 37 I.L.M. 1 (1998).

3 The FCPA defines "foreign official" broadly to include employees of all government entities (national, state, provincial and municipal, without limitation) as well as employees of state-owned enterprises, *i.e.*, entities in which there is more than fifty percent equity ownership or other situations in which there is control-in-fact by a non-U.S. government entity. The statute also treats as "foreign officials" non-U.S. political parties, political candidates and political party employees as well as employees of dozens of international and non-governmental organizations such as the EU, the United Nations and various UN entities, the World Bank, the International Red Cross, and the African, Asian and Inter-American Development Banks. *See* 15 U.S.C. §§ 78dd-1(f)(1)(A), 78dd-2(h)(2)(A), 78dd-3(f)(2)(A) (2006).

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News from the BRICs

The Rio Tinto Case Opens a New Chapter in China

Since four employees of international mining concern Rio Tinto were taken into custody by Chinese authorities on July 5, 2009, there have been nearly daily barrages in the international press, with Chinese government officials alleging a widespread conspiracy by mining companies to bribe Chinese officials, and denials by the companies involved, which find themselves in an unprecedented situation in which not only the liberty of employees but also contracts constituting a major source of income are threatened.[1]

The Rio Tinto case is significant on several fronts. First, until the Rio Tinto arrests, the prevailing view at many businesses operating in China was that local authorities focused on punishing – at times severely – officials, including employees of state-owned enterprises, who took bribes, leaving governments in the home countries of non-Chinese firms to deal with those who may have paid bribes in China. Other than the developments in the Rio Tinto case itself, July 2009 was typical in this regard, as two U.S. companies, Avery Dennison Corp. and Control Components, Inc., resolved FCPA cases against them arising out of alleged bribery of Chinese authorities, the most recent of well over 20 China-related FCPA dispositions in the past decade,[2] while the anti-bribery news from the Chinese judicial system was the execution of the former head of the Capital Airports Holding Company,[3] and, earlier, issuance of a suspended death sentence against the former CEO of the state oil company Sinopec.[4] After the Rio Tinto arrests, however, U.S.-listed companies face a concrete risk, if the stakes seem high enough to Chinese government officials, of severe regulatory actions against them and their employees, particularly if the case can be postured by the Chinese government as implicating

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1 David Barboza, Mining Company Inquiry Puts Focus on a Black Market in China's Steel Industry, *The New York Times* (July 14, 2009), http://www.nytimes.com/2009/07/15/world/asia/15riotinto.html?fta=y; David Barboza, China Calls Concerns on Rio Tinto "Noise", *The New York Times* (July 16, 2009), http://www.nytimes.com/2009/07/17/world/asia/17riotinto.html?fta=y; David Barboza, China May Ease Charges of Rio Tinto Workers, *The New York Times* (July 19, 2009), http://www.nytimes.com/2009/07/20/world/asia/20riotinto.html?fta=y; David Barboza, Mining Executive Held By China is Seen as an Unlikely Pawn, *The New York Times* (July 26, 2009), http://www.nytimes.com/2009/07/27/world/asia/27riotinto.html?fta=y; David Barboza, China Says $100 Billion Was Bilked by Rio Tinto, *The New York Times* (Aug. 9, 2009), http://www.nytimes.com/2009/08/10/business/global/10riotinto.html?scp=2&sq=rio%20tinto&st=cse; David Barboza, China Seems to Retract Claim Against Rio Tinto, *The New York Times* (Aug. 10, 2009), http://www.nytimes.com/2009/08/11/world/asia/11riotinto.html?hp; David Barboza, Four on Rio Tinto's Staff Won't Face Spying Charges, *The New York Times* (Aug. 12, 2009), http://www.nytimes.com/2009/08/13/business/global/13riotinto.html?_r=1&hp.

2 *In re Avery Dennison Corp.*, Order Instituting Cease-and-Desist Proceedings, Admin. Proc. No. 3-13564 (SEC July 28, 2009), http://www.sec.gov/litigation/admin/2009/34-60393.pdf; *see also* SEC Litig. Rel. No. 21156 (SEC July 28, 2009), *http://www.sec.gov/litigation/litreleases/2009/lr21156.htm*; Criminal Information, *United States v. Control Components, Inc.*, SA Cr. No. 09-00162 (C.D. Cal. Filed July 22, 2009); *id.* Plea (C.D. Cal. filed July 31, 2009); "Control Components Pleads Guilty to Foreign Bribery Charges and Agrees to Pay $18.2 Million Fine," U.S. DoJ Rel. (Aug. 1, 2009), http://www.usdoj.gov/criminal/pr/press_releases/2009/07/07-31-09control-guilty.pdf.

3 Michael Wines and Mark McDonald, Former Beijing Airport Director is Executed, *The New York Times* (August 7, 2009), http://www.nytimes.com/2009/08/08/world/asia/08china.html.

4 Mark McDonald, Beijing Court Convicts Ex-Sinopec Chief of Bribery, *The New York Times* (July 15, 2009), http://www.nytimes.com/2009/07/16/business/global/16sinopec.html.

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U.S. v. Bourke:
Red Flags and the Perils of Conscious Avoidance

Last month's guilty verdict against a U.S. investor for conspiracy to violate the FCPA and the Travel Act provides a stark reminder that federal prosecutors can prove "knowledge" of bribes under the FCPA by showing that an individual consciously disregarded red flags of bribery, including the prevalence of corruption in a particular country and the reputation of a business partner for corrupt practices, in order to avoid learning that bribes were in fact paid.

In *United States v. Bourke*, investor Frederic Bourke, founder of Dooney & Bourke, a company that sells handbags and other accessories, was convicted after a jury trial in the Southern District of New York on charges related to his participation in an alleged scheme in 1997 to 1998 to provide stock, gifts and cash worth hundreds of millions of dollars to senior officials in Azerbaijan. The bribes were allegedly paid to ensure that officials would rig the planned privatization of the state oil company, SOCAR, to the benefit of Bourke and his alleged co-conspirators. Viktor Kozeny, a Czech investor who was Bourke's neighbor in Aspen, Colorado and is currently a fugitive, is alleged to have masterminded the scheme and arranged for the payments. Bourke invested $8 million with Kozeny. According to evidence introduced at trial, Kozeny told his investors that their hoped-for stake in SOCAR might give them control of half the Azeri economy. But SOCAR was never privatized and Bourke, among others, lost his investment.

In addition to conspiracy, Bourke was convicted of making false statements to federal agents when he denied in interviews knowing that Kozeny had bribed Azeri officials. Bourke was acquitted of a money laundering charge. He faces a maximum penalty of five years in prison and a $250,000 fine for each of the two counts on which he was convicted.

In a pretrial ruling last year, Judge Shira Scheindlin rejected Bourke's request for a jury instruction on the affirmative defense that his conduct was "lawful under the written laws and regulations" of Azerbaijan, and limited the circumstances under which Bourke would be entitled to an instruction on extortion as a defense. *See United States v. Kozeny, et al.*, 582 F. Supp. 2d 535 (S.D.N.Y. 2008). Ultimately, the court did not instruct the jury on extortion.

The government's theory at trial was that even if Bourke did not affirmatively *know* that Kozeny was bribing Azeri officials, he at least was *aware of a high probability* that bribes were being paid and *consciously and intentionally avoided* confirming this fact. Under the FCPA, as Judge Scheindlin explained to the jury in her charge, this would be legally equivalent to actual knowledge when it came to determining whether Bourke was guilty. *See* 15 U.S.C. § 78dd-2(h)(3)(B)(2006)(defining "knowledge" for purposes of establishing liability under FCPA).

In addition to testimony from two cooperating witnesses that they told Bourke about the bribes, the government introduced a mosaic of circumstantial evidence to prove conscious avoidance. Prosecutors submitted evidence, including the expert testimony of a professor of international relations, that corruption was prevalent in Azerbaijan and that Bourke had been so warned. The judge admitted this evidence after denying a motion *in limine* in which Bourke argued the government was incorrectly trying to ratchet down the standard for an FCPA violation from "knowledge" to mere negligence. *See United States v. Kozeny et al.*, No. 05 Cr. 518(SAS), 2009 WL 1514369 (S.D.N.Y. May 29, 2009).

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The government also introduced evidence that privatization in other former communist countries had been tainted by corruption, that SOCAR was a strategic asset of Azerbaijan that government officials would not let go of lightly, and that Bourke had been aware that Kozeny was notoriously dubbed a "Pirate of Prague" in 1996 by *Fortune* magazine for his role in Czech privatization. Jurors reportedly said after

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U.S. v. Bourke: Red Flags and the Perils of Conscious Avoidance ■ Continued from page 3

the trial that it was the evidence of red flags that helped lead them to convict. (*See* Adam Klasfeld, Jurors Feel for Bourke But Convict Him, Courthouse News Service (July 10, 2009), http://www.courthousenews.com/2009/07/10/Jurors_Feel_for_Bourke_But_Convict_Him.htm. Coverage by Bloomberg News of the Bourke trial, including jurors' comments, is archived at Bloomberg.com.)

The Bourke prosecution marks an important expansion of the government's effort to prosecute individuals under the FCPA. Bourke neither paid nor promised any bribes himself. He lost money in his investment with Kozeny, and in fact maintained that Kozeny swindled him. But while the facts of the case may be colorful and while individual prosecutions under the FCPA have been relatively uncommon to date, the red flags that helped convict Bourke are not unlike those that multinational companies encounter frequently in anti-corruption due diligence: a country with high levels of corruption, a large transaction (in this case a privatization) known to carry corruption risk, and a business partner with a suspect reputation. The steps needed to reduce such risks are familiar ones: know the risks of the country and the business; look closely at a potential partner's practices, credentials and reputation; replace a troubling partner with a clean one; insist on safeguards from the partner such as anti-corruption clauses, audit rights and termination rights; and be prepared to act decisively if and when problems nonetheless occur. ■

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with our foreign counterparts, and taking a more global approach to these violations."[4]

The sharp increase in FCPA enforcement authority reflected in the SEC's new unit – an exploding number of cases and active investigations, an increase in the size of fines, penalties, and disgorgement of ill-gotten gains, and a growing list of collateral consequences for companies faced with liability – has led to an overflow of information bearing on FCPA compliance. It is our hope that *FCPA Update* will offer a useful review of recent developments, particularly those warranting adjustments to company compliance programs and approaches to internal investigations.

This inaugural edition highlights the recent conviction in *United States v. Bourke*, one of the first FCPA cases to go to trial in more than four years, and the New York State Superintendent of Insurance's June 29, 2009 Circular Letter setting forth the Department of Insurance's expectations regarding New York-regulated insurers' compliance with the FCPA. Also presented is "News from the BRICs," which will be a recurring column on FCPA compliance for businesses with operations in Brazil, Russia, India and China.

FCPA Update will draw on the expertise of Debevoise & Plimpton LLP's white collar and internal investigations practice group, under the leadership of former U.S. Attorney for the Southern District of New York Mary Jo White, former U.S. Attorney General and U.S. District Judge Michael B. Mukasey, former Iran-Contra Associate Counsel and Assistant U.S. Attorney Bruce E. Yannett, and former SEC Associate Director of Enforcement Paul R. Berger. The firm's FCPA practice, including partners, counsel, and associates in the United States, Europe, and Asia, includes specialists in accounting, internal controls, banking, insurance, construction, pharmaceuticals, medical devices and healthcare, consumer products, mining, energy, government procurement, cross-border mergers and acquisitions, and joint venture formation.[5] ■

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4 Robert Khuzami, "My First 100 Days as Director of Enforcement" (Remarks before the New York City Bar Ass'n) (Aug. 5, 2009), http://www.sec.gov/news/speech/2009/spch080509rk.htm.

5 For a copy of fact sheets discussing Debevoise & Plimpton LLP's FCPA practice and White Collar Litigation Practice Group, see http://www.debevoise.com/publications/FCPAfactsheet.pdf and http://www.debevoise.com/publications/WhiteCollarfactsheet.pdf.

New York State Superintendent of Insurance Calls for FCPA Compliance

On June 29, 2009, in one of his last acts before leaving his post as head of the New York State Department of Insurance, Superintendent Eric Dinallo issued Circular Letter No. 11 (2009) setting forth "the Superintendent's expectations regarding compliance by licensees" respecting the FCPA, as well as the federal Bank Secrecy Act and laws administered by the U.S. Treasury Department's Office of Foreign Assets Control.

Justified as part of the Superintendent's duty to oversee risk management on the part of regulated insurers, the Circular Letter (available at http://www.ins.state.ny.us/circltr/2009/cl2009_11.htm) states that a company's activities may be made the subject of "limited inquiry" on five "minimum" requirements, namely, whether policies and procedures:

(1) "establish that the licensee will adopt procedures and internal controls that are, in its opinion, reasonably designed to enable the licensee to comply with the requirements of the referenced regulatory regimes";

(2) "identify a specific person responsible for the design and implementation of procedures and internal controls commensurate with the risks presented";

(3) "ensure that the procedures and internal controls are updated as changes in the law and circumstances warrant, and that those modifications are communicated in a timely manner to all appropriate personnel";

(4) "ensure that where the licensee's business, circumstances, or risks warrant, the procedures and controls are subject to independent testing and monitoring by internal audit and/or external audit"; and

(5) "ensure that procedures are in place to apprise senior management of non-compliance with regulations and compliance policies."

Most entities regulated by the N.Y. Department of Insurance and also subject to the FCPA have likely already developed FCPA compliance programs. However, the issuance of the recent Circular Letter suggests that insurers may wish to work with outside counsel and other independent advisors to take reasonable steps to assure that such programs are state-of-the art.

Recurring FCPA issues faced by insurers include the risk that M&A activity can lead to inherited FCPA liability, that sales of group insurance and financial services to government employers and pension plans may be marred by corruption, and that virtually any private payee, from an accounting firm to a public relations advisor, can be a vehicle for making improper payments abroad. Companies with subsidiaries or affiliates operating in China, where broad swaths of the workforce are employed at state-owned enterprises, need to take special care in a broad array of business interactions given that the employees at such enterprises are considered "foreign officials" under the FCPA. ■

Upcoming Speaking Engagements

October 1-2, 2009
Paul R. Berger

"The FCPA Year in Review: Update on Recent Investigations, Landmark Settlements and Increased International Cooperation"

FCPA Boot Camp
American Conference Institute
Miami
Conference Brochure:
http://image.exct.net/lib/fef31178736702/d/1/805L10%201795.pdf

November 17-18, 2009
Bruce E. Yannett

"Coordinating a Multi-Jurisdictional Government Investigation: Managing Privacy and Double Jeopardy Risks"

22nd National Conference on Foreign Corrupt Practices Act
American Conference Institute
Washington, D.C.
Conference Brochure:
http://www.fcpaconference.com/agenda.html

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"state secrets" under China's very general laws regulating the export of sensitive information.[5]

Second, the misconduct alleged by the Chinese government, which Rio Tinto has denied, concerns a type of FCPA violation often overlooked by compliance managers – the bribe paid not to win a deal outright, but for confidential information that can provide a business with a competitive advantage in negotiations with state-owned enterprises. The allegation that an employee of a U.S.-listed entity in fact paid a Chinese official or employee of a state-owned enterprise for information the U.S.-listed company employee was not entitled to receive, if proved, almost surely would constitute a payment to obtain an "improper advantage" under the FCPA, and trigger the full range of U.S. regulatory consequences. Under many government decision-making systems in China, it is rare that one individual controls the outcome of a state purchase. Even so, many officials possess confidential information. As a result, the number of potential bribe recipients and the risks of trading in confidential information, are possibly greater than those attending the "classic bribe" to win a project or sale outright. Managers of international companies and compliance programs accordingly would do well to review training materials and compliance guidelines to address this particular form of risk.

IKEA Limits its Investment in Russia

Multinational companies are no doubt aware of the corruption risk in Russia. In September 2008, Russia ranked 147th out of 180 countries in the Transparency International Corruption Perceptions Index,[6] a drop of nearly 60 places since 2004.[7] Even so, Swedish retailer IKEA made news on June 23, 2009 when it announced it would suspend additional investment in Russia, despite statements in recent months by Russian President Dmitri A. Medvedev that corruption is a national problem and warrants corrective action.[8]

IKEA's action follows the December 2008 civil FCPA settlement by Siemens AG, in which the SEC alleged that the company paid bribes in connection with the sale of both medical devices and traffic solutions equipment in Russia,[9] and the April 2007 settlement of the SEC's case against Baker Hughes, Inc., regarding payments of alleged bribes in Russia and elsewhere.[10] (As is customary in such SEC settlements, neither defendant admitted or denied the SEC allegations.) IKEA's decision not to pull out of Russia entirely suggests sophisticated firms will continue to do business there, but with an acute awareness of the pressures on employees to engage in non-compliant behavior.

U.S.-listed companies are well-advised to calibrate compliance programs to address Russia's unique corruption risks. Steps could include stricter limits of authority for and greater internal audit oversight of Russian operations. It goes without saying that there should be strong support by senior management outside Russia for refusals to pay bribes.

Although relations between Russia and the West will ebb and flow with daily news events, the strengthening of private compliance programs for Russia business operations could be of importance to the joint goals of the U.S. and Russian governments to increase transparency in Russian business dealings. Wise companies will note that the making of a corrupt payment in Russia could one day soon lead to costly anti-bribery proceedings brought by both U.S. and Russian authorities. ■

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5 *See* PRC Criminal Law, Art. 111, www.lawinfochina.com. Under the Chinese State Secrets Law, effective May 1, 1989, state secrets are defined as "matters that have a vital bearing on state security and national interests and, as specified by legal procedure, are entrusted to a limited number of people for a given period of time." PRC State Secrets Law, Art. 2, www.lawinfochina.com. Although Article 8 of that law provides added guidance as to what is deemed a "state secret," clauses (4) and (5) thereof contain potentially expansive language bringing within the definition "secrets in economic and social development" and "secrets concerning science and technology."

6 *See http://www.transparency.org/news_room/in_focus/2008/cpi2008/cpi_2008_table.*

7 *See http://www.transparency.org/policy_research/surveys_indices/cpi/2004.*

8 *See* Andrew E. Kramer, "Ikea Plans to Halt Investment in Russia," *The New York Times* (June 23, 2009), *www.nytimes.com/2009/06/24/business/global/24ruble.html.* According to a recent public opinion survey, more than half of Russian citizens believe graft is "unavoidable" and 58 percent believe it is impossible to fight. *See* The FCPA Blog, www.fcpablog.blogspot.com/2009/05/resignation-and-reform-in-russia.html.

9 *SEC v. Siemens AG*, No. 1:08 CV 02167 (D.D.C. filed Dec. 12, 2008), http://www.sec.gov/litigation/complaints/2008/comp20829.pdf; *SEC v. Siemens AG*, SEC Litig. Rel. No. 20829 (SEC Dec. 15, 2008), http://www.sec.gov/litigation/litreleases/2008/lr20829.htm.

10 *SEC v. Baker Hughes, Inc.,* No. H 07-1408 (S.D. Tex. filed Apr. 26, 2007), http://www.sec.gov/litigation/complaints/2007/comp20094.pdf; *SEC v. Baker Hughes, Inc.*, SEC Litig. Rel. No. 20094 (SEC Apr. 26, 2007), http://www.sec.gov/litigation/litreleases/2007/lr20094.htm.