

FCPA Update

April 2010 ■ Vol. 1, No. 9

News from the BRICs: A Special Report

Russia: H-P Bribery Investigation and Public and Private Anti-Corruption Efforts

Two major corporations have recently made news for allegedly paying bribes to win business in Russia. First, Daimler AG's Russian subsidiary, DaimlerChrysler Automotive Russia SAO ("DCAR"),¹ pleaded guilty to violating the FCPA in March 2010 in connection with improper payments to Russian government officials. Then, in mid-April, *The Wall Street Journal* reported that German prosecutors are investigating Hewlett-Packard Co. ("H-P"), the California-based IT company, for allegedly corrupt activity in Russia.² This article describes the allegations against H-P, as well as emerging responses to Russia's corruption problem, including both a new private sector initiative and a governmental anti-bribery plan.

According to *The Wall Street Journal*, German prosecutors suspect H-P of having paid approximately €8 million in bribes through a German subsidiary for a €35 million contract to equip the Office of the Prosecutor General in Russia with a state-of-the-art computer system in 2003.³ The Prosecutor General is responsible for investigating corruption and bribery.⁴ The Dresden-based prosecutor has reportedly identified one current and two former H-P sales and marketing executives who worked in Germany and Russia as the focus of the investigation.⁵ The three individuals were arrested in December 2009 for suspected foreign bribery, tax

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- 1 The name of Daimler AG's Russian subsidiary has since changed to Mercedes-Benz Russia ZAO.
- 2 David Crawford, "H-P Executives Face Bribery Probes," *The Wall Street Journal*, (Apr. 15, 2010), <http://online.wsj.com/article/SB10001424052702303348504575184302111110966.html?mod=googlewsj>. See also David Crawford and Dionne Searcey, "U.S. Joins H-P Bribery Investigation," *The Wall Street Journal*, (Apr. 16, 2010), <http://online.wsj.com/article/SB10001424052702304628704575186151115576646.html>.
- 3 "H-P Executives Face Bribery Probes," *id.*
- 4 Stephen Foley, "HP Accused of Paying Bribes to Seal Deal in Russia," *The Independent*, (Apr. 16, 2010), <http://www.independent.co.uk/news/business/news/hp-accused-of-paying-bribes-to-seal-deal-in-russia-1946361.html>.
- 5 See Crawford and Crawford and Searcey, note 2, *supra*.

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evasion, and breach of trust. They have been released on bail.⁶ *The Wall Street Journal* reports that search warrants suggest that as many as ten suspects are within the sights of the Dresden prosecutor.⁷

The investigation reportedly began in 2007 after a German tax auditor became suspicious of payments a German H-P subsidiary made totaling €22 million to a small computer hardware firm near Leipzig from 2004 to 2006.⁸ The H-P subsidiary recorded the payments as having been made for services rendered in Moscow.⁹ The investigation also identified three payment intermediaries, shell companies in multiple jurisdictions, and a Moscow-based computer supplier with foreign bank accounts as having conspired with H-P to perpetrate the alleged bribery scheme.¹⁰ Using H-P funds, the intermediaries – based in former East Germany – allegedly paid fake invoices to the shell companies for equipment.¹¹ The illicit funds then flowed through bank accounts all over the world – including the U.K., the U.S., New Zealand, the British

Virgin Islands, Latvia, Lithuania, Belize, Austria, and Switzerland – before making their way to Russia.¹² The ultimate intended payment beneficiaries have not been identified, but German prosecutors presume them to include Russian public officials.¹³

The response by prosecutors exemplifies increasing cross-border cooperation by authorities to pursue bribery. In addition to the German prosecutor's investigation, Swiss police arrested one of the three suspects and presented search warrants, and Russian prosecutors raided H-P's offices in Moscow.¹⁴ Not surprisingly, the U.S. Department of Justice ("DOJ") and the Securities and Exchange Commission ("SEC") are also investigating the matter.¹⁵

H-P is, of course, not the first foreign corporation suspected of having run afoul of anti-bribery laws while doing business in Russia. Only weeks earlier, Daimler AG reached a settlement following the DOJ and SEC's long-running investigations of allegations of improper payments in 22 countries.¹⁶ Daimler AG entered into a

deferred prosecution agreement with the DOJ and paid a cumulative penalty of \$185 million to resolve the DOJ and SEC cases, while its Russian subsidiary pleaded guilty to violating the FCPA's anti-bribery provision.¹⁷

These cases serve as reminders of the acute corruption risks in Russia. Russia ranked 146th out of 180 countries in Transparency International's 2009 Corruption Perception Index with a score of 2.2 on a 10-point scale representing the perceived level of public sector corruption.¹⁸ Russia fared even worse in Transparency International's most recent Bribe Payers Index, finishing last in the ranking that measures the likelihood that companies from the twenty-two largest economies will pay bribes in their business transactions.¹⁹

Anecdotal evidence of corruption corroborates the country's poor rankings in corruption indices. Last year, in response to long-standing criticism of the police force, the Ministry of Internal Affairs announced a new code of conduct for police officers pursuant to which they could lose their jobs or face criminal

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6 *Id.*

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.*

11 See Crawford and Crawford and Searcey, note 2, *supra*.

12 *Id.*

13 *Id.*

14 *Id.*

15 *Id.* *The Wall Street Journal* notes that H-P has not reported the German investigation in its Form 10-Q SEC filings.

16 DOJ Press Rel. 10-360, Daimler AG and Three Subsidiaries Resolve Foreign Corrupt Practices Act Investigation and Agree to Pay \$93.6 Million in Criminal Penalties, (Apr. 1, 2010), <http://www.justice.gov/opa/pr/2010/April/10-crm-360.html>.

17 *United States v. Daimler AG*, Crim. No.: 1:10-cr-00063-RJL, Deferred Prosecution Agreement (D.D.C. 2010), www.justice.gov/criminal/fraud/fcpa/cases/docs/daimlerag-def-agree.pdf. The DOJ alleged that Daimler's Russian subsidiary made over €3 million in improper payments to Russian officials to secure business.

18 Transparency International, Corruption Perceptions Index 2009, http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table.

19 Transparency International, Bribe Payers Index 2008, http://www.transparency.org/policy_research/surveys_indices/bpi/bpi_2008#bpi_table.

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charges for violating the code, which includes a section on taking bribes.²⁰

In April 2010, more than fifty predominantly German-based companies launched an initiative aimed at reducing the corruption risk and associated cost of doing business in Russia. These companies pledged not to offer bribes in Russian business transactions.²¹ Signed at an official Kremlin ceremony and entitled “Corporate Ethics Initiative for Business in the Russian Federation,” the pact requires signatories to pursue a “zero-tolerance policy toward bribery and corruption” and to implement anti-bribery practices derived from Transparency International’s Business Principles for Countering Bribery. A signatory that learns of a bribery violation by a fellow signatory is instructed to inform the respective firm of the wrongdoing in an attempt to remedy the infringement. A signatory may also request expulsion of another for material breaches of the anti-bribery principles governing the Initiative. If the allegation of a material breach is contested, the determination of whether to expel the signatory will be left to a three-

member dispute adjudication board governed by the substantive laws of Switzerland.²²

The Russian government has publicly welcomed the corporate initiative.²³ Although Russia has not signed the Organization for Economic Cooperation and Development anti-bribery convention, President Dmitry Medvedev has repeatedly stated that the fight against corruption is at the forefront of his agenda and recently promulgated a new government policy against public corruption.²⁴ This national anti-corruption strategy requires the heads of federal executive bodies and government agencies to take measures to prevent and resolve conflicts of interests and to update their anti-corruption plans, including the training of civil servants, within months.²⁵ The governmental organ responsible for implementing the strategy is said to have drafted amendments to the civil service law that would drastically increase penalties for corrupt offenses and require disciplinary sanctions, including the possible removal of corrupt civil servants.²⁶

It remains to be seen whether

continued high-profile investigations and prosecutions by foreign prosecutors, the private sector pact not to pay bribes, and the government’s anti-corruption strategy will change the environment in Russia. Although these events are significant and put the topic of corruption in focus, meaningful improvements will depend on how vigorously Russian authorities implement and enforce anti-corruption laws. A report that two Russian state agencies have commenced their own investigations into the Daimler matter may be a sign that Russia is beginning to act on its anti-corruption rhetoric.²⁷ ■

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20 John Wendle, “New Rules for Russia’s Cops: No Bribes or Wild Sex,” *Time Magazine*, (Apr. 15, 2009), <http://www.time.com/time/world/article/0,8599,1891215,00.html>.

21 Prominent firms that signed the pact include Axel Springer Russia, Continental Tires Russia, Deutsche Bahn AG, Deutsche Bank Ltd., Moscow, Mercedes-Benz Russia, Siemens LLC and Volkswagen Group Russia. The text of the Initiative with a list of signatories is available on the website of the German-Russian Chamber of Commerce. Corporate Ethics Initiative for Business in the Russian Federation, (Apr. 21, 2010), <http://russland.ahk.de/events/eventbeschreibungen/2010/corporate-ethics-initiative-for-business-in-the-russian-federation/>.

22 *Id.*

24 “Major German Firms Decide Against Giving Bribes to Russian Government Officials,” *Itar-Tass World Service*, (Apr. 22, 2010).

25 *Id.*

26 *Id.*

27 Gleb Bryanski, “Russia Looks into Daimler Corruption Charges,” *Reuters*, (Apr. 23, 2010), <http://www.reuters.com/article/idUSLDE63M1ZW20100423?type=marketsNews>.

News from the BRICs: China

Avon Suspends Four Executives in Anti-Bribery Investigation

Despite China's recent removal from the Global Integrity "watch list" of countries identified as having a heightened risk for corruption,¹ announcements of compliance actions in China have re-focused attention on the BRIC country poised to become the world's second-largest economy later this year. Avon Products Inc.'s ("Avon") recent announcement offers another example of why China remains a risk for U.S. businesses seeking to expand or maintain sales abroad as the United States emerges from recession.

On April 13, 2010, an Avon spokesperson confirmed that the cosmetics company had suspended four executives as a result of an internal investigation into alleged bribery that began with Avon's China operations.² Eighteen months earlier, on October 20, 2008, Avon announced that it had commenced an investigation of possible FCPA violations in China in June 2008.³ Prior to its 2008

announcement, Avon voluntarily contacted the Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") to advise both agencies of its investigation.⁴ A DOJ spokesperson declined to comment on the suspension of the executives⁵ and neither agency has released any statements. Avon's investigation is ongoing and the company reported that it has not reached any conclusions.⁶

Avon began its investigation after an employee wrote a letter to the company's chief executive alleging the improper purchasing of trips to France, New York, Canada, and Hawaii for Chinese government officials with ties to Avon's business.⁷ In addition to travel, the company disclosed that it is examining entertainment and other expenses that may have been improperly incurred in China.⁸

The employees in China who were suspended are the president of Avon's

Chinese unit, its chief financial officer, and the head of the corporate affairs and government relations group.⁹ The fourth suspended employee worked in Avon's New York office and formerly served as the head of internal audit.¹⁰ An Avon spokesperson stated that the four employees had been asked to take administrative leaves of absence pending the outcome of the investigation, which she described as a "customary action" in such circumstances.¹¹

The probe reportedly involves several million dollars and covers a dozen or more undisclosed countries.¹² It includes certain countries in Latin America, where Avon makes a substantial percentage of its sales and profits.¹³ According to Avon's 2009 annual report, Avon derived approximately 40 percent of its \$10.4 billion overall revenue from Latin America.¹⁴ The Chinese market accounted for \$353.4 million of Avon's revenue.¹⁵ Approximately 80 percent of

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1 Samuel Rubinfeld, "Global Integrity Drops China From Corruption-Watch List," *The Wall Street Journal*, (Feb. 26, 2010), http://online.wsj.com/article/BT-CO-20100226-715499.html?mod=WSJ_World_MIDDLEHeadlinesAsia.

2 Ellen Byron, "Avon Suspends Four Executives Amid Bribery Probe," *The Wall Street Journal*, (Apr. 13, 2010), <http://online.wsj.com/article/SB10001424052702304506904575180501075099806.html>.

3 Avon Statement on Voluntary Disclosure, (Oct. 20, 2008), <http://phx.corporate-ir.net/phoenix.zhtml?c=90402&p=irol-newsArticle&ID=1214457&highlight=>

4 *Id.*

5 See Byron, note 2, *supra*.

6 "Avon Suspends 4 Executives in Probe," *The Associated Press*, (Apr. 13, 2010), <http://www.msnbc.msn.com/id/36459447/>.

7 See Byron, note 2, *supra*.

8 See Avon Voluntary Disclosure, note 3, *supra*.

9 See Byron, note 2, *supra*.

10 *Id.*

11 *Id.*

12 See *The Associated Press*, note 6, *supra*.

13 See Byron, note 2, *supra*.

14 Avon Products Inc., Annual Report (Form 10-K), at 28 (Feb. 25, 2010), www.avoncompany.com/investor/annualreport/pdf/annualreport2009.pdf.

15 *Id.*

16 *Id.*

Avon Suspends Four Executives in Anti-Bribery Investigation ■ Continued from page 5

the company's 2009 revenue came from outside of North America.¹⁶

Avon has a significant history in China. In 1990, it became the first international direct selling company to enter China, but initially did not engage in direct selling because it was not legal at the time.¹⁷ Instead, Avon set up a network of 6,300 independent beauty boutiques and over 1,000 cosmetic parlors in department stores.¹⁸ On April 8, 2005, the Chinese government granted Avon permission to run a pilot door-to-door selling campaign in Beijing, Tianjin, and Guangdong Province.¹⁹ China implemented new regulations governing direct sales on December 1, 2005,²⁰ and in late February 2006, Avon became the first company to receive a direct-selling license from China's Ministry of Commerce.²¹ Avon's CEO is fluent in Chinese, considered something of a celebrity in China, and has frequently met with senior government officials.²²

When Avon received its direct-selling license, the CEO stated that the company shouldered a great responsibility as the

first company allowed to make direct sales in China.²³ With that responsibility arguably came heightened scrutiny for potential misconduct. Doing business in China almost inevitably involves entering into relationships with government officials because agencies and banks are state-run and many individuals in positions of authority are affiliated with the Communist Party. Providing government officials with gifts and entertainment is part of Chinese social and commercial traditions and serves to affirm *guanxi*, or relationships with the officials. These traditions have led to abuse in China; in recent years, several foreign companies have been accused of significant FCPA violations under the guise of maintaining *guanxi*.²⁴

The Avon case is only the latest example of why companies seeking benefits from government regulators and employees of state-owned enterprises in China should develop and rigorously test compliance programs and aggressively monitor business activities. Because the

potential for violating the FCPA to effect legal change is great, strict guidelines that either cap spending on gifts, travel, and entertainment, or offer specific standards for these expenditures may help to reduce the risk. Companies should provide training in the mandates of the FCPA in Chinese as well as in the primary language of the company's employees so both expatriate managers assigned to Chinese operations and local employees are fully aware of what constitutes a violation. ■

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17 "Avon Grabs China's First License for Direct Sales," *People's Daily*, (Mar. 5, 2006), http://english.peopledaily.com.cn/200603/05/eng20060305_247980.html.

18 *Id.*

19 *Id.*

20 *Id.*

21 *Id.* See also Avon Annual Report, note 14, *supra*.

22 See Byron, note 2, *supra*.

23 See *People's Daily*, note 17, *supra*.

24 *Id.*

OECD Council Recommendations Set International Anti-Bribery Compliance Benchmarks

Large, medium, and small-sized businesses subject to the FCPA face common but differing challenges in implementing anti-bribery compliance programs. The issue of how much is reasonable to spend on compliance-related tasks, procedures, and personnel gives rise to the recurring need for benchmarks that set standards that are both attainable and yet sufficiently robust to reasonably deter, detect, and remediate noncompliance.

On February 18, 2010, the Council for Further Combating Bribery of Foreign Government Officials in International Business Transactions, a formal body operating under the auspices of the Organization for Economic Cooperation and Development and the OECD Convention,¹ took another constructive step in setting international standards for anti-bribery compliance programs, announcing Annex II to the Council's November 26, 2009 Recommendation.² Explicitly styled "good practice guidance," Annex II sets forth an approach that is avowedly "flexible, and intended to be adapted by companies, in particular small and medium-sized enterprises ... according to their individual circumstances, including their size, type, legal structure, and geographical and industrial sector of

operation, as well as the jurisdictional and other basic legal principles under which they operate."³

The operative terms provide in relevant part:

Companies should consider, *inter alia*, the following good practices for ensuring effective internal controls, ethics, and compliance programs or measures for the purpose of preventing and detecting foreign bribery:

1. strong, explicit and visible support and commitment from senior management to the company's internal controls, ethics, and compliance programs or measures for preventing and detecting foreign bribery;

2. a clearly articulated and visible corporate policy prohibiting foreign bribery;

3. compliance with this prohibition and the related internal controls, ethics, and compliance programs or measures is the duty of individuals at all levels of the company;

4. oversight of ethics and compliance programs or measures regarding foreign bribery, including the authority to report matters directly to independent monitoring bodies such as internal audit committees of boards of directors or of supervisory boards, is the duty of one or more senior

corporate officers, with an adequate level of autonomy from management, resources, and authority;

5. ethics and compliance programs or measures designed to prevent and detect foreign bribery, applicable to all directors, officers, and employees, and applicable to all entities over which a company has effective control, including subsidiaries, on, *inter alia*, the following areas:

- i) gifts;
- ii) hospitality, entertainment and expenses;
- iii) customer travel;
- iv) political contributions;
- v) charitable donations and sponsorships;
- vi) facilitation payments; and
- vii) solicitation and extortion;

6. ethics and compliance programs or measures designed to prevent and detect foreign bribery applicable, where appropriate and subject to contractual arrangements, to third parties such as agents and other intermediaries, consultants, representatives, distributors, contractors and suppliers, consortia, and joint venture partners

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1 Organization for Economic Cooperation and Development, Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions, (Nov. 26, 2009), <http://www.oecd.org/dataoecd/11/40/44176910.pdf>.

2 *Id.*

3 Organization for Economic Cooperation and Development, Annex II: Good Practice Guidance on Internal Controls, Ethics, and Compliance, *incorporated in* Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions, at 12, (Nov. 26, 2009), <http://www.oecd.org/dataoecd/11/40/44176910.pdf>.

OECD Council Recommendations ■ Continued from page 7

(hereinafter “business partners”), including, *inter alia*, the following essential elements:

i) properly documented risk-based due diligence pertaining to the hiring, as well as the appropriate and regular oversight of business partners;

ii) informing business partners of the company’s commitment to abiding by laws on the prohibitions against foreign bribery, and of the company’s ethics and compliance program or measures for preventing and detecting such bribery; and

iii) seeking a reciprocal commitment from business partners.

7. a system of financial and accounting procedures, including a system of internal controls, reasonably designed to ensure the maintenance of fair and accurate books, records, and accounts, to ensure that they cannot be used for the purpose of foreign bribery or hiding such bribery;

8. measures designed to ensure periodic communication, and documented training for all levels of the company, on the company’s ethics and compliance program or measures regarding foreign bribery, as well as, where appropriate, for subsidiaries;

9. appropriate measures to encourage and provide positive support for the observance of ethics and compliance programs or measures against foreign bribery, at all levels of the company;

10. appropriate disciplinary

procedures to address, among other things, violations, at all levels of the company, of laws against foreign bribery, and the company’s ethics and compliance program or measures regarding foreign bribery;

11. effective measures for:

i) providing guidance and advice to directors, officers, employees, and, where appropriate, business partners, on complying with the company’s ethics and compliance program or measures, including when they need urgent advice on difficult situations in foreign jurisdictions;

ii) internal and where possible confidential reporting by, and protection of, directors, officers, employees, and, where appropriate, business partners, not willing to violate professional standards or ethics under instructions or pressure from hierarchical superiors, as well as for directors, officers, employees, and, where appropriate, business partners, willing to report breaches of the law or professional standards or ethics occurring within the company, in good faith and on reasonable grounds; and

iii) undertaking appropriate action in response to such reports;

12. periodic reviews of the ethics and compliance programs or measures, designed to evaluate and improve their effectiveness in preventing and detecting foreign bribery, taking into account relevant developments in the field, and evolving international and industry standards.⁴

The OECD Annex II standards, if taken seriously, will unquestionably raise the bar for compliance in countries outside of the U.S. that have signed the OECD anti-bribery convention, if not the U.S. as well. Although companies that have settled FCPA enforcement actions have typically been required to adopt compliance programs of a similar nature and scope, the OECD Council’s Annex II standards announce explicitly that these multi-faceted aspects of compliance programs constitute not only the penance owed for non-compliance, but true best practices. In the coming months, in-house counsel, compliance managers, and senior executives alike will be challenged to assess the degree to which their companies already meet the Annex II standards and what steps will be necessary to meet the standards’ demands. ■

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⁴ *Id.* at 12-14.