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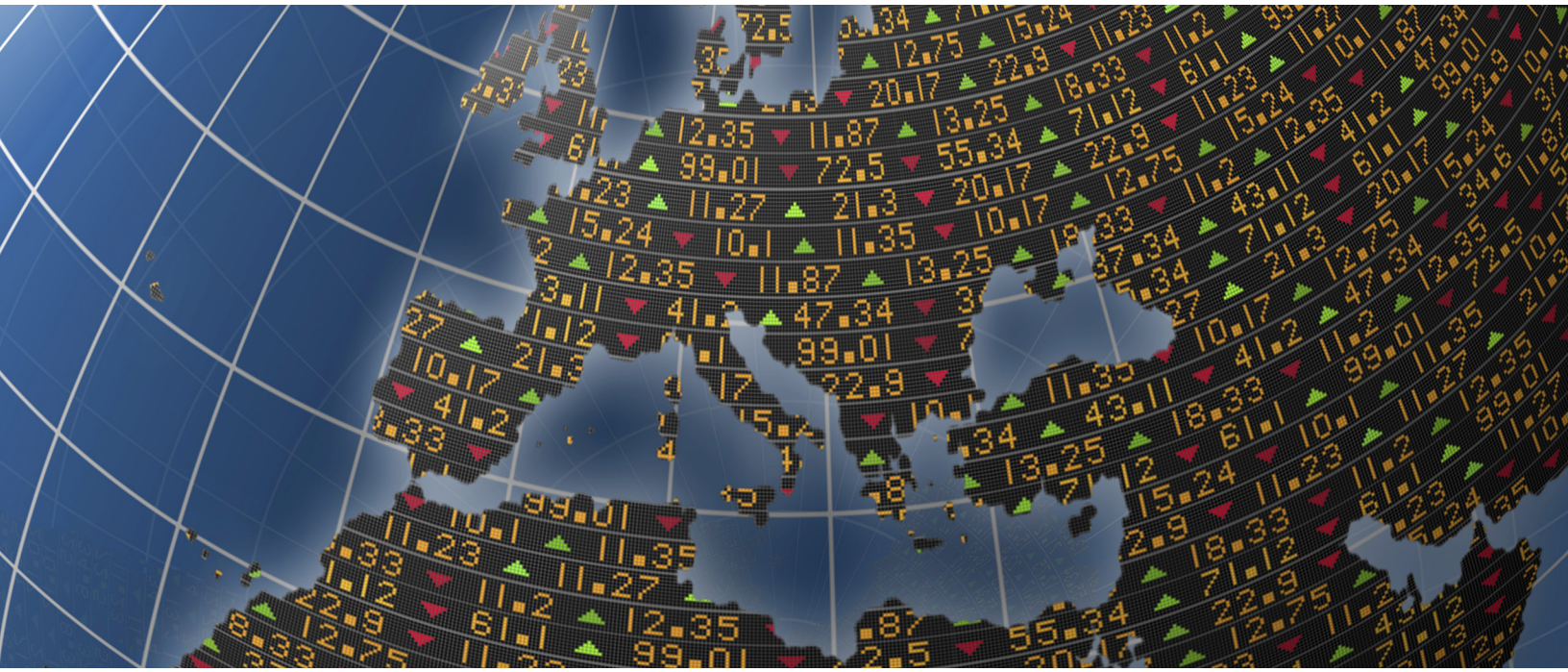

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SEC Settlements with Frank's International and Philips Highlight Fundamental FCPA Risks

In April and May 2023, the SEC brought its third and fourth FCPA enforcement actions of 2023, imposing approximately $70 million in civil penalties and disgorgement in two actions in connection with alleged FCPA violations in Angola and China. These settlements with oilfield services provider Frank's International and large, multinational healthcare device manufacturer Philips (now an FCPA recidivist) reinforce some of the key themes we highlighted last month[1] and the need for robust due diligence and monitoring of third-party agents and distributors that interface with government officials. These settlements also highlight that enforcement authorities remain focused on internal controls violations regardless

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1. *See* Bruce E. Yannett, Andreas A. Glimenakis, Paige Sferrazza & Ned Terrace, "Mining and Gaming Cases Round Out Q1 2023 FCPA Enforcement," FCPA Update, Vol. 14, No. 9 (Apr. 2023), https://www.debevoise.com/insights/publications/2023/04/fcpa-update-april-2023.

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of the size of the company and that internal controls vary but should be tailored to the scale of a company's business.

These actions continue the trend we have seen this year of smaller cases being brought by the SEC that demonstrate foundational aspects of FCPA risk. (In fact, just last week the SEC resolved another smaller FCPA enforcement action – its fifth of 2023 – with consulting firm Gartner.[2]) If there is a potential violation, enforcement authorities will be interested, and companies would be well-advised to regularly and continuously assess and address anti-corruption risk.

Frank's International N.V.

On April 26, 2023, Frank's International N.V. ("Frank's"),[3] a global oilfield services company formerly headquartered in the Netherlands, agreed to pay nearly $8 million to settle SEC charges that it violated the anti-bribery, books and records, and internal accounting controls provisions of the FCPA.[4] The SEC found that Frank's paid commissions to a sales agent who allegedly diverted a portion of those funds to pay bribes to Angolan government officials to influence the award of oil and natural gas services contracts.[5]

The Frank's Order

From 1938 until its August 2013 IPO, Frank's was a privately held company that was majority-owned and managed by its founder's family.[6] In 2007, Frank's attempted to expand its business in Angola by contracting to provide tubular services to support international oil companies with drilling rights in the country, but Frank's hiring was blocked by the Angolan state-owned oil company, Sociedade Nacional de Combustíveis de Angola, E.P. ("Sonangol"), which was responsible for awarding oil and natural gas contracts.[7] According to the Order, senior Frank's managers learned that Frank's could win the contract if Frank's formed a consulting company and paid 5% of the value of contracts that it won to high-ranking Sonangol officials.

To win the contract, Frank's hired a sales agent who did not have the relevant technical qualifications but had existing personal relationships with Sonangol employees, including a senior Sonangol official responsible for awarding contracts to

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2. Order, *In re Gartner, Inc.*, Securities Exchange Act Release No. 97609 (May. 26, 2023), https://www.sec.gov/litigation/admin/2023/34-97609.pdf.
3. Now known as Expro Group Holdings N.V., following a 2021 merger.
4. Order, *In re Frank's Int'l N.V.*, Securities Exchange Act Release No. 97381 (Apr. 26, 2023), https://www.sec.gov/litigation/admin/2023/34-97381.pdf ["Frank's Order"]; U.S. Sec. & Exch. Comm'n Enforcement Action File No. 3-97397, "SEC Charges Frank's International with FCPA Violations in Angola" (Apr. 26, 2023), https://www.sec.gov/enforce/34-97381-s.
5. Frank's Order ¶ 1.
6. *Id.* ¶ 7.
7. *Id.* ¶¶ 9-10.

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vendors.[8] Frank's hired the agent without a contract and without having conducted any due diligence. Upon hiring the agent, the number of Sonangol officials in attendance in their business meetings with Frank's increased significantly.[9] The SEC found that Frank's executives exchanged emails regarding the timing of payments to the sales agent in relation to the company's initially blocked Sonangol contract.[10] To address questions from Frank's finance and accounting heads in Houston about the payments (at that point $688,000), Frank's regional offices executed an agency agreement with one of the agent's companies and backdated the agreement to account for any previous payments.[11]

"These settlements also highlight that enforcement authorities remain focused on internal controls violations regardless of the size of the company and that internal controls vary but should be tailored to the scale of a company's business."

Between 2008 and 2014, Frank's subsidiaries entered into four separate agency agreements with the sales agent.[12] Under the second agreement, the agent was to be paid a 10% sales commission for specific projects; however, the SEC found that only 2.2% was paid in commissions to the agent.[13] According to the Order, the agent submitted various invoices and was paid for "marketing expenses" on behalf of the company, which were recorded as "business expenses – entertainment and meals" in its books and records. The SEC found that the sales agent diverted some of the funds received under the second agreement to the senior official with whom he had a personal relationship.[14] During this time, Frank's was awarded four contracts in Angola.

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8. *Id.* ¶¶ 10-11.
9. *Id.* ¶ 11.
10. *Id.* ¶ 12.
11. *Id.* ¶ 14.
12. *Id.* ¶ 20.
13. *Id.* ¶ 15.
14. *Id.* ¶16.

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Interestingly, Frank's did not become a public company and issuer for purposes of the FCPA until August 2013.[15] However, the SEC found that Frank's continued to make payments to the sales agent and recorded the payments as commissions after becoming a public company, thus triggering FCPA liability for the post-2013 conduct. These payments also coincided with the awarding of five more Angolan contracts to Frank's. In addition, in 2013 and 2014, Frank's executives approved travel and entertainment benefits for the senior Sonangol official and his companion.[16]

In resolving the charges, the SEC considered Frank's self-reporting and cooperation, which included voluntarily producing relevant documents, bringing foreign witnesses to the United States for interviews, and voluntarily sharing facts – including facts about underlying conduct before becoming a public company.[17] The SEC also considered Frank's efforts to remediate its wrongdoing by terminating employees involved in the misconduct and its relationship with the sales agent, and bolstering its internal controls and compliance program after its 2021 merger with Expro. Without admitting or denying the SEC's findings, Frank's settled with the SEC and agreed to cease and desist from committing or causing any future FCPA violations, as well as to pay nearly $8 million in disgorgement and penalties for the post-August 2013 conduct.[18]

Koninklijke Philips N.V.

On May 11, 2023, Koninklijke Philips N.V. ("Philips"), a healthcare device manufacturer based in the Netherlands, agreed to pay more than $62 million to settle SEC charges that it violated the books and records and internal accounting controls provisions of the FCPA.[19] The settlement relates to the sale of diagnostic equipment in China and comes just over 10 years after Philips paid $4.5 million in disgorgement and prejudgment interest to resolve allegations of similar conduct in Poland.[20]

The Philips Order

Philips subsidiaries in China ("Philips China") sell medical technology largely through distributors or sub-dealers to state-owned hospitals. The SEC found that

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15. *Id.* ¶ 18.
16. *Id.* ¶ 19.
17. *Id.* ¶ 27.
18. *Id.* § II.
19. Order, *In re Koninklijke Philips N.V.*, Securities Exchange Act Release No. 97479 (May 11, 2023), https://www.sec.gov/litigation/admin/2023/34-97479.pdf ["Philips Order"]; U.S. Sec. & Exch. Comm'n Press Release No. 2023-92, "Dutch Medical Supplier Philips to Pay More Than $62 Million to Settle FCPA Charges" (May 11, 2023), https://www.sec.gov/news/press-release/2023-92 ["Philips Press Release"].
20. Philips Order ¶¶ 4-5; Order, *In re Koninklijke Philips Electronics N.V.*, Securities Exchange Act Release No. 69327 (Apr. 5, 2013), https://www.sec.gov/litigation/admin/2013/34-69327.pdf.

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employees of those subsidiaries improperly influenced public hospital tenders to help their distributors and sub-dealers win bids to sell Philips medical equipment.[21] According to the Order, the misconduct – which occurred throughout China from 2014 through 2019 – followed a consistent pattern.[22] A public hospital employee, after consulting with a Philips China sales manager or employee, distributor, or sub-dealer, would draft technical specifications tailored to Philips products to increase the odds that Philips' device would be selected.[23] When the company or one of its third-party sellers won the bid, the hospital would then direct the winner to prepare two more bids to meet a three-bid minimum for public tenders.[24]

In the Order, the SEC described two examples of violative conduct from 2017. In one instance, the Hainan Province sales manager for Philips China paid a hospital radiology director $14,500 in exchange for help with the hospital's procurement process.[25] The Philips China sales team then shared the company's product specifications with the radiology director, the Philips distributor prepared an additional bid with products from a different manufacturer, and the hospital selected the Philips devices – valued at $4.6 million. In another instance, public hospital officials, after consulting with Philips China employees, tailored public tender specifications to disqualify all potential bidders except Philips China and two other suppliers.[26] Thanks to Philips China's inappropriate influence on the tender, a Philips distributor won a contract worth $475,000.

By giving distributors special price discounts, the SEC found that Philips China created a risk that large distributor margins would enable improper payments to employees of public hospitals – and this risk was exacerbated by high pressure to make sales.[27]

For this alleged conduct, the SEC charged Philips with failing to keep adequate documentation of the business justification or management's approval of the pricing discounts to distributors in its books and records.[28] It also charged Phillips with deficient internal accounting controls regarding the use of third parties and management's approval or authorization of the discounts,[29] and found that Philips

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21. Philips Order ¶¶ 5, 7.
22. *Id.* ¶¶ 7-9.
23. *Id.* ¶¶ 8(a), (b).
24. *Id.* ¶ 8(c).
25. *Id.* ¶ 10.
26. *Id.* ¶ 11.
27. *Id.* ¶ 12.
28. *Id.* ¶ 16.
29. *Id.* ¶¶ 12, 18.

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did not enforce existing due diligence, training, or testing procedures related to the engagement of distributors, despite remedial measures taken in connection with its previous FCPA settlement.[30]

Philips cooperated with the SEC's investigation and was credited for taking remedial measures, including bolstering internal accounting controls, terminating employment and business relationships with individuals involved in wrongdoing, and improving its tone with regard to compliance.[31] While Philips did not admit or deny any of the SEC's findings, it agreed to cease and desist from further FCPA violations.[32] In addition, the SEC required Philips to self-report to the SEC on its ongoing remediation and compliance enhancements over a two-year period.[33]

Takeaways

Here are a few takeaways from these two resolutions:

- **IPO readiness should involve careful anti-corruption and anti-bribery assessments and remediation.**[34] Because the SEC's accounting provisions apply when a company becomes an issuer – and because public companies are generally subject to higher regulatory burdens and more heightened scrutiny – companies preparing to go public should conduct thorough risk assessments of overseas operations and undertake remedial efforts and enhancements, if necessary. As demonstrated in the Frank's case, in which the company went public in 2013 but alleged misconduct was cited as occurring between 2008 and 2014, a company's actions prior to going public may be scrutinized and cited as evidence of recurring or ongoing misconduct (even if not fully calculated in any penalty amounts). In charging accounting and substantive bribery violations, the SEC focused on the fact that improper commission payments were initiated before Frank's became a public company and continued after that point. Given Frank's 2021 merger with Expro and this 2023 resolution alleging misconduct dating back 9 to 15 years, this case is also a reminder for companies and private equity firms contemplating corporate mergers to conduct robust pre-deal due diligence in light of the risks of successor liability.

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30. *Id.* ¶ 13; Philips Press Release.
31. *Id.* ¶¶ 20-21.
32. *Id.* § II.
33. *Id.* ¶ 22.
34. *See also* Andrew M. Levine, Philip Rohlik & Kamya B. Mehta, "Mitigating Anti-Corruption Risk in M&A Transactions: Successor Liability and Beyond" at 11-12, FCPA Update, Vol. 10, No. 5 (Dec. 2018), https://www.debevoise.com/insights/publications/2018/12/fcpa-update-december-2018.

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- **Companies must carefully diligence third-party agents at onboarding and monitor them on an ongoing basis**. Both Frank's and Philips allegedly failed to address the risk that funds paid to intermediaries would eventually flow to unscrupulous government officials. In both cases, payments were facilitated by inaccurate bookkeeping, insufficient documentation, and inadequate internal accounting controls. Frank's allegedly did not conduct due diligence or prepare a written agreement before engaging the sales agent whose only qualification was a personal relationship with a senior foreign official with a gatekeeping function. Philips allegedly failed to enforce due diligence and training procedures that were in place around the engagement of distributors, despite using distributors and sub-dealers to sell products in a high-risk jurisdiction to government customers from whom employees were pressured to win additional sales – and

"[T]his case is also a reminder for companies and private equity firms contemplating corporate mergers to conduct robust pre-deal due diligence in light of the risks of successor liability."

despite a previous FCPA settlement for similar conduct in Poland. It is best practice to carefully select and screen third parties that act on your behalf and to conduct risk-based due diligence regarding their backgrounds, reputation, and qualifications. Companies also should ensure that third-party engagements are supported by written agreements and that appropriate contractual safeguards, including anti-corruption and anti-bribery provisions, are implemented before third-party agents begin working. Employees – particularly those in sales and other customer-facing functions – should receive tailored training and should be empowered to raise red flags; those in control functions should be empowered to carefully monitor the relationships with and work of third-party intermediaries and report concerns if and when they arise.

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- **The healthcare industry is back in the spotlight**. The case against Philips, now an FCPA recidivist, coupled with recent disclosures of open FCPA probes faced by pharma company Pfizer (which resolved a previous FCPA matter in 2012[35]) and medical device supplier Stryker (which resolved two previous FCPA matters in 2013 and 2018[36]), among others, highlights that the SEC may be in the midst of another healthcare industry sweep.[37]
- **The SEC is focusing on the nuts and bolts**. These cases are the SEC's third and fourth cases of 2023, all involving misconduct in a single country, all involving the use of sales agents, consultants, or distributors supported by insufficient documentation, two involving no profits at all, and none (at least yet) involving a DOJ component. The cases resulted in relatively modest disgorgement and penalty numbers, which illustrate that enforcement authorities are not going to limit themselves to the large multi-jurisdictional bribery schemes.

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35. U.S. Dep't of Justice Press Release No. 12-980, "Pfizer H.C.P. Corp. Agrees to Pay $15 Million Penalty to Resolve Foreign Bribery Investigation" (Aug. 7, 2012), https://www.justice.gov/opa/pr/pfizer-hcp-corp-agrees-pay-15-million-penalty-resolve-foreign-bribery-investigation.
36. U.S. Sec. & Exch. Comm'n Press Release No. 2013-229, "SEC Charges Stryker Corporation With FCPA Violations" (Oct. 24, 2013), https://www.sec.gov/news/press-release/2013-229; U.S. Sec. & Exch. Comm'n Press Release No. 2018-222, "SEC Charges Stryker A Second Time for FCPA Violations" (Sept. 28, 2018), https://www.sec.gov/news/press-release/2018-222.
37. Pfizer Inc, Quarterly Report (Form 10-Q) at 30 (May 10, 2023), https://files.lbr.cloud/public/2023-05/PFE%20-%2010-Q%20FY23%20Q1%20-%2005.10.23.pdf?VersionId=7i4s23pMZfUTIhZBEHpUmxnx3c0ATrv6; Stryker Corp., Quarterly Report (Form 10-Q) at 7 (May 2, 2023), https://www.sec.gov/ix?doc=/Archives/edgar/data/310764/000031076423000067/syk-20230331.htm.

UK Introduces New "Failure to Prevent Fraud" Corporate Offense

Following confirmation by the government of the United Kingdom earlier this year that it intended to create a new "failure to prevent" corporate criminal offense, it has now published the much-anticipated draft wording of a failure to prevent fraud offense. This will form part of the Economic Crime and Corporate Transparency Bill (the "ECCT Bill"), which is currently being debated by the House of Lords. Once enacted, the ECCT Bill will be the most important law tackling economic crime since the Bribery Act 2010.[1] It is also the culmination of a long debate about the reform of corporate criminal liability, including a review by the Law Commission completed last year.[2]

What are the key features of the offense?

An organization will be liable under the new offense (as currently drafted) where:

- It is a "large organisation"
  - A large organization is a company or partnership that meets at least two of these three criteria: over 250 employees, over £36 million turnover, or over £18 million in total assets.
- An "associate" of the organization commits a specified fraud offense; and
  - Associates include employees, agents, subsidiaries, and any others who perform services for or on behalf of the organization.
  - Notable specified offenses include fraud by false representation, failing to disclose information or abuse of position (all under the Fraud Act 2006), false accounting and false statements by company directors (both under the Theft Act 1968), and the common law offense of cheating the public revenue, as well as aiding or abetting any of these offenses.
- The associate intended to benefit (directly or indirectly) either the organization or a third party to which the organization is providing services.
  - In the latter scenario, the organization will not be liable where it was a victim of the fraud or was intended to be a victim.

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1. The ECCT Bill follows the Economic Crime (Transparency and Enforcement) Act 2022, which we covered here: https://www.debevoise.com/insights/publications/2022/03/uk-economic-crime-act-strengthens.
2. Our summary of the options paper published by the Law Commission in June 2022 is here: https://www.debevoise.com/insights/publications/2022/06/fcpa-update-june-2022.

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- Unless the organization had implemented reasonable procedures designed to prevent associates from committing fraud.

Some other significant aspects of the offense are:

- It will have considerable extraterritorial application, based on the extraterritorial effect of many of the specified fraud offenses. For example, if an associate commits any element of a relevant offense under the Fraud Act 2006 in the UK (such as by making a false statement in the UK or by making a gain in the UK through defrauding UK victims), the organization could be liable, even if the rest of the conduct occurred overseas and both the organization and the associate are based overseas.
- A conviction may result in an unlimited fine for the organization.
- Organizations will be able to enter into deferred prosecution agreements ("DPAs") with the UK authorities in relation to alleged violations.
- Although the government has ruled out a similar money laundering offense, the draft law explicitly permits the Home Secretary to make regulations adding an offense of failure to prevent money laundering under sections 327-329 of the Proceeds of Crime Act 2002, as well as other economic crimes involving dishonesty or fraud.

What are the aims of the offense?

This new offense responds to growing public pressure on the government in recent years to take more serious steps to combat fraud. While estimates of the financial cost of fraud in the UK vary widely, figures of well over £100 billion per year have been calculated. The government states that fraud is the most common offense in the UK, amounting to 41% of all crime in the year to September 2022.

The Director of the Serious Fraud Office ("SFO") has described the offense as a "game-changer for law enforcement," making it significantly easier to hold companies to account when they profit from fraud. The SFO has long campaigned for a failure to prevent fraud offense to help overcome the high hurdle presented by the UK's prevalent "directing mind and will" test for attributing the criminal conduct and state of mind of an employee to their employing company. Notably, in the SFO's failed prosecution of Barclays for conspiracy to commit fraud by false representation through allegedly misleading statements in its prospectuses and subscription agreements for capital raisings involving Qatari investors, the Court of Appeal found in 2020 that in the circumstances of that case, even the bank's chief executive and

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chief financial officer did not represent its directing mind and will. If a failure to prevent offense had been available previously, the SFO could have chosen to use it as a more straightforward basis for the DPAs that it entered into with Tesco, G4S, and Serco, instead of the primary fraud and false accounting offenses under the Fraud Act 2006 and Theft Act 1968.

While the enforcement potential of these reforms is important, a factsheet and an impact assessment published by the government explain that it does not actually expect a significant increase in prosecutions. Instead, the primary purpose of the offense is to deter wrongdoing and drive a cultural change within organizations to focus on taking actions that protect the public and other businesses from a range of fraudulent practices.

How does it compare to the other 'failure to prevent' offenses?

Fundamentally, the new offense is very similar to the existing failure to prevent bribery and failure to prevent the facilitation of tax evasion offenses. It is a strict liability offense, with no requirement to prove that the company's senior management was involved in, or even knew about, the misconduct. However, the new offense includes some important differences in each of its key elements:

"Companies will need to review fraud risks across their entire operations, including in relation to customers, suppliers, business partners, employees, agents, and investors."

- **Large organization.** The focus is on large organizations, adopting the criteria for large companies in the Companies Act 2006. Approximately 25,000 UK entities will be in scope (there is no estimate of the number of large overseas organizations that could potentially be affected). Despite the likely greater fraud risks posed by the much higher number of small and medium-sized enterprises, these businesses will be left to the existing legal framework, as the government believes that bringing them within the scope of the new offense would impose a disproportionate compliance burden. However, this exemption has caused considerable controversy and it is possible that it may be removed or amended before the ECCT Bill is passed (or at a later date).

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- **Associate.** Unlike the failure to prevent bribery offense, where the primary test as to whether someone is an associated person is whether they perform services for or on behalf of the company in the relevant circumstances (which may, but does not necessarily, include an employee, agent, or subsidiary), the new offense assumes an employee, agent, or subsidiary to be an associate of the company (as well as any others who perform services for or on its behalf). This places an even greater onus on large companies to ensure that their subsidiaries implement group-wide anti-fraud procedures.
- **Benefit.** Although the concept that the associate's fraud must be intended to benefit the company (not just the associate personally) is familiar, the new offense widens this to capture a situation where the associate intends to benefit a third party that has engaged the company, rather than the company itself. In such situations, there may also be an intended indirect benefit to the company in any event. However, fraud (unlike bribery) is often perpetrated by individuals for purely personal gain, in which case their employer will not liable, reducing the potential application of the new offense.
- **Reasonable procedures.** Like the tax evasion corporate offense, there is a defense of "reasonable" prevention procedures, which is considered to place a lower compliance burden on companies than the "adequate" procedures language in the Bribery Act.
- **Extraterritorial scope.** While the failure to prevent bribery offense in the Bribery Act requires the company to be incorporated in the UK or carry on business (or part of a business in the UK), the new offense has a very different and potentially broader jurisdictional reach, depending on the nature of the underlying fraud offense. Both large UK companies and large foreign companies with some UK operations or a small UK subsidiary could be in scope. Even a foreign company that has no UK connections could be captured if, for example, an employee makes false statements that lead someone in the UK to buy a product from the company. However, unlike the Bribery Act, a UK company cannot be prosecuted for failing to prevent fraud occurring entirely overseas without any UK victims.

What impact could this have and what should companies be thinking about?

The new offense will not come into force until the ECCT Bill has been enacted and the government has published guidance on what constitutes reasonable fraud prevention procedures. Based on previous experience, that process is likely to take at least a year. However, given the extremely wide and flexible nature of the offense,

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it is advisable for large UK and overseas companies to start thinking now about how they might be affected and how they should respond.

A company's exposure to bribery and facilitation of tax evasion are usually relatively straightforward to explain, identify, and assess, but the enormously varied nature of fraudulent activity means that each company, and particularly each industry, will face unique issues. Companies will need to review fraud risks across their entire operations, including in relation to customers, suppliers, business partners, employees, agents, and investors.

For businesses such as financial services firms that deal with high volumes of payment flows, existing anti-fraud systems may require enhancement. Technology companies may need to think carefully about how their platforms might be misused to defraud customers or users. Companies that deal with the public sector or large numbers of individuals should also be especially alert to the new offense, due to the higher risk of fraud and likely pressure for such fraud to be prosecuted.

For many companies, we expect that there will be considerable difficulty and complexity involved in designing and implementing an effective package of fraud prevention measures. Large companies are generally unlikely to be the perpetrators of fraudulent schemes for their own gain, but rather the victims of fraud. Having prescriptive prevention procedures for a concept as broad and amorphous as fraud will inherently be very challenging. Furthermore, the task for affected companies is magnified by the number of other primary offenses that have been prescribed in the draft law and therefore need to be addressed, not all of which are closely related to fraud.

As a result, formulating comprehensive but user-friendly policies and procedures, and then delivering tailored training programs to employees, is likely to be a major compliance project. As with anti-bribery procedures, robust due diligence on third parties, monitoring, and audit processes will be important. Large companies should consider focusing their analysis on potential fraud against investors and customers, and in particular on procedures to avoid making misleading statements to either group or presenting inaccurate financial reports.

The government's March 2023 economic crime plan includes £400 million over the next three years to provide funding for 475 more investigations staff and improved technology and intelligence sharing to combat fraud and other financial crime. This should generate more cases for the SFO and other agencies to investigate and prosecute, although no additional funds have been allocated

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for this purpose, so it is unclear whether the new offense will lead to a significant upturn in enforcement activity. Another possibility is that the new offense will encourage fraud victims to bring private prosecutions against companies to recover compensation, especially where a group of people has been defrauded by similar conduct.

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