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FOREIGN CORRUPT PRACTICES ACT UPDATE

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FCPA Enforcement Continues Apace

Three recent cases illustrate the US government's continuing and vigorous efforts to enforce the Foreign Corrupt Practices Act (FCPA). First, earlier this month, the Department of Justice (DOJ) announced the indictments of three individuals allegedly involved in a scheme to pay millions of dollars in bribes to foreign government officials in Azerbaijan to ensure, and profit from, the privatization of that country's state-run oil company. Second, during the summer, the DOJ and the Securities and Exchange Commission (SEC) began parallel criminal and civil FCPA enforcement actions against a former employee of US-based ITXC Corp., alleging that the employee bribed a high-ranking official of Nigeria's state-owned telephone company to secure a lucrative telephone services contract. Third, in May 2005, a wholly-owned Chinese subsidiary of Diagnostic Products Corp. (DPC), a US-based medical equipment firm, plead guilty to criminal charges brought by the DOJ; at the same time, DPC settled a parallel SEC probe alleging FCPA violations by agreeing to pay nearly $4.8 million in penalties. The criminal and civil actions in this case arose out of approximately $1.6 million in sales "commissions" made by DPC, through its subsidiary, to doctors and laboratory staff employed by state-owned hospitals in China in order to generate business.

These government investigations continue the trend of vigorous FCPA enforcement. The past two years have witnessed an explosion in the number of FCPA enforcement cases, with record penalties being levied in some instances. Both the DOJ and SEC have stated that FCPA enforcement is among their priorities and that additional resources and attention have been directed to this area.

The FCPA's Antibribery and Accounting Provisions

The FCPA antibribery provisions make it unlawful for any issuer, domestic concern, or person acting within the United States to offer or make a payment of anything of value directly or indirectly to a foreign official, international organization official, political party or party official, or any candidate for public office, for the purpose of influencing that official to assist in obtaining or retaining business. 15 U.S.C. §§78dd-1 to -3. A covered company can be held liable for payments made on its behalf by agents or distributors.

The FCPA's accounting provisions require companies with securities listed in US trading markets to keep books, records and accounts, which accurately and fairly reflect any transaction and disposition of assets in reasonable detail, and to maintain an adequate system of internal accounting controls. 15 U.S.C. §78m(b). A covered company is responsible for ensuring that its controlled subsidiaries, including foreign subsidiaries, comply with the FCPA's accounting provisions.

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The Kozeny Investigation

On October 6, 2005, the DOJ announced indictments against Viktor Kozeny, a Czech businessman and Bahamas resident; David Pinkerton, an executive in the private equity group of American International Group Inc.; and Frederic Bourke, Jr., an individual investor, for conspiracy to violate the FCPA. A federal grand jury in Manhattan indicted the defendants based on alleged improper payments and promises to senior government officials of Azerbaijan, beginning in August 1997 and continuing until 1999, that were intended to ensure that Kozeny and certain individual and institutional investors (collectively, "the investment consortium") acquired a controlling interest in the State Oil Company of the Azerbaijan Republic (SOCAR) following its privatization.

The indictment alleges that Kozeny, acting on his own behalf and as an agent of Bourke, Pinkerton and other members of the investment consortium, engaged in a series of improper payments and promises to pay four senior Azeri officials (who included a senior official of the Government of Azerbaijan, a senior SOCAR official and two senior officials of the State Property Committee). According to the indictment, Kozeny controlled two British Virgin Island companies, Oily Rock Ltd. and Minaret Ltd., which purchased government-issued vouchers and options to bid for shares of state-owned industries in Azerbaijan.

The reported bribes took a variety of forms. For instance, in August 1997, Kozeny purportedly transferred two-thirds of the vouchers and options purchased by Oily Rock and two-thirds of the investment consortium's future profits arising from SOCAR's privatization in return for official assurances that the investment consortium would be permitted to acquire a controlling interest in SOCAR upon its privatization. Other bribes to senior Azeri officials allegedly included transfers arising out of a $300 million increase in Oily Rock's authorized share capital, payments of over $11 million in May and June 1998, gifts of jewelry and other luxury items in May 1998, and several all-expense-paid visits to New York for medical treatment in 1998.

The twenty-seven count indictment in this alleged bribery scheme includes twelve separate counts of FCPA violations and seven counts of violations of the Travel Act.[1] Each of the defendants is also charged with money laundering conspiracy; separate, substantive money laundering violations; and in the case of Bourke and Pinkerton, making false statements to the FBI. If convicted, the defendants face up to five years in prison and a maximum fine of $250,000 (or twice the gross gain or loss arising from the alleged violations) for each FCPA violation.

Of particular note is the fact that Kozeny, a Czech businessman and Bahamian resident, was arrested in the Bahamas and must be extradited to the United States. His attorney reportedly is claiming that the FCPA does not apply to him because he is not a US citizen or resident. A foreign individual may be subject to the FCPA, however, if acting as an agent of a US issuer or domestic concern, or if acting while in the United States. It is not clear how the DOJ will respond to the jurisdictional issue that Kozeny apparently intends to raise.

The Amoako Investigation

Over the summer, the SEC and DOJ filed parallel civil and criminal actions against Yaw Osei Amoako, who is a former Africa regional director for ITXC Corp. The actions allege that Amoako violated the antibribery provisions of the FCPA by making improper payments to a senior official of the Nigerian-owned telephone company, Nigerian Telecommunications Ltd. (Nitel). The

1. The Travel Act makes it illegal to travel or use the mails or other interstate facilities to undertake certain unlawful activity, including violations of the FCPA's antibribery provisions. 18 U.S.C. §1952.

payments allegedly were intended to secure a lucrative contract allowing ITXC to transmit telephone calls into Nigeria.

In particular, the government's filings allege that between November 2002 and May 2004, Amoako arranged for ITXC to make wire transfers in excess of $166,000 to a Nitel deputy general manager. As consideration for these payments, ITXC allegedly expected the deputy general manager at Nitel to steer a contract to ITXC. ITXC in fact won the contract and netted over $1.1 million as a result. On June 1, 2004, ITXC merged with Teleglobe International Holdings Ltd. (Teleglobe). Teleglobe terminated Amoako's employment on August 19, 2004, after an internal investigation concluded he had violated the FCPA.

This case is yet another example of an FCPA enforcement action in the context of a merger or acquisition. (See Foreign Corrupt Practices Act Updates for March 7, 2005, and January 5, 2005, for discussions of the Titan and Invision cases, respectively, arising in the merger context.)

The DPC Investigation and Agreements

On May 20, 2005, the DOJ and SEC announced the results of parallel criminal and civil FCPA enforcement actions against DPC and its wholly-owned Chinese subsidiary DPC (Tianjin) Co. Ltd. (DPC Tianjin), providers of diagnostic medical equipment. DPC Tianjin pled guilty pursuant to a plea agreement with the DOJ, and DPC agreed to a cease-and-desist order (SEC order) to settle the SEC investigation. DPC agreed to pay almost $4.8 million combined in penalties, which consisted of a $2 million criminal fine in connection with the criminal plea, over $2 million in "disgorgement" paid in connection with the SEC settlement, and nearly $750,000 in prejudgment interest on the "disgorgement" amount.

The settlements resulted primarily from alleged corrupt sales commissions awarded to physicians and laboratory personnel who controlled purchasing decisions in state-owned hospitals in China.

The SEC order states that DPC, through DPC Tianjin, routinely made improper commission payments totaling about $1.6 million to these personnel at state-owned hospitals to induce them to purchase DPC products from 1991 through 2002. The payments, which were typically calculated as a percentage of sales made to Chinese hospitals, allowed DPC to earn profits in excess of $2 million. During this time, the SEC order indicates that DPC Tianjin improperly characterized these payments as legitimate business expenses in its books and records, which were reflected in consolidated financial statements enclosed with DPC's public filings.

Both government investigations stemmed from information that DPC voluntarily disclosed after DPC Tianjin's auditors raised concerns about the payments. After DPC management learned of these payments, DPC instructed DPC Tianjin to cease all commission payments and began an internal investigation of the matter. This review led to various remedial measures and the adoption of an FCPA compliance program.

The DPC case is significant because, among other things, it highlights the sometimes-hidden FCPA exposure that US companies face when engaging in business activities in China. Business in China often entails dealings with employees of state-owned companies, like hospitals, who the DOJ and SEC assert qualify as "foreign officials" within the meaning of the FCPA and must be treated with the same caution as any other foreign official. The DPC case also is notable because it shows the aggressiveness with which the US government is pursuing alleged violators of the FCPA even when companies voluntarily disclose violations and cooperate with the US government. Finally, the SEC's case is yet another reminder of the risks to all parent companies whose shares are publicly traded on US

exchanges—whether the companies are foreign or domestic—if they fail to ensure FCPA compliance by their subsidiaries.

Practical Advice

US companies and foreign companies that do business in the United States, or whose shares are traded on US exchanges, should seek to implement a comprehensive FCPA compliance program and to apply that program to even their subsidiaries.

The following lessons emerge from these cases:

- Certain high-risk regions of the world, including parts of Central Asia, Africa (in particular, Nigeria), and China, continue to present significant FCPA compliance challenges, and company management and auditors must proactively implement aggressive controls over operations in such areas.
- Companies that have significant business dealings in countries with command economies or emerging markets should exercise particular care to ensure otherwise permissible payments to employees or officers are not prohibited under the FCPA because those persons work for a state-owned enterprise.
- In deciding how to dispose of a case, the DOJ and the SEC continue to give credit to companies that volunteered information and cooperated in the conduct of an internal investigation in ways that make the investigation transparent to the government agencies and shed light on the factual record. Just how much credit is "earned" as a result is sometimes uncertain, and whether the credit given is sufficient is often debated between the government and cooperating companies, and certainly in the defense bar.

For a fuller discussion of these and other FCPA issues, see Roger M. Witten, *Complying with the Foreign Corrupt Practices Act* (Matthew Bender, 4th ed. 2003). If you have any questions or need additional information, please contact:

Roger Witten
+1 (212) 230-8850
roger.witten@wilmerhale.com

Stephen Preston
+1 (202) 663-6900
stephen.preston@wilmerhale.com

Robert Keefe
+1 (617) 526-6334
robert.keefe@wilmerhale.com

Kimberly Parker
+1 (202) 663-6987
kimberly.parker@wilmerhale.com

Stephen Heifetz
+1 (202) 663-6558
stephen.heifetz@wilmerhale.com

Aimen Mir
+1 (202) 663-6639
aimen.mir@wilmerhale.com

Atman Trivedi
+1 (202) 663-6807
atman.trivedi@wilmerhale.com