

Foreign Corrupt Practices Act Updates

IBM Consents to Civil Penalty and SEC Cease and Desist Order Based on Argentine Bribe Scandal

International Business Machines Corporation (IBM) recently agreed with the Securities and Exchange Commission (SEC) to pay a civil penalty of \$300,000 and to accept entry of an administrative cease and desist order arising out of alleged bribes paid by its Argentine subsidiary.^{1/} The SEC's investigation paralleled an ongoing investigation by the Argentine government into the same transaction.

This case is the first foreign bribery-related case brought by the SEC in more than three years. It closes a five-year investigation into the widely publicized IBM Argentina bribery scandal.

The FCPA's Antibribery and Accounting Provisions

The Foreign Corrupt Practices Act's (FCPA) antibribery provisions make it unlawful for any issuer, domestic concern, or person acting within the United States corruptly to make or offer to 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 any official act to assist in obtaining or retaining business. 15 U.S.C. § 78m(b). The FCPA's accounting provisions require companies with securities listed in

U.S. 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. § 78dd-1 to -3.

The FCPA's antibribery provisions do not apply directly to a foreign subsidiary of a U.S. company so long as the subsidiary itself is not an issuer or a U.S. company and so long as no acts in furtherance of the corrupt payment take place in the United States. A U.S. parent company is not liable for corrupt payments made by a foreign subsidiary unless the parent knowingly participates in or authorizes the corrupt payment.

On the other hand, a U.S. company is responsible for ensuring that its foreign subsidiary complies with the accounting provisions. The parent must assure that its subsidiary both maintains accurate books and records and establishes and implements internal accounting controls. The parent can be held liable for its failure to ensure the accuracy of a subsidiary's books and records even if it has no knowledge or reason to know of the inadequate

^{1/} *Securities and Exchange Commission v. International Business Machines Corp.*, 1:00CV030400 (D.D.C. Dec. 21, 2000); *In the Matter of International Business Machines Corp.*, Administrative Proceeding File No. 3-13097, Rel. No. 34-43761, Dec. 21, 2000.

recordkeeping and even if adequate internal controls are in place to prevent FCPA violations.

The SEC's Allegations and Findings

According to the SEC, IBM's subsidiary IBM Argentina S.A. (IBM Argentina) entered into a \$250 million contract in 1994 to modernize the computer systems of Banco de la Nación Argentina (BNA), a government-owned commercial bank in Argentina. Part of the contract included a \$37 million subcontract (15% of the total contract amount) with an Argentine company. This subcontract was made without the knowledge or approval of any IBM employee in the United States. IBM Argentina paid \$22 million of the subcontract amount, of which at least \$4.5 million was allegedly transferred to BNA directors, who were government officials under the FCPA.

Senior managers at IBM Argentina overrode company procurement, contracting and review procedures by fabricating documents, including a backdated authorization letter, and by inaccurately describing the reasons for hiring the subcontractor. The payments to the subcontractor that were allegedly passed on to Argentine government officials were inaccurately recorded in IBM Argentina's records as third-party subcontractor expenses. While IBM did not falsify records in its consolidation of IBM Argentina's financial records, the inaccurate information in IBM Argentina's records was included in IBM's 1994 Form 10-K, albeit without the knowledge or approval of any IBM employee in the United States.

The SEC found that IBM violated the FCPA's accounting provisions by failing to ensure that IBM Argentina maintained accurate books and records disclosing the allegedly corrupt

payments. Without admitting or denying the SEC's allegations and findings, IBM consented to a court order requiring it to pay a civil penalty of \$300,000 (6.6% of the \$4.5 million alleged to be a corrupt payment) and to an administrative order requiring it to cease and desist from violating the FCPA's accounting provisions.

The Argentine Investigation

Unlike many previous cases, the U.S. enforcement authorities were not the first "cops" on the scene. Argentine authorities began investigating the transaction after a routine tax audit uncovered evidence that some of the money IBM Argentina paid to the subcontractor was passed on to "phantom" companies. So far, fifteen BNA directors and IBM Argentina executives have been indicted for bribery in Argentina. The Argentine judge in charge of the investigation also issued an international arrest warrant through Interpol for four U.S. IBM executives. The warrant was withdrawn when the executives testified before him in the U.S.^{2/} The judge has warned, however, that the arrest warrants could be reinstated if new evidence is discovered showing that IBM had responsibility for the corrupt payments.^{3/} At least five other IBM Argentina public contracts are currently under investigation for alleged corrupt payments. Another Argentine judge has begun an investigation into whether IBM Argentina is guilty of tax evasion because it claimed the alleged bribes as deductible expenses.^{4/}

Aftermath

When it learned of the scandal surrounding IBM Argentina, IBM launched an internal investigation. The investigation concluded that company policy had been violated in obtaining the BNA contract but that no laws had been broken. IBM promptly fired or requested resignations from 13

^{2/} Andres Oppenheimer, "IBM Executives Deny Home Office Knew of Bribes in Argentina Bureau," *Knight-Ridder Tribune Business News*, October 1, 2000.

^{3/} *Id.*

^{4/} "IBM Argentina Blasts Tax Evasion Accusations," *National Post*, June 9, 2000.

IBM Argentina executives. It also enhanced its procurement policies to prevent similar problems in the future.

IBM's reputation and business interests in Argentina have suffered as a result of the scandal. BNA revoked the contract with IBM Argentina after paying only \$80 million of the \$250 million contract price, citing IBM's alleged inadequate performance. In subsequent court litigation, IBM agreed to reimburse BNA \$34 million.^{5/} Other Argentine government agencies have either revoked contracts with IBM or ended longstanding relationships with the company. The total amount of lost business is estimated at more than \$500 million.^{6/} In an effort to repair some of the public relations damage, IBM has stopped bidding on public contracts in Argentina and instructed its Latin American division not to bid on any contract that is not awarded in a public, contested bidding process.^{7/}

Significance of SEC Settlement

IBM's settlement with the SEC is significant because it shows that the SEC will pursue an FCPA books and records case even when the false books and records are those of an issuer's foreign subsidiary and the issuer has no knowledge of their falsity, let alone of the more serious misconduct they conceal. Moreover, because the SEC did not allege that IBM's internal controls were inadequate, it is clear that the SEC believes an issuer can be held liable for the books and records violations of a foreign subsidiary, even when it had reasonable controls in place to prevent FCPA violations.

The SEC-IBM settlement is a reminder of several other points:

- Issuers can be held liable under the FCPA's accounting provisions even when, because of

lack of knowledge or lack of a jurisdictional nexus, they cannot be held liable under the antibribery provisions.

- Even when corrupt payments do not violate the FCPA, they almost certainly violate the law of the country where they are made and may lead to criminal investigations and severe penalties.

- An issuer may be held liable for unauthorized payments made by foreign subcontractors as well as through the more common means of foreign agents, consultants, and joint venture partners.

- In addition to the purely legal consequences of corrupt payments, there are often severe public relations and business consequences. IBM's \$300,000 civil penalty pales in comparison to the reported loss of \$500 million in Argentine business.

For a fuller discussion of these and other FCPA issues, see Stephen F. Black and Roger M. Witten, *Complying with the Foreign Corrupt Practices Act*, 11 Business Law Monographs (Matthew Bender 2000) (2001 edition forthcoming).

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^{5/} "Argentina: IBM to Reimburse US \$34 mil to Banco Nacion," *South American Business Information*, November 10, 1997.

^{6/} "IBM's Last Tangle in Argentina," *The Economist*, August 1, 1998.

^{7/} *Id.*

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