Foreign Corrupt Practices Act

WILMERHALE

New Enforcement Actions Include Largest FCPA Criminal Fine to Date
US Attorney General Highlights FCPA Enforcement in Recent Speech

At the American Bar Association White Collar Crime Conference on March 1, 2007, Attorney General Alberto R. Gonzales discussed the US Department of Justice's (DOJ) focus on combating international corruption. First, he observed that the *Vetco Gray* case (discussed below) and the *Schnitzer Steel* and *Statoil* cases (discussed in the November 2006 WilmerHale FCPA Briefing Series)[1] demonstrate that the DOJ has substantially increased its focus and attention on the US Foreign Corrupt Practices Act (FCPA). Second, he noted that the DOJ is also providing training and assistance to foreign law enforcement partners. These remarks suggest both that the FCPA continues to be a high priority for enforcement and that we will likely see a higher level of cooperation between international government regulators than we have in the past, which will be of particular importance for companies facing investigation in more than one jurisdiction.

The *Vetco Gray* case and two other recent cases illustrate the continuing and active enforcement of the FCPA by the DOJ and the Securities and Exchange Commission (SEC).

First, on February 6, 2007, Vetco Gray Controls Inc., Vetco Gray UK Ltd. and Vetco Gray Controls Ltd. pleaded guilty to violations of the FCPA's antibribery provisions and conspiracy to violate the FCPA in connection with corrupt payments to Nigerian customs officials that were made through an agent. A fourth Vetco entity, Aibel Group Ltd., entered into a deferred prosecution agreement with the DOJ relating to the same conduct. The total fine assessed against the three convicted Vetco entities—$26 million—is the largest in an FCPA criminal enforcement action to date. The size of the fine is in part a reflection of the fact that this is the second time in three years that Vetco companies have pleaded guilty to FCPA charges.

Second, on February 7, 2007, the SEC entered into a settlement with El Paso Corporation for violations of the FCPA's books and records and internal controls provisions. On the same day, the DOJ entered into a non-prosecution agreement with El Paso. These allegations arose from kickbacks paid by El Paso and a predecessor company to the Iraqi regime under the United Nations Oil-for-Food Program (OFFP). The *El Paso* case, one of many OFFP cases currently being investigated by the DOJ and SEC, may be an acknowledgement by the US government that it cannot generally proceed on antibribery grounds in OFFP cases because the corrupt payments were made to the Iraqi government itself, not to individual government officials.

Third, on February 13, 2007, the SEC entered into a settlement with Dow Chemical Company for alleged books and records and internal controls violations by a fifth-tier Dow Indian subsidiary. Dow agreed to pay a civil penalty of $325,000. The Indian subsidiary—of which Dow owned 51%–76% over the relevant period—allegedly made corrupt payments to Indian federal and state officials and deliberately falsified books and records in order to disguise the payments. The case demonstrates that US companies will be held responsible for the activities of their foreign subsidiaries under the FCPA's books and records and internal controls provisions even when the parent company had no knowledge of the corrupt activity.

These developments demonstrate the ongoing commitment of the US government to vigorous anti-corruption enforcement, particularly in the acquisition and joint venture context, and that it is necessary for US companies and their affiliates to have strong compliance programs, books and records, and internal controls.

The FCPA's Antibribery and Accounting Provisions

The FCPA's 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.[2] 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 that accurately and fairly reflect any transaction and disposition of assets in reasonable detail, and to maintain an adequate system of internal accounting controls.[3] A covered company is responsible for ensuring that its controlled subsidiaries, including foreign subsidiaries, comply with the FCPA's accounting provisions.

Vetco

The February 6, 2007, plea agreements and deferred prosecution agreement were the second round of FCPA prosecutions against Vetco entities in recent years for improper conduct in Nigeria. Vetco Gray was originally part of ABB Handels-und Verwaltungs AG (ABB). On July 6, 2004, ABB Vetco Gray UK Ltd. and an affiliated company pleaded guilty and paid total criminal fines of $10.5 million, and its Swiss parent company disgorged $5.9 million in allegedly illicit profits in a civil settlement with the SEC after the subsidiaries paid more than $1 million in bribes to Nigerian government officials who evaluated and approved potential bids for work on oil exploration projects.[4] Four former ABB employees later settled civil charges with the SEC relating to the same conduct.[5]

A week after the guilty pleas were entered in 2004, ABB sold its upstream oil and gas businesses and assets to a group of private equity entities. After the sale, ABB Offshore Systems Inc. became Vetco Gray Controls Inc. (Vetco Gray Controls), a company incorporated in Texas (and consequently a "domestic concern" within the meaning of the FCPA).[6] ABB Vetco Gray UK Ltd. became Vetco Gray UK Ltd. (Vetco Gray UK) and was incorporated under the laws of the UK with a principal place of business in Scotland. Vetco Gray UK is a "person" within the meaning of the FCPA.[7] ABB Vetco Gray Offshore Systems Ltd. became Vetco Gray Controls Ltd., a business incorporated under the laws of the United Kingdom with a principal place of business in Nailsea, England, and offices in Aberdeen, Scotland. Like Vetco Gray UK, Vetco Gray Controls Ltd. is a person within the meaning of the FCPA.

At the time of the sale, the DOJ issued an Opinion Release (No. 2004-02) indicating that it did not intend to take further enforcement action against the acquirors or the acquirees for prior conduct based on, among other things, a commitment by the acquirors to effectively institute and implement in the acquired entities a compliance system, internal controls, training and other procedures sufficient to deter and detect violations of the FCPA, and to conduct internal reviews of the Vetco companies' businesses in a variety of countries.

According to the government's papers, in February 2001, Vetco Gray UK was awarded a contract (the Bonga Contract) in connection with Nigeria's first deep-water oil drilling project. The three convicted Vetco entities supplied goods and engineering services under the Bonga Contract. Vetco Gray Controls in Houston, Texas, was responsible for the transportation and customs clearance of all goods and equipment for the project into Nigeria.

Vetco Gray Controls hired a shipping agent to facilitate shipments of goods to Nigeria, and the agent provided services to all three convicted Vetco subsidiaries. According to the criminal information, the defendants and the agent participated in a conspiracy to make corrupt payments to Nigerian customs officials to induce the officials to provide the Vetco entities with preferential treatment in the customs clearance process, and to secure an improper advantage with respect to the importation of goods and equipment into Nigeria. Vetco Gray Controls, which was based in the United States, communicated with the other Vetco entities and the agent to facilitate the process and the related payments.

The agent provided improper services (referred to as "express courier services," "interventions" and "evacuations") to the Vetco entities. Each of these services assisted Vetco in moving goods through Nigerian customs cheaply and quickly and resolving problems that arose with Nigerian customs officials. In connection with the express courier services, the agent explained that it would be unable to provide the Vetco entities with receipts for the agent's special fee or for payment of customs duties.

When a Vetco Gray Controls logistics coordinator raised questions, the coordinator was told that the express courier service operated pursuant to an "on-the-side," "internal" agreement between the agent and unnamed customs officials. When the coordinator sought further explanations, the coordinator was told that it was "none of [the coordinator's] business how [the agent would] get it done," and that the coordinator did "not want to know" what the agent had to do. Emails and memos cited in the government's papers indicate that communications took place between employees of all three defendant entities discussing the potentially corrupt nature of payments to the agent. The payments to the agent for express courier services were invoiced to the Vetco entities as "local processing fees" or "administrative transport fees." In some cases, these fees were approximately a third of the cost of the legal customs duties.

Between 2002 and 2005 (a period beginning well in advance of the 2004 guilty pleas and acquisition), approximately 378 payments for express courier services were made, totaling over $2 million. In addition, the agent performed at least 19 "interventions" between April 2003 and April 2005, totaling $59,733, and at least 21 "evacuations" at a cost ranging from $1,644 to $32,497 each, for a total of $74,862. The defendants' employees engaged in emails and phone calls to the United States discussing many of these payments, and personnel in the United States approved payments.

The large fines assessed against the Vetco entities in the 2007 action took into account the companies' alleged failure to comply with commitments made to the DOJ in 2004 to implement compliance programs and internal controls. The DOJ stated in its press release that the resolution of the matter resulted, in large part, from Vetco's voluntary disclosure and remediation, seemingly indicating that the fines likely would have been higher absent those factors. In addition to the criminal fines, the plea agreements require the defendants to (1) hire an independent monitor to oversee the creation and maintenance of a robust compliance program; (2) undertake and complete previously committed-to investigations of the companies' conduct in various other countries as originally required under the FCPA Opinion Release; and (3) ensure that, in the event that any of the companies are sold, the sale shall bind any future purchaser to the monitoring and investigating obligations. GE has announced its plans to purchase the Vetco entities and thus will be bound by the requirements of the plea agreements.

Several critical lessons emerge from the *Vetco* case:

- The case is one of many recent reminders of the importance of FCPA issues in the acquisition context—here, despite being aware of FCPA issues at the time of the acquisition and making specific commitments to the DOJ to remedy them and investigate in other countries, the private equity acquirors apparently did not take sufficient steps to prevent improper conduct similar to the conduct that resulted in the first round of guilty pleas.
- While the FCPA often is perceived as not covering foreign affiliates, jurisdiction may be asserted under 15 U.S.C. §78dd-3 against foreign companies that take actions in the United States, including calling or sending emails to the United States.
- The case emphasizes the importance of adequate due diligence and control of agents. The communications with the shipping agent and the inadequate documentation raised numerous "red flags," yet these clear signs either were not noted or not addressed by managers or internal auditors.
- Although the FCPA is expressly limited to transactions made for the purpose of obtaining or retaining business, the case is a stark example of the broad interpretation of those terms by the enforcement community. Here, payments made to avoid customs restrictions do not appear to relate to the obtaining or retaining of business, yet they were viewed as sufficiently connected to result in a criminal enforcement action. At least one court in a prior case has supported the government's broad view of the statutory language.
- This case is another example of the DOJ's and SEC's insistence on the appointment of a compliance monitor in connection with the resolution of FCPA cases. This relief has apparently become standard, and difficult to avoid.

El Paso

On February 7, 2007, the SEC entered into a settlement with El Paso Corporation (El Paso), a Texas based energy company, for violations of the books and records and internal controls provisions of the FCPA. On the same day, the DOJ entered into a non-prosecution agreement with El Paso relating to the same conduct.

According to the SEC's complaint, from approximately June 2001–June 2002, El Paso indirectly made approximately $5.5 million in illegal surcharge payments in connection with its purchases of crude oil from third parties under the United Nations OFFP. Without admitting or denying the allegations in the SEC's complaint, El Paso consented to the entry of a final judgment permanently enjoining it from future violations of the FCPA's books and records and internal controls provisions and ordering it to disgorge $5,482,363 in profits and pay a civil penalty of $2,250,000. The disgorgement obligation was deemed satisfied by El Paso's forfeiture of $5,482,363 pursuant to the non-prosecution agreement with the US Attorney's Office for the Southern District of New York, which will seek to transfer this money to the Development Fund of Iraq, to be paid as restitution for the benefit of the people of Iraq.

The UN OFFP was established in 1996 as a form of humanitarian relief to the Iraqi population, which faced significant hardship under the 1990–2003 UN sanctions preventing member states from trading in any Iraqi commodities or products. Iraq was permitted to sell oil on the condition that all of its oil proceeds were deposited into an escrow bank account monitored by the United Nations, and the funds could only be used to purchase designated humanitarian goods for the benefit of the Iraqi people. The government of Iraq sold oil through Iraq's State Oil Marketing Organization (SOMO). Under the OFFP, Iraqi government officials had the power to select the companies and individuals who received the rights to purchase Iraqi oil.

According to the SEC's complaint, from approximately August 2000–March 2003, Iraqi government officials conditioned the distribution of allocations of oil under the OFFP on the recipient's agreement to pay kickbacks. The kickbacks usually were paid in the form of a surcharge on each barrel of oil sold and were deposited into Iraqi-controlled bank accounts in Jordan and Lebanon in the names of SOMO officials or other Iraqi individuals. Money from these accounts subsequently was transferred to the Iraqi Central Bank in Baghdad.

In September 2000, the Coastal Corporation, which later was acquired by El Paso, received a surcharge demand from a SOMO official. An El Paso consultant and former Coastal official arranged for a $201,877 surcharge payment, which was sent to a bank in Jordan on El Paso's behalf. After being notified that all future purchases would include surcharges, El Paso ceased purchasing crude oil directly from Iraq but continued its purchases from third parties, and, according to the SEC's complaint, knew or was reckless in not knowing that illegal surcharges were paid in connection with those purchases and passed back to El Paso in price premiums.

El Paso allegedly entered into 14 additional third-party transactions involving contracts to purchase oil. According to the SEC's complaint, approximately 25–30 cents of every barrel was illegally kicked back to Iraq by third parties. Although El Paso inserted a provision in some of its third-party purchase contracts requiring its contract partners to represent that they had made "no surcharge or other payment to SOMO," the company allegedly did not conduct sufficient due diligence to ensure that any such representations were truthful, and the SEC complaint alleges that recorded conversations prove the company knew the provision was ineffective.

The SEC's complaint also alleges that El Paso failed to maintain a system of internal controls sufficient to ensure that the company's transactions were executed in accordance with management's authorization, and that the transactions would be recorded as necessary to maintain accountability for the company's assets. El Paso allegedly failed to maintain adequate records of its Iraqi crude oil contracts because (1) its contract files did not contain proof that invoices had been paid for at least 13 shipments; (2) there was no process for documenting commercially reasonable prices paid for oil cargos; (3) there was no evidence that documents were reviewed by anyone to ensure propriety and adequacy; and (4) there were inadequate explanations of why documents were missing from files. The SEC also alleged that El Paso violated the accounting provisions by failing to designate what portion of the oil purchase price constituted surcharge payments to Iraq, in violation of UN regulations and US and international trade sanctions.

The DOJ's non-prosecution agreement did not specify the violations engaged in by El Paso, but it referenced the conduct charged in the indictment of Coastal's former chief executive and others, which included, among other things, charges of wire fraud but not charges under the FCPA. The non-prosecution agreement also contained a commitment that the Treasury Department's Office of

Foreign Assets Control would not pursue civil charges against El Paso.

The SEC's accounting-related allegations and the DOJ's apparent focus on wire fraud and trade-related charges, despite what appear to be clear instances of bribery, may be an acknowledgment by the government that FCPA antibribery allegations are not appropriate in the OFFP context because the kickbacks were made to the Iraqi government rather than to Iraqi officials. Nonetheless, as it has in many cases before, the government may charge companies that are engaging in corrupt practices overseas under the accounting provisions and other statutes.

Dow

On February 13, 2007, the SEC settled a case against Dow Chemical Company (Dow) for violations of the FCPA's books and records and internal controls provisions relating to alleged improper payments made by DE-Nocil Crop Protection Ltd. (DE-Nocil), a fifth-tier subsidiary of Dow doing business in India. Without admitting or denying the allegations in the complaint, Dow settled the action by paying a civil penalty of $325,000.

DE-Nocil was required to obtain government registration for its products at both state and federal levels prior to marketing them in India. The SEC's complaint alleged that, between 1996–2001, DE-Nocil made improper payments through consultants and unrelated companies to Indian government officials in order to register several agro-chemical products slated for marketing in time for India's growing season. DE-Nocil accumulated the funds for the payments to government officials off its books with the cooperation of a contractor who added fictitious "incidental charges" on its bills. The contractor accumulated and segregated these funds and then disbursed the funds to federal and state regulators as directed by DE-Nocil.

DE-Nocil allegedly paid an estimated $200,000 in improper payments and gifts to Indian state and federal officials, which were not accurately reflected in Dow's books and records. The payments were made without knowledge or approval of any Dow employee. Dow conducted an internal investigation of DE-Nocil and then voluntarily approached the SEC staff and presented the results. Dow also took extensive remedial actions, including (1) taking employee disciplinary actions; (2) retaining an independent auditor to conduct a forensic audit of the books and records and internal controls at DE-Nocil; (3) reporting its internal investigation to the Audit Committee of the Board of Directors; (4) providing FCPA compliance training to employees at DE-Nocil, as well as at DE-Nocil's immediate parent; (5) restructuring its global compliance program; (6) expanding FCPA compliance training worldwide; (7) training auditors to recognize FCPA issues; (8) joining a nonprofit association specializing in antibribery due diligence that, among other things, screens potential partners and other third parties that work with multinational corporations; and (9) hiring an independent consultant to review and assess its FCPA compliance program.

The Dow case is another example of a US company being held responsible for the accuracy of books and records of foreign subsidiaries even when the parent company has no knowledge of corrupt activity. Interestingly, all of the conduct alleged in the complaint occurred in 2001 or before, which appears to be outside the FCPA's five-year statute of limitations. It is unclear whether Dow entered into a tolling agreement or whether the SEC viewed the books and records and internal controls conduct as constituting ongoing violations. Dow's extensive remedial actions in this instance may have assisted it in avoiding any disgorgement and in keeping the fine relatively low.

WilmerHale lawyers regularly speak on legal developments under the Foreign Corrupt Practices Act and related enforcement issues. Below is a listing of recent and upcoming topics and events:

Roger Witten, Partner

Recent

February 21, 2007, New York, NY. PLI Conference on "The Foreign Corrupt Practices Act – Coping with Heightened Enforcement Risks." Roger participated on a panel called "Roundtable of Hypothetical Cases with Enforcement Officials and Defense Counsel."

Future

March 27–28, 2007, New York, NY. ACI's 17th National Conference on the Foreign Corrupt Practices Act. Roger will participate on a panel called "The Year in Review: Prosecutors Speak on Recent FCPA Investigations and Prosecutions."

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May 3–4, 2007, Paris, France. International Bar Association 5th Annual Conference on "The Awakening Giant of Anti-Corruption Enforcement." Roger will participate on a panel called "Prosecutors Forum: Parallel Investigations and Prosecutions, Oil for Food Prosecutions, Sanctions and Penalties, Prosecutorial Priorities."

June 21, 2007, Berlin, Germany. Joint Humboldt University-WilmerHale 12th Annual International Business and Trade Law Conference. Roger will deliver a speech on "Legal Aspects of Corporate Compliance in a Global Economy."

Kimberly Parker, Partner

Recent

January 30–31, 2007, Houston, TX. ACI's FCPA Boot Camp. Kimberly chaired the first day of the conference and participated on panels called "Demystifying the FCPA" and "Conducting FCPA Compliance Reviews."

Future

April 10, 2007, Webcast. Foreign Corrupt Practices Act: Charting a Safe Course in the Context of an Acquisition. Kimberly will be joining Ernst & Young LLP on a panel discussing the FCPA in the context of an acquisition.

June 4–5, 2007, San Francisco, CA. ACI's FCPA Conference. Kimberly will be chairing the first day of the conference and participating on panels called "Demystifying the FCPA" and "Conducting FCPA Compliance Reviews."

Jay Holtmeier, Counsel

Future

April 10, 2007, Webcast. Foreign Corrupt Practices Act: Charting a Safe Course in the Context of an Acquisition. Jay will be joining Ernst & Young LLP on a panel discussing the FCPA in the context of an acquisition.

May 1–2, 2007, New York, NY. ACI's Anti-Corruption for Pharma & Life Sciences – Minimizing Exposure Under Expansive Definitions of Foreign "Government Officials." Jay will participate on a panel called "Averting the 'Purchase' of an FCPA Violation in the New Wave of Pharmaceutical/Life Sciences Mergers and Acquisitions."

NOTES

1. *See* November 2006 WilmerHale FCPA Briefing Series at http://www.wilmerhale.com/files/Publication/c2883dfb-debd-46f2-9ec9-b67cd710eae0/Presentation/PublicationAttachment/ec38c5db-0973-4850-8fd7-b761afffc9db/FCPA_Nov2006.pdf.
2. 15 U.S.C. §§78dd-1 to -3.
3. 15 U.S.C. §78m(b).
4. *See* July 27, 2004 WilmerHale FCPA Update at http://www.wilmerhale.com/files/Publication/3e8e537a-af21-4ccd-9009-564f5121db41/Presentation/PublicationAttachment/0fb0137c-9c09-4859-9969-3c408a2da63b/FCPA 07-27-04.pdf.
5. *See* August 2006 WilmerHale FCPA Briefing Series at http://www.wilmerhale.com/files/Publication/d0ed0ebd-5238-4712-a98f-02d33787d24b/Presentation/PublicationAttachment/d16bc193-73d7-445b-891e-07758fb8cab5/FCPAaugustV4.pdf.
6. 15 U.S.C. §78dd-2(h)(1)(B).
7. 15 U.S.C. §78dd-3(f)(1).

FOR MORE INFORMATION ON THIS OR OTHER FCPA MATTERS, PLEASE CONTACT:

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