Updates in Global Anti-Bribery Enforcement

2009-05-13

Since the start of the new year, global anti-corruption enforcement has remained active. In February, the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) settled the second-largest FCPA cases in history with Halliburton and Kellogg Brown & Root. The DOJ recently brought its largest multi-party FCPA indictment against six employees of a California-based valve company for allegedly violating the FCPA by bribing foreign officials and the Travel Act for engaging in commercial bribery. Meanwhile, cases were resolved against ITT and Latin Node, and Morgan Stanley disclosed that it was investigating possible FCPA violations in China.

One other potential FCPA development includes an effort on the part of Congress to create explicit guidelines regarding deferred prosecution agreements in a push to increase transparency in agreements between companies and US prosecutors.

KBR, Halliburton, and its Employees Engaged in Nigerian Bribery and Kickback Scheme

Kellogg Brown & Root LLC (KBR), a Houston-based subsidiary of Halliburton Company that is engaged in global engineering and construction, pleaded guilty on February 11, 2009 to FCPA anti-bribery charges for a decade-long scheme to bribe Nigerian government officials to obtain engineering, procurement, and construction (EPC) contracts. The EPC contracts for the development of liquefied natural gas facilities on Bonny Island, Nigeria were valued at more than $6 billion.

KBR was part of a four-company joint venture that was awarded four EPC contracts by Nigeria LNG Ltd. (NLNG) between 1995 and 2004. The government-owned Nigerian National Petroleum Corporation (NNPC) was the largest shareholder of NLNG, owning 49% of the company. Three multinational companies owned the remainder of NLNG. KBR paid "consulting fees" to two agents for their help in bribing a range of Nigerian government officials, including officials of the executive branch of the Nigerian government, NNPC officials, and NLNG officials. KBR paid approximately $132 million to the first agent, a consulting company incorporated in Gibraltar, and more than $50 million to the second agent, a global trading company headquartered in Tokyo.

Relatedly, on February 17, 2009, two UK citizens, Jeffrey Tesler and Wojciech Chodan were indicted by a federal grand jury for allegedly violating the anti-bribery provisions of the FCPA for their role in

KBR's bribes of Nigerian officials.[1]

KBR agreed to pay a $402 million fine, the second largest criminal fine for an FCPA violation following Siemens' $450 million fine in December 2008. Tesler and Chodan each face up to 55 years in prison if convicted. The indictment also seeks forfeiture from Tesler and Chodan of more than $132 million.

Also on February 11, 2009, KBR's parent company, KBR Inc., and its former parent company, Halliburton Company, reached a settlement in a related civil action filed by the SEC. The SEC's complaint asserted that Halliburton had implied knowledge of the joint venture's activities due to its extensive involvement at KBR. The SEC's complaint charged KBR Inc. with violating the FCPA's anti-bribery, books and records, and internal controls provisions. KBR Inc. and Halliburton jointly agreed to pay $177 million in disgorgement of profits.

The combined settlement is notable because of the sheer scope of the penalties that were imposed, $402 million in criminal fines to the DOJ and $177 million in disgorgement to the SEC. The total sanctions in the case are the largest amount ever paid by US companies since the FCPA's inception.

The case also serves as yet another example of the increasing cooperation among international enforcement authorities. The US authorities cooperated with their counterparts in France, Italy, Switzerland, and the United Kingdom in resolving the matter.

The Tesler and Chodan indictments are noteworthy in light of the government's position with respect to the jurisdictional reach of the FCPA over foreign citizens who apparently were not in the US at any time relevant to the charged conduct. The FCPA provides for jurisdiction over foreign companies and nationals that take any act in furtherance of a corrupt payment while within the territory of the United States.[2] This language has not been interpreted by any court, but, in this case, the DOJ is contending that it confers jurisdiction whenever a foreign company or national acting as an agent of an issuer or domestic concern *causes an act to be done within the territory of the United States*.[3] The indictment of Tesler and Chodan states that they were agents of KBR and sent some of the bribe money through "bank accounts in New York, New York, to be further credited to bank accounts in Switzerland and Monaco controlled by Tesler for Tesler to use to bribe Nigerian government officials," thus holding them liable under the FCPA.[4]

It is also significant that NLNG, the employer of the recipients of the bribes, was owned 49% by the Nigerian government. In light of the ownership level, together with government representation on the board and in management, the US government took the view that NLNG was a government entity and instrumentality for purposes of the FCPA. The case provides a lesson that corporate compliance programs cannot rely mechanistically on majority ownership levels alone to determine government status.

The case also provides important lessons for companies entering into joint venture agreements. Although the joint venture at issue in this case was only minority-owned by KBR, the settlement documents indicated that officers and employees at the highest level of KBR, including its former CEO, were closely involved in the joint venture and its business in Nigeria from the joint venture's inception. Other high ranking personnel of KBR also were closely involved, serving as sales, legal, and operational personnel. Despite KBR's minority ownership, the DOJ still charged the company with anti-bribery violations due to its level of operational control and knowledge. This highlights the importance in the joint venture context of conducting proper due diligence on joint venture partners initially and of maintaining proper internal controls throughout the relationship.

Finally, the case is relatively unusual due to the use of the forfeiture remedy against Tesler and Chodan.[5] The US Government is demanding the entire $132 million that KBR allegedly transferred to Tesler's Gibraltar company or the property derived from it. Apparently, the DOJ is not distinguishing the KBR money Tesler allegedly paid out in bribes from amounts he may have kept.

Multi-Party Prosecution of Employees of California-Based Valve Company

On January 8, 2009, Mario Covino, the former director of worldwide factory sales for a California-based valve company, pleaded guilty in federal court to a single count of conspiring to violate the FCPA by paying at least $1 million in bribes to foreign officials in several countries. He admitted that from March 2003 through August 2007, he caused employees and agents of the valve company to make corrupt payments to foreign officials employed at state-owned enterprises in order to assist in obtaining and retaining business, ultimately resulting in approximately $5 million in profits.

On February 3, 2009, Richard Morlok, the former finance director for the company, also pleaded guilty to a one-count information charging him with conspiring to make corrupt payments to foreign government officials for the purpose of securing business. Morlok admitted that from 2003 through 2006, he caused employees and agents to make corrupt payments totaling approximately $628,000 to foreign officials employed at state-owned enterprises in order to assist in obtaining and retaining business, resulting in approximately $3.5 million in profits.

Covino and Morlok admitted providing false and misleading responses to internal auditors during a 2004 internal audit of the company's commission payments. Covino also admitted deleting emails and instructing others to delete emails that referred to corrupt payments, for the purpose of obstructing the internal audit. Morlok admitted to providing false and misleading information to external auditors in 2004.

Covino and Morlok have agreed to cooperate with the DOJ in its ongoing investigation. Sentencing is scheduled for July 20, 2009 and July 10, 2009 respectively. Both face a maximum of five years in prison.

Relatedly, and in what is now the biggest multi-party indictment of individuals yet under the FCPA, six more former executives of the valve company were charged on April 8, 2009 with an alleged decade-long conspiracy to win contracts by bribing officials at foreign state-owned companies, as well as foreign and domestic private companies. For these six newly indicted executives, the indictment charges that from 2003 to 2007, the defendants caused the company to pay approximately $4.9 million in bribes to officials of foreign state-owned companies, in violation of the anti-bribery provisions of the FCPA, and approximately $1.95 million in bribes to officers and employees of foreign and domestic privately owned companies, in violation of the Travel Act. In total, the indictment alleges that the defendants and others caused the valve company to make approximately 236 corrupt payments in more than 30 countries, resulting in profits of approximately $46.5 million from sales related to those corrupt payments. Defendant Hong Carson also was charged with obstruction of justice in connection with her alleged destruction of documents by flushing them down the toilet just before being interviewed by the company's lawyers. That crime carries a maximum penalty of 20 years in prison and a fine of $250,000.

The DOJ's use of the Travel Act is a significant development in anti-corruption enforcement, as it completely eliminates the requirements (necessary under the FCPA's anti-bribery provisions) that the intended recipient of the bribe be a foreign government official. In general terms, the Travel Act is a federal law criminalizing activities that are unlawful under state law if the defendant travels in, or uses other means of, interstate or foreign commerce.[6] The DOJ and SEC previously have brought charges against issuers under the FCPA's books and records provisions where commercial bribery was inaccurately recorded in a company's accounting records.[7] Use of the Travel Act expands the DOJ's prosecutorial reach over commercial bribery in cases where the defendant is not an issuer and the FCPA's accounting provisions are unavailable (and of course, in cases where the commercial bribery is accurately recorded).

The Travel Act has previously been used primarily in domestic commercial bribery cases,[8] and, until now, has rarely been used by the DOJ's Fraud Section in prosecuting foreign bribery cases.[9] At a recent conference, a DOJ prosecutor stated that he was not aware of the DOJ initiating investigations solely focused on books and records or commercial bribery offenses, but where such offenses are found in FCPA anti-bribery investigations, the DOJ believes there is a US law enforcement interest in pursuing such charges. This could have significant consequences for companies whose compliance programs focus only on bribery of foreign government officials.

The multi-defendant indictment again emphasizes the DOJ's strategy of targeting individuals, not just companies. Mark Mendelsohn, Deputy Chief of the Fraud Section, and the DOJ official responsible for FCPA criminal prosecutions, stated in September 2008: "The number of individual prosecutions has risen – and that's not an accident. That is quite intentional on the part of the Department. It is our view that to have a credible deterrent effect, people have to go to jail. People have to be prosecuted where appropriate. This is a federal crime. This is not fun and games."[10]

Latin Node Pleads Guilty to FCPA Violation, Paying $2 Million Criminal Fine

Latin Node Inc., a privately held Florida corporation, pleaded guilty on April 7, 2009 to violating the FCPA's anti-bribery provisions in connection with improper payments in Honduras and Yemen and agreed to pay a $2 million criminal fine. Florida-based eLandia International Inc. discovered the potential FCPA violations after it acquired Latin Node in 2007. According to the DOJ's press release, eLandia voluntarily disclosed the violations immediately, conducted an internal FCPA investigation, shared the results of the investigation with the DOJ, cooperated fully in the government's investigation, and took appropriate remedial action, including terminating senior Latin Node management involved in or having knowledge of the violations. Because the company is not an issuer, it did not face an enforcement action by the SEC.

Latin Node provided wholesale telecommunications services using Internet protocol technology. Latin Node admitted that from approximately March 2004 through June 2007, it paid or caused to be paid approximately $1,099,889 in payments to third parties, to be used to bribe officials at Hondutel, the Honduran state-owned telecommunications company. The payments were made from Latin Node's Miami bank account and were approved by the company's senior executives.
In addition, from approximately July 2005 to April 2006, Latin Node made 17 other payments from its Miami bank, totaling $1,150,654, either directly to Yemeni officials or through a third-party consultant, in exchange for favorable interconnection rates.

eLandia is just the latest in a long line of companies that have inherited FCPA issues following acquisitions, and the case underscores the importance of conducting proper FCPA due diligence, to the extent feasible in the business context of the proposed transaction, before making an acquisition. Companies subject to the FCPA should, if circumstances allow, complete a thorough review before acquiring a company, paying particular attention to where the target does business abroad, what the reputations of those countries are, whether the target sells to government entities or parastatals or has other involvement with foreign government officials, e.g., customs, tax, etc.[11]

Resolution in ITT Corporation Civil Enforcement Action

The SEC filed a civil injunctive action in the US District Court for the District of Columbia against New York-based ITT Corporation, alleging violations of the FCPA's books and records and internal controls provisions. ITT settled on February 11, 2009.

The alleged violations were a result of payments to Chinese government officials by ITT's wholly-owned Chinese subsidiary, Nanjing Goulds Pumps Ltd. (NGP). According to the complaint, from 2001 to 2005, NGP allegedly paid directly or through third-party agents approximately $200,000 in bribes to employees of Chinese state-owned enterprises to sell water pumps for large infrastructure projects. The payments were allegedly disguised as increased commissions in NGP's books and records. The improper NGP entries were consolidated and included in ITT's financial statements contained in filings with the SEC for the company's fiscal years 2001 through 2005. ITT generated over $4 million in sales through the alleged bribes and made profits of more than $1 million.

The SEC's complaint states that ITT did not make or keep books, records, or accounts which, in reasonable detail, accurately and fairly reflected the illicit payments by NGP employees and the related disposition of its assets. The complaint also alleged that ITT failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (1) transactions were executed in accordance with management's general or specific authorization; (2) transactions were recorded as necessary to maintain accountability for its assets; and (3) access to its assets was permitted only in accordance with management's general or specific authorization. As with a number of other SEC internal control cases, the complaint did not elaborate upon the specific alleged internal control failures beyond mentioning these statutory elements.

Without admitting or denying the allegations in the SEC's complaint, ITT consented to the entry of a final judgment (1) permanently enjoining it from future violations of Section 13(b)(2)(A) and (B) of the

Exchange Act; (2) ordering the company to pay disgorgement of $1,041,112, together with prejudgment interest of $387,538.11; and (3) imposing a $250,000 civil penalty. The SEC stated that ITT self-reported the violations, cooperated with the SEC's investigation, and instituted remedial measures.

Notably, the settlement did not require the engagement of an independent compliance monitor. Possible explanations are the small number of payments by an isolated business unit and/or the extent of the company's remedial steps.

Morgan Stanley Discloses Possible FCPA Violations in China Real Estate Deals

In an SEC filing the week of February 13, 2009, Morgan Stanley disclosed that it was investigating possible FCPA violations in China. The bank indicated that it had recently uncovered actions related to a China-based employee in an overseas real estate subsidiary that appeared to have violated the FCPA. Upon discovery, Morgan Stanley terminated the employee, reported the activities to the appropriate authorities, and is continuing to investigate the matter.

The filing did not identify the person involved, but reports from news agencies and employees indicate that in December 2008, the China-based managing director of Morgan Stanley Real Estate in Shanghai, Garth Peterson, left the bank. The episode also reportedly resulted in the forced administrative leave of Morgan Stanley's global head of real estate investing.

This investigation is further evidence of the FCPA-related risks for companies operating in China. China has been an especially difficult country for FCPA compliance, and several high-ranking Chinese officials from Shanghai have been arrested in recent years for corruption in connection with deals in the property market.

The DOJ has stated publicly that financial services firms are of interest from an enforcement perspective. Specifically, Mark Mendelsohn suggested that the financial services industry's businesses could "pose risks" under the FCPA and stated that the industry "will be in focus" going forward.[12]

House Representatives Urge Reforms for Deferred Prosecution Agreements

On April 2, 2009, members of the US House of Representatives introduced legislation intended to alter the use of deferred prosecution agreements and the related use of monitors to oversee such agreements. Entitled "The Accountability in Deferred Prosecution Act of 2009," the bill would regulate the process employed by the DOJ whereby US prosecutors determine when to use deferred prosecutions, the terms and conditions of the agreements, and the selection of outside monitors. These changes would set guidelines and fee schedules with standard practices and procedures.

Deferred prosecution agreements in the corporate context give corporate defendants a period of probation, during which time charges are held in abeyance, so that they can resolve any problematic issues within the company and cooperate with the authorities. Because of the proliferation of such agreements in recent years, from an estimated two a year before 2003, to as many as 35 in 2007, legislators have stated that they are responding to calls for more oversight, accountability, and public disclosure to prevent misuse of power and financial favoritism.

The proposed legislation includes the following noteworthy provisions:

- The bill would require guidelines for the use of deferred prosecutions by US Attorneys. Specifically, it would require the Attorney General to provide public written guidelines for deferred prosecution agreements and non-prosecution agreements in order to promote uniformity and to assist prosecutors as they negotiate and implement the agreements. The guidelines would consider the impact on employees and shareholders.
- The bill would remove the selection of federal monitors from the hands of US Attorneys and shift the responsibility to district court judges, who would select from a pool of pre-qualified firms. These firms would be paid according to a pre-determined fee schedule.
- The bill would require full disclosure of deferred prosecution agreements. The text of the agreements, together with all the terms and understandings between an independent monitor appointed pursuant to that agreement and the organization monitored, would be placed on the public website of the Department of Justice.
- The bill would establish judicial oversight and require status reports. This would require prosecutors to file all deferred prosecution agreements with a district court for approval. Quarterly status reports would be required for submission to the court and for public disclosure.

The legislation would expand upon existing guidelines issued by the DOJ on March 7, 2008. The DOJ's March memorandum advised prosecutors that, in appointing a monitor, they should be aware of potential benefits to the company and the public, as well as the cost and impact of the monitor on the operation of the company. It also described the monitor's primary responsibility of assessing and monitoring a company's compliance with the terms of its agreements, including when a company does not have an effective internal compliance program or internal controls.

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[1] Albert "Jack" Stanley, former CEO of KBR, pleaded guilty in connection with the case in September 2008.

[2]*See* 15 U.S.C. § 78dd-3(a), (f)(1).

[3] United States Attorneys' Manual, Title 9, Criminal Resource Manual § 1018 "Prohibited Foreign Corrupt Practices" (2000).

[4] Indictment at 20.e, *United States v. Tesler* (S.D.T.X. 2009) (H-09-098).

[5]*See* 28 U.S.C. § 2461 (2007); Title 18 USC § 981 (a)(1)(C) (2007) ("all property, real and personal, which constitutes or is derived from proceeds traceable to the violations").

[6]*See* Travel Act, 18 U.S.C. § 1952 (2007).

[7]*See* In re York Int'l Corp., Exchange Act Release No. 20319 (Oct. 1, 2007); In re Schnitzer Steel

Indus., Inc., Order Instituting Cease-and-Desist Proceedings, Exchange Act Release No. 54606 (Oct. 16, 2006).

[8]*See* e.g., Perrin v. United States, 444 U.S. 37 (1979); *United States v. Palfrey*, 499 F.Supp.2d 34 (D.D.C. 2007); *United States v. Welch*, 327 F.3d 1081 (10th Cir. 2003); *United States v. Solano*, 29 Fed.App. 831 (3d Cir. 2002).

[9]*See United States v. Kozeny*, 493 F.Supp.2d 693, 705-06 (S.D.N.Y. 2007) (stating that Travel Act is violated where a person or business performs or attempts to perform an unlawful activity, including a violation of the FCPA).

[10]*Mendelsohn Says Criminal Bribery Prosecutions Doubled in 2007*, CORPORATE CRIME REPORTER, September 16, 2008.

[11] For a fuller discussion of this subject, *see* ROGER M. WITTEN & KIMBERLY A. PARKER, COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT (6th ed., Matthew Bender 2008).

[12] Mark F. Mendelsohn, Statement, Deputy Chief of the Fraud Section, US Department of Justice (Nov. 18, 2008).

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