SHEARMAN & STERLING LLP

Recent Trends and Patterns in FCPA Enforcement

(as of February 13, 2008)

Recent Trends and Patterns in FCPA Enforcement

In addition to a general increase in FCPA enforcement activity in recent years, four distinctive new trends can be seen. First, both the frequency and severity of enforcement have increased in recent years. While there are fluctuations over short periods, over the past five years there is clearly the trend toward more aggressive investigations and enforcement proceedings by the DOJ and the SEC. including a steady increase in proceedings brought against individuals. These proceedings are also resulting in more severe punishments in the form of fines for corporations and jail time for individuals.

The second trend is the use of more creative methods in resolution of criminal cases. In recent years, the DOJ has increasingly used non-prosecution (or deferred prosecution) agreements in FCPA matters apparently to provide a reward to defendants who voluntarily disclose and cooperate in the DOJ's investigation and, of course, to provide an incentive to other companies to do likewise.

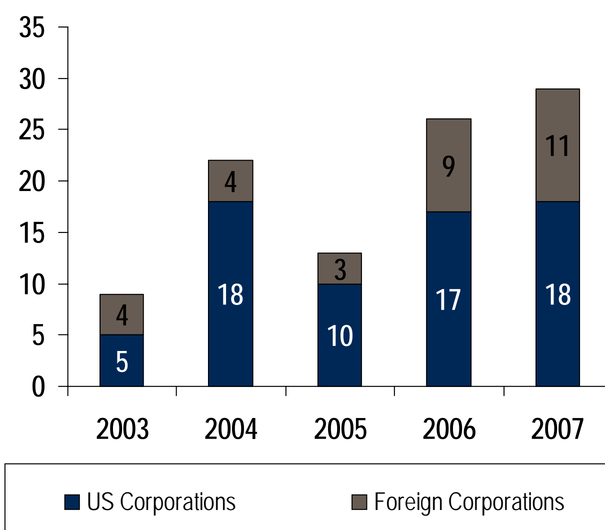
Post-proceeding monitors of compliance conduct is the third major trend emerging from recent proceedings.

The final development is a spike in self-reporting of FCPA problems discovered as part of merger or acquisition activity. This may be somewhat of a self-fulfilling prophecy as more parties are worried about successor liability arising from prior corrupt conduct by the acquired company.

Time may show each of these trends to be mere anomalies in a larger anti-corruption movement, but at this point, one thing is clear: this is a period of rapid change in anti-corruption enforcement activity.

I. Aggressive Enforcement and Larger Penalties

Growth in New Investigations: One of the most important recent trends in FCPA enforcement is the increased aggressiveness of government enforcement of the FCPA. Both the DOJ and the SEC have become increasingly aggressive in pursuing potential FCPA violations. In 2004, there were new investigations reported involving 22 corporations, compared to nine corporations in 2003. After a decline in the number of new investigations reported in 2005 to 13, there has been a dramatic increase in new investigations, with new investigations launched involving 26 corporations in 2006 and 29 in 2007. Accounting for closed investigations, those moved to prosecutions, and combining multiple investigations involving the same corporation, there are at present open investigations reported involving 82 corporations.



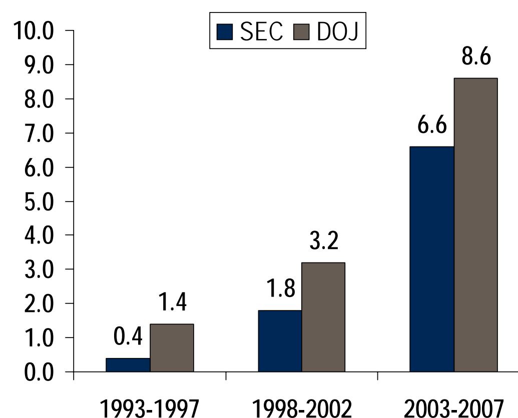
While the majority of investigations in 2003 and 2004 focused on U.S. corporations, the ratio of investigations

of U.S. corporations to foreign corporations increased significantly in 2004. Of the 22 investigations launched in 2004, 18 concerned U.S. companies, while only four concerned foreign corporations. The numbers have been similar in 2005-2007, with 45 of the 68 new investigations concerning U.S. companies and only 23 concerning foreign corporations.

Increase in Consolidated Investigations: While the majority of disclosed investigations deal with a single company's activities in generally a handful of countries, the DOJ and SEC have also launched several consolidated investigations involving the activities of multiple companies in multiple jurisdictions. The investigation surrounding the now defunct U.N. Iraq oil-for-food program involves numerous companies and is parallel to, but independent of, investigations being conducted by several agencies including the U.N. and several Congressional committees. Most recently, a number of companies and individuals have either been indicted or reached resolutions with the government in connection with these investigations. For example, the DOJ has made public its intention to conduct a criminal investigation into the U.N. official who headed the oil-for-food program. Similarly, in 2007, the DOJ and SEC launched investigations into a dozen oil companies in connection with customs payments in Nigeria and elsewhere, including the use of a global freight-forwarding entity. The investigations appear to have arisen from the facts underlying the Vetco International matter and are currently ongoing. For some companies, the scope of that investigation has expanded to cover other types of payments. Also in 2007, the DOJ and SEC launched a new investigation into five medical device manufacturers for sales activities in foreign countries.

Aggressive Prosecution: Alongside the growth in new reported investigations, the last five years have also seen a significant increase in overall prosecution of FCPA violations. Between 2003 and 2007, the average number of new DOJ proceedings was nearly three times the average number in the preceding five years. Between 1993 and present, the majority of new proceedings occurred in the latter part of this time period, between 2001 and present. It is worth noting that, of the new criminal proceedings brought by the DOJ between 2001 and present, 24 involved charges against a corporation. Of those 24 proceedings against corporations, fourteen occurred in 2007, three in 2006, five in 2005 and one in 2004. Additionally, 12 of the 24 proceedings against companies were against foreign companies. In the cases of Vetco and ABB, the prosecution was of both foreign and domestic subsidiaries of a foreign parent corporation.

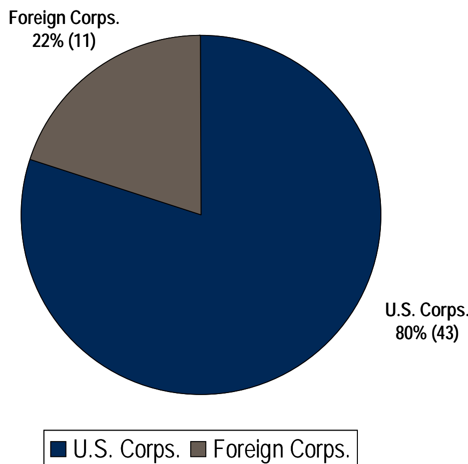
Average SEC & DOJ Proceedings: 1990 – 2007



In addition to the DOJ, the SEC has shown a greater degree of aggressiveness in enforcement in the recent past. Between the years 1990 and 1995, the SEC did not

bring any formal proceedings for violations of the FCPA. The number of proceedings brought between 1995 and 2000 increased slightly to less than one case per year. From 2001 to the end of 2006, however, the SEC averaged over four formal proceedings a year. In 2007, the SEC brought 16 new proceedings

Total SEC Proceedings: 1990 – 2007

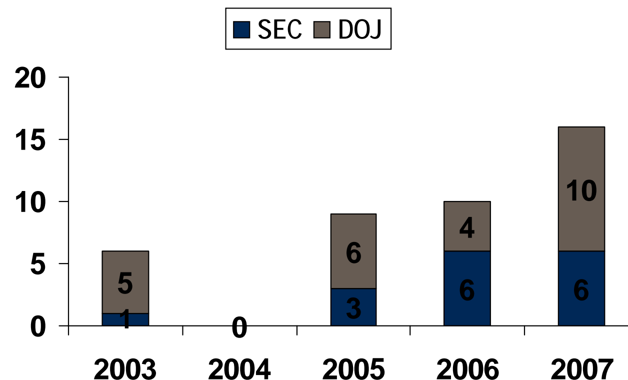


Of the SEC proceedings brought since 1990, the vast majority was of U.S. corporations. Resolution of SEC proceedings during this period usually involved an injunction, a fine, or both. In the case of ABB, the SEC once again used its enforcement power to impart liability on the parent company as a result of the actions of its subsidiaries. In addition, FCPA enforcement against supervisory issuers, as in ABB, was extended to an action against a company because of its distributors' conduct (InVision).

In addition to cases charging actual bribery, the SEC generally enforces the record-keeping and accounting provisions of the FCPA (mostly through injunctive actions). The recent SEC settlement with Bristow Group Inc. reinforces the message that the SEC will bring books and records charges in cases where it may not feel that anti-bribery charges can be brought, for example if the business purpose requirement is not satisfied.

<u>Prosecutions of Individuals</u>: The burden of responsibility continues to be borne by individuals alongside companies, as evident in the most recent 2005-2007 DOJ actions against a number of individuals. These include *U.S. v. Green & Green, U.S. v. Steph, U.S. v. Ott & Young, U.S. v. Wooh, U.S. v. Jefferson, U.S. v. Smith, U.S. v. Amoako, U.S. v. Salam, U.S. v. Sapsizian & Acosta, U.S. v. Novak, U.S. v. Head, U.S. v. Brown* and *U.S. v. Kozeny, Bourke, & Pinkerton*.

Proceedings Against Individuals: 2003 – 2007



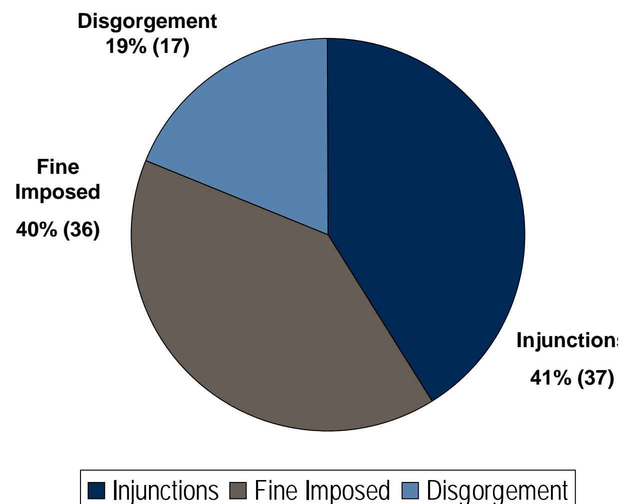
Since 1990, the DOJ has brought over twice as many prosecutions against individuals as it has against corporations. In 2005, the DOJ brought actions against six individuals while, in

2006, it brought actions against 4 individuals. However, in 2007, the DOJ brought actions against ten individuals. Notably, in June 2007, FCPA charges were brought against a U.S. government official for the first time. Sitting Representative William Jefferson was charged with offering bribes to senior Nigerian government officials, along with soliciting bribes and other charges.

Two recent cases, however, have also demonstrated the considerable reach of the FCPA and the jurisdiction of the SEC over individuals. In one case, David M. Pillor, the former Senior Vice President for Sales and Marketing at InVision, without admitting or denying the allegations against him, agreed to pay a civil penalty for failing to maintain a system of internal controls adequate to detect actual violations of the FCPA. In another case, John Samson, John Munro and Ian Campbell, three British citizens who were employees of foreign subsidiaries of ABB, itself a non-U.S. entity, recently consented to the entry of judgments against them for violations of the FCPA.

Larger Penalties: In addition, this increased aggressiveness has also taken the form of larger penalties imposed by the SEC and DOJ and the insistence by the SEC that settling companies disgorge profits obtained through the violation. In April 2007, Baker Hughes agreed to pay the largest FCPA penalty in history – $44 million. The agreement with the DOJ and SEC included a criminal fine of $11 million and a civil penalty and disgorgement of approximately $33 million, in connection with Baker Hughes's improper business practices in a number of countries.

Total SEC Dispositions: 1990 – 2007



2007 also saw two of the largest criminal fines to date. Three subsidiaries of Vetco International agreed to pay $26 million, while Chevron agreed to pay $27 million to various enforcement bodies, in addition to a $3 million civil penalty. In addition, York International agreed to combined DOJ and SEC fines of $12 million and $10 million in disgorgement. El Paso Corporation also agreed to a fine of $2.25 million and disgorgement of approximately $5.5 million. In 2006, Statoil ASA agreed to a DOJ fine of $10.5 million and SEC disgorgement of $10.5 million. A Korean subsidiary of Schnitzer Steel Industries, Inc. agreed to a DOJ fine of $7.5 million while Schnitzer Steel agreed to pay $7.7 million in disgorgement and prejudgment interest.

These recent penalties appear to be continuing the trend of large fines begun in the last several years. In July 2004, ABB settled parallel DOJ and SEC proceedings with a $10.5 million penalty and $5.9 million in

disgorgement and prejudgment interest. The following year, Diagnostics Products Corporation reached a settlement with the SEC and DOJ for $4.8 million, consisting of $2.0 million in fines and approximately $2.8 million in disgorgement of profits and interest. While 2004 marked the first time that the SEC required a company to disgorge the profits of the unlawful FCPA activities, the practice appears to have become routine, as evident in recent examples from 2006 and 2007.

Parallel International Investigations: In addition to FCPA enforcement in the United States, companies are increasingly facing parallel investigations in foreign jurisdictions under other nations' anti-corruption laws. The FCPA is part of a broader international agenda to combat bribery, that includes the European Union's Convention on the Protection of European Communities' Financial Interests, the Organization of American States' Inter-American Convention Against Corruption, the Organization for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Officials in International Business Transactions, the United Nations' Convention Against Corruption, the African Union's Convention on Preventing and Combating Corruption, as well as policies instituted by the World Bank and the International Monetary Fund allowing for the investigation of corruption committed by companies and governments.

Among recent FCPA investigations by the United States government, parallel investigations in the following foreign jurisdictions were reported: Brazil (Gtech); China (Siemens); Costa Rica (Alcatel Lucent); France (Halliburton, Total SA); Germany (Bristol Meyers, DaimlerChrysler, Siemens); Greece (Siemens); Hungary (Siemens); India (Xerox); Indonesia (Freeport, Monsanto, Siemens); Israel (Siemens); Italy (Immucor, UDI, Siemens); Korea (IBM); Liechtenstein (Siemens); Nigeria (Halliburton, Siemens); Norway (Siemens); Russia (Siemens); and Switzerland (Siemens). In addition, investigations into the defunct U.N. Iraq oil-for-food program by the governments of Australia, France, Denmark, India, South Africa and Sweden have also been reported. While the level of coordination between various governments and agencies currently conducting investigations is not fully apparent, the investigative and prosecutorial demands presented by these alleged violations are significant opportunities for the creation of an international standard of business propriety, casting aside any doubts about the strength of the international anti-corruption effort.

Parallel Litigation: In addition to growing domestic and international enforcement by governments, parallel litigation related to the FCPA is also increasing in frequency, particularly in the area of securities litigation. Even before a company settles FCPA allegations with the government, but particularly if it has admitted responsibility, it may be sued under securities laws by shareholders claiming to have purchased their shares at inflated prices, under ERISA by employees whose pensions include company shares, and as a nominal defendant in derivative actions brought by shareholders to recover for alleged wrongdoing by officers and directors. Competitors have also brought suits charging companies under various legal theories for having obtained business through bribes, and in at least one case, a foreign sales agent brought suit after its contract was terminated, allegedly for refusal to violate the FCPA. Finally, former employees have sued for unlawful termination, alleging that they were fired for "blowing the whistle" on

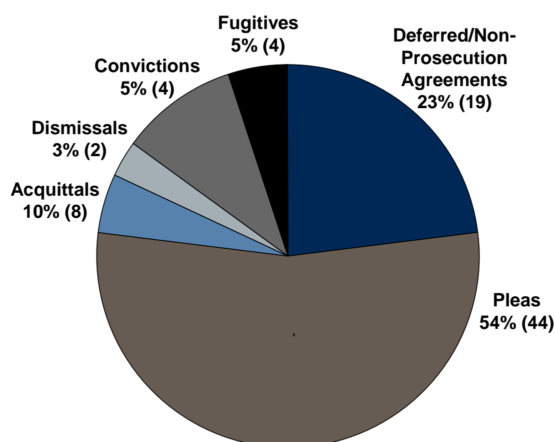
bribery or for refusal to violate the FCPA. The number of such suits should grow as more companies face prosecution by the DOJ and SEC.

Another type of parallel proceeding that is beginning to appear is suits involving foreign sovereigns, either in U.S. courts or in arbitration fora such as ICSID, against companies accused of bribing officials of those countries. According to at least one tribunal, a contract procured through bribery is unenforceable as it violates international public policy, notwithstanding the foreign country's failure to prosecute the foreign official. In that case, the government of Kenya conceded that the bribe had been paid and used this fact as a complete defense to the contract.

II. Non-Prosecution (or Deferred Prosecution) Agreements

To date, the vast majority of cases brought by the DOJ are resolved through plea agreements. Since 1990, DOJ prosecutions under the FCPA against 81 individual defendants and corporations have been resolved. Of those 81, forty-four were resolved through plea agreements. In only four of those cases were there a conviction after trial. In the cases where a plea was taken or a defendant was convicted, defendants were sentenced to a term in prison, fined, or both. Sentences have been imposed in 26 of those cases, and sentencing has been deferred in two others. Recently, the defendants in *U.S. v. David Kay and Douglas Murphy* received terms of 37 months and 63 months, respectively.

Total Criminal Dispositions: 1990 – 2007



In 1990 and 1991, seven prosecutions ended in acquittals or dismissals of the charges. Since then, only one case (in 2004) has been dismissed and two persons were acquitted in one other case (in 2005). In addition, at least four individuals have failed to appear in court to answer the charges against them.

Recently, the DOJ appears to have adopted a new approach. From December 2004 to the present, the DOJ has entered into several non-prosecution (or deferred prosecution) agreements with the companies Lucent Technologies, Ingersoll-Rand, Akzo Nobel, York International, Chevron, Paradigm B.V., Textron, Omega Advisors, Baker Hughes, Aibel Group, Schnitzer Steel, Statoil, Monsanto, InVision, and the Micrus Corporation. The DOJ agreed not to prosecute those companies in exchange for, among other things, proof of continuing compliance. Non-prosecution agreements contain elements similar to plea agreements, including fines and monitoring. For example, in the non-prosecution agreement with InVision in 2004,

the company agreed to pay a fine of $800,000, to accept responsibility for the misconduct, and to adopt an FCPA compliance program and internal controls designed to prevent future violations. The SEC also appears to be experimenting with leniency. In April 2006, the SEC settled its administrative proceeding against Oil States International simply by issuing a cease-and-desist order prohibiting future violations of the FCPA by Oil States. The company was not required to admit or deny the findings of the order.

III. Appointment of Monitors and Consultants

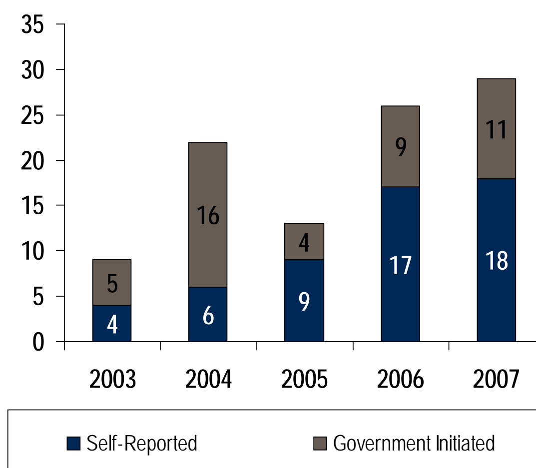
A clear trend has recently developed of appointing monitors or consultants to companies to ensure FCPA compliance, as part of settlement agreements with the SEC and DOJ. Such appointments have not only become more common but have been for longer terms. The following companies have all agreed to such appointments in the recent past: Ingersoll-Rand, York International, Paradigm B.V., Baker Hughes, Vetco International, Schnitzer Steel, Statoil, ABB, Diagnostic Products Corporation, DPC (Tianjin) Ltd., InVision, Micrus, Monsanto, and Titan. In eight of those cases, Ingersoll-Rand, York International, Baker Hughes, Vetco International, Schnitzer Steel, Statoil, Monsanto and Micrus, the monitors and compliance experts were appointed for terms of three years. Some commentators have voiced concern over the wide latitude given to such monitors and consultants in reviewing a company's business activities as well as over the implications for confidentiality and the waiver of attorney-client privilege implicated with the presence of such third-parties within the companies.

IV. Discovery and Voluntary Disclosure

44 of the 68 newly disclosed FCPA investigations in 2005-2007 were voluntarily disclosed to the SEC or the DOJ following internal investigations by the companies. By contrast, the government initiated the majority of the reported investigations in both 2003 and 2004. These facts underscore the trend toward companies taking on the onus of reporting and accountability and may indicate that companies now perceive the act of self-reporting to be favorable to the ultimate outcome of the investigation.

Indeed, as in the recent case of ABB, a company that immediately self-reports a potential violation and continues to cooperate at every stage of the investigation may well receive favorable treatment when reaching a final resolution of the matter. In

Reported Investigations: 2002 – 2006



the case of Monsanto, a company that discovered alleged violations of the FCPA following an internal review, the investigation was resolved through a favorable non-prosecution agreement. Monsanto had discovered the violations, disclosed them immediately and fully to the SEC and DOJ, and had cooperated fully with the investigations. The use of a non-prosecution agreement as a resolution to an investigation could be seen as a potential benefit of voluntary disclosure.

Disclosures and M&A Due Diligence: There is also an emerging trend concerning the manner in which FCPA violations are discovered and disclosed – namely during the course of a merger or acquisition. The violations that resulted in three of the most recent and significant FCPA prosecutions (ABB, InVision, and Titan Corporation) came to light during the course of M&A due diligence. In all three, information disclosed to the SEC and the DOJ was a result of various company investigations conducted in the course of diligence proceedings and the assessment of potential liabilities. In the case of Titan, information about Titan's FCPA violations was disclosed during the course of due diligence conducted by Lockheed Martin Corporation for the purposes of a merger, which was ultimately not consummated. Lockheed required in negotiations that Titan resolve the FCPA issues as a condition to finalizing the merger.

These three instances of discovery and self-reporting seem to indicate a correlation between the disclosure of FCPA violations and the process of due diligence in mergers and acquisitions. However, it is important to recognize that the dramatic swell in the overall number of mergers and acquisitions in 2005 increased the overall likelihood that violations discovered in the course of due diligence would be specifically FCPA-related.

V. Department of Justice FCPA Review Releases

Through the use of the Opinion Procedure Release process, corporations obtain limited assurance that their proposed conduct conforms to current enforcement policy. Over the years, these releases have provided corporations with guidance on a wide range of activities. In the recent ABB case, the DOJ issued an opinion relating to the tricky issue of successor liability that served to reinforce a 2002 opinion.

In ABB, the parent corporation sought to sell a group of subsidiaries to a consortium of third parties. During the negotiations, FCPA problems came to light. Internal investigations were conducted, the two subsidiaries later pled guilty to violating the FCPA, and the parent company agreed to settle the SEC proceeding. After the plea, the consortium seeking to purchase the subsidiaries sought, and received, an opinion procedure release assuring them that they would not be held responsible for the past conduct of the subsidiaries. The DOJ stated that they would not seek to prosecute the consortium for the prior illegal acts of ABB's subsidiaries so long as certain compliance-related obligations were met going forward.

While this new way of approaching a potentially hazardous transaction permits the acquirer to complete the acquisition with a reduced fear of future prosecution, the February 2007 guilty pleas of the subsidiaries involved in the deal highlights the ever-present risk of FCPA liability in successor enterprises and the need for ongoing compliance. The underlying corrupt activity in the three Vetco subsidiaries that pleaded

guilty in February 2007 began before the sale from ABB in 2004 and continued for at least nine months after the closing of the deal in July 2005. The lack of an effective compliance program was cited by the DOJ as one of the factors in levying the largest criminal fine to date against the Vetco subsidiaries.

In January 2008, the DOJ also issued a lengthy opinion release involving due diligence in the M&A context. The Requestor sought to purchase a majority interest in a foreign target from an entity that could potentially have been considered a foreign official. The DOJ relied on the Requestor's fulsome due diligence and disclosures to the foreign government, as well as the representations and warranties included in the proposed transaction, including termination rights, and declined to take enforcement action. Notably, the DOJ responded to the company's request to expedite the opinion release due to the time-sensitive nature of the transaction and issued its 13-page opinion release within two weeks from the date of the request.

VI. Conclusion

In the last five years of FCPA enforcement by the SEC and DOJ, several significant trends have emerged. FCPA enforcement has become increasingly more aggressive in all stages, from investigation to prosecution. In response, companies are shouldering more responsibility in the investigatory aspects of enforcement.

Over the last two years, several significant dispositions of cases (Ingersoll-Rand, Chevron, York International, Baker Hughes, Vetco International, El Paso, Schnitzer Steel, Statoil, Titan, ABB, InVision, Monsanto, and Schering-Plough) highlighted new and emerging trends. While fines and penalties continue to be a common aspect of enforcement, they appear to be increasing in amounts, as indicated by the unprecedented fines levied against Baker Hughes, Titan, Vetco, Chevron and others. Disgorgement of profits from the corrupt payments, first used in 2004, has become a well-established component of enforcement actions. Enforcement actions against individuals, resulting in fines and terms of imprisonment, have also become increasingly common. In addition, there has been an explosion in the implementation of monitors and consultants to ensure FCPA compliance in connection with settlements. In the meantime, non-prosecution (or deferred prosecution) agreements have been used more widely, often in instances in which the parties have voluntarily disclosed potential FCPA violations. The practice of voluntary disclosure has also increased due to the apparent link between discovery and disclosure of potential violations of the FCPA and the process of due diligence conducted during a merger or acquisition.

While the FCPA enforcement landscape is constantly evolving, all signs continue to point to a heightened degree of scrutiny of and graver consequences for FCPA violators in the future.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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