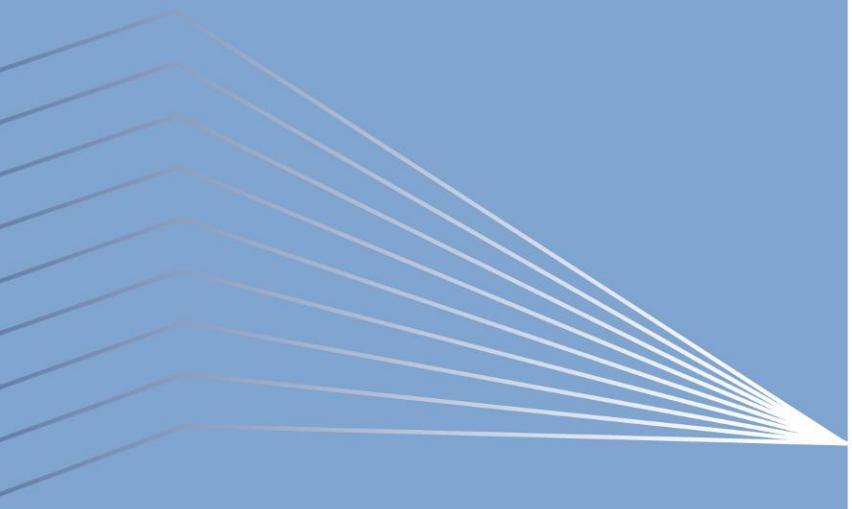
SHEARMAN & STERLING LLP



FCPA Digest

Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act

JANUARY 2013

Table of Contents

Recent Trends and Patterns in FCPA Enforcement

Table of Contents

Recent Trends and Patterns in FCPA Enforcement

In our last *Trends & Patterns*, we noted that the year had been "a fairly slow time" in terms of enforcement actions. The second half of the year hasn't changed that story—since July, the government has brought only five additional enforcement actions—*Pfizer/Wyeth*, *Tyco International*, *Oracle*, *Allianz*, and *Eli Lilly*. This may be explained by the various pending motions in cases against individuals and, as we noted earlier, the DOJ, in particular, has been busily clearing away some previous cases with pleas, dismissals, and sentencings. Obviously, the most significant act of the last half of 2012 was the release of the long-awaited U.S. guidance on the FCPA, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (the "*Guide*"), much of which confirms our reading of the tea-leaves of previous enforcement action, including some of the more disturbing positions that we have identified in our previous *Trends & Patterns*.

Among the highlights:

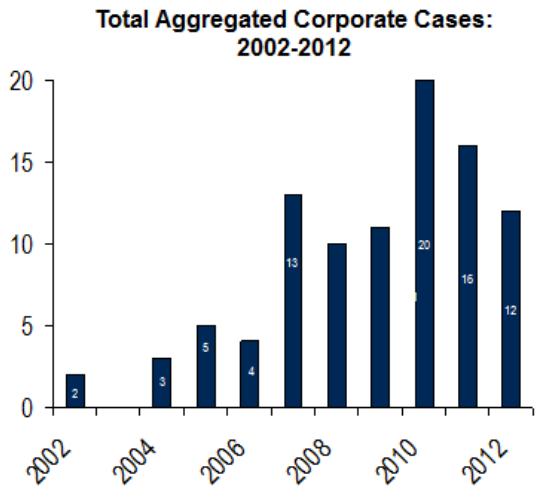
- Over $260 million in penalties in 2012, but the average penalties ($21.7 million) and the adjusted average ($17.7 million) were both considerably down from previous years;
- Significantly fewer new cases against individuals;
- Few appointments of independent monitors, with an emerging default of self-monitoring and reporting;
- A wealth of sentencings, with widely disparate results, reflecting in part differing judicial attitudes to the FCPA and white collar crimes in general;
- Continued aggressive theories of jurisdiction and parent-subsidiary liability;
- Comprehensive (but not groundbreaking) official guidance on the FCPA from the DOJ and SEC, as well as revisions to guidance on the U.K. Bribery Act previously issued by the U.K. enforcement authorities; and
- Increased enforcement outside the United States and the likely adoption of deferred prosecutions in the United Kingdom.

Enforcement Actions and Strategies

Statistics

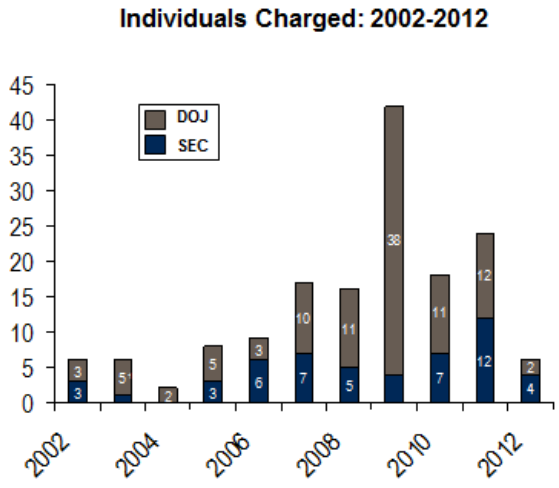
In 2012, the government brought twelve enforcement actions against corporations: *Marubeni*, *Smith & Nephew*, *BizJet/Lufthansa Technik*, *Biomet*, *Data Systems & Solutions*, *Orthofix*, *NORDAM*, *Pfizer/Wyeth*, *Tyco International*, *Oracle*, *Allianz*, and *Eli Lilly*.

Recent Trends and Patterns in FCPA Enforcement



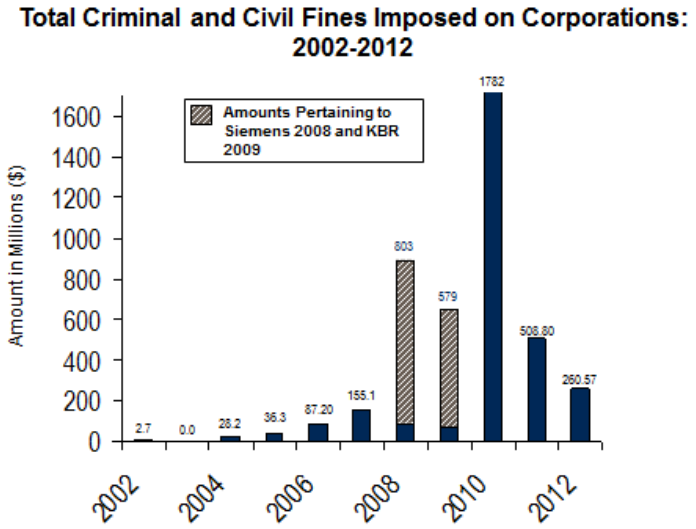
This pace of enforcement actions is slightly down from previous years, which have seen annual totals averaging fourteen cases per year since 2007. Interestingly, in contrast to previous years, less than half (five) of these matters were parallel enforcement actions with coordinated actions brought by the SEC and the DOJ. Of the remaining, the DOJ slightly edged out the SEC, with four independent actions (*Marubeni*, *Bizjet/Lufthansa*, *Data Systems*, and *NORDAM*) against three from the SEC (*Oracle*, *Allianz*, and *Eli Lilly*) (all of which were brought in December). Although the pace was slightly down this year, a substantial number of companies have announced new investigations during the past year, and some have publicly announced reserves for enforcement fines, suggesting that they are close to a settlement. In addition, the several industry sweeps—pharmaceuticals, medical devices, sovereign wealth funds, China media sales—have been out for some time, and it is likely that some of them may bear fruit in the near term. Indeed, this year has seen five enforcement actions against medical device and pharmaceutical companies and one declination (Grifols S.A./Talecris).

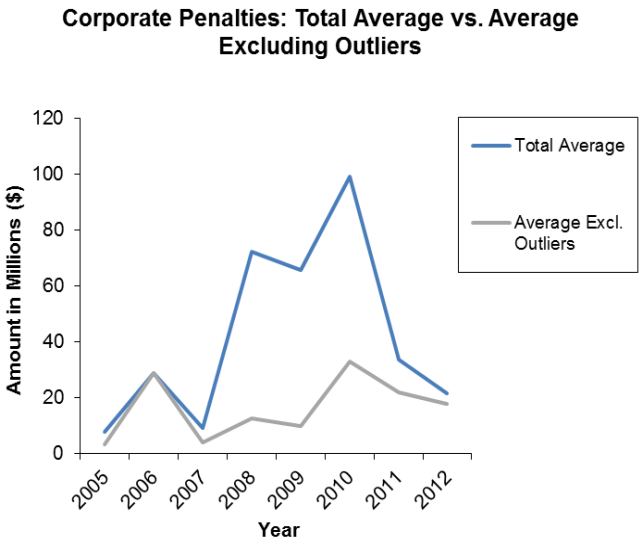
This year saw a substantial drop in actions against individuals, with only five individuals having been charged in 2012. One of those individuals, *Cecilia Zurita*, was added to the existing *Haiti Telecom* case. Three more individuals, *James Ruehlen*, *Mark Jackson*, and *Thomas O'Rourke*, all of whom were charged by the SEC, are all current or former executives of *Noble Corporation*, which settled with the SEC and the DOJ in 2010. Thus, the only truly new case is that brought by the DOJ and the SEC against the former Morgan Stanley employee, *Garth Peterson*. We note, however, that the government took special pains in several of the corporate cases to identify a number of executives by title and make specific allegations concerning their participation in illegal acts; it is possible that the government may proceed against some of these individuals in the future, even several years after the corporate settlement, as it did with the *Noble* executives this year and the *Siemens* executives last year. Further, there remains a considerable pipeline of



individuals awaiting trial (albeit some of them are fugitives or have not been served), including at least seventeen defendants in DOJ cases and at least eleven defendants in SEC cases.

On the penalties side, the corporate penalties assessed in 2012 are consistent with those imposed in previous years. Altogether, the government collected $260,571,467 in financial penalties (fines, DPA/NPA penalties, disgorgement, and pre-judgment interest) from corporations in 2012. This equates to an average of $21.7 million per corporation with a range of $2 million (*NORDAM* and *Oracle*) to $54.6 million (*Marubeni*) and $60 million (*Pfizer/Wyeth*). *Marubeni* and *Pfizer*'s penalties are, each respectively, over twice that of any of the other companies. *Marubeni* was part of the *TSKJ* cases, which have yielded over $1 billion in total fines to date, and *Pfizer* saw enforcement actions against three different entities, regarding two wholly different courses of conduct which took place in at least eleven countries. *NORDAM* received a significant discount on the basis of potential insolvency, and in *Oracle* the SEC did not specifically allege bribery but only books-and-records and internal controls violations. Therefore, a more accurate average, with those four outliers removed, is $17.7 million. Both of these numbers, in fact, compare favorably with previous years. For example, using the same criteria, the averages in 2011 were considerably greater, at $33.8 million (total average) and $22.1 million (average with high and low outliers removed).





On the individuals side, one of the individuals, *Zurita*, is a fugitive and two others, *Ruehlen* and *Jackson*, are pending trial (although the court recently significantly limited the penalties available unless the SEC cures certain statute of limitations issues in an amended complaint). The other *Noble Corp*. defendant, *O'Rourke*, is presumably cooperating and has settled with the SEC for the relatively

modest fine of $35,000. The one new criminal defendant, *Garth Peterson*, was sentenced to nine months of incarceration and three years of supervised release. This sentence was a significant departure from the Sentencing Guidelines, which recommended a sentence of fifty-seven to seventy-one months.

As noted below, the courts have imposed widely disparate sentences in FCPA cases. In *Peterson* the court noted Peterson's harsh upbringing as one reason for the lenient sentence and further noted, in a statement that is likely to cause some controversy, that significant periods of incarceration are not necessary to deter white collar criminals because they are more likely to weigh any potential gain from criminal conduct against the risks of conviction. In addition, in the parallel SEC case, Peterson agreed to disgorge approximately $3.6 million, including $241,589 in cash and his shares in the investment vehicle he shared with the Chinese official—shares that are estimated to be worth $3.4 million. Judge Weinstein considered the sentencing and civil disgorgement together as sufficient to send a message that any bribery of foreign officials would result in a substantial sentence and significant financial penalties.

In contrast to the relative dearth of new enforcement actions against individuals in 2012, numerous individuals pleaded guilty, were convicted, or were sentenced for their guilty pleas and convictions related to enforcement actions from previous years. *Jean Rene Duperval*, *Haiti Telecom*'s former head of international relations and the first ever foreign official to stand trial in connection with offenses related to a violation of the FCPA, was convicted of twenty-one money-laundering counts.[1] The government was also able to resolve the *CCI* case almost in its entirety, with four of the five remaining defendants pleading guilty this year: *Stuart Carson*; his wife *Hong Carson*; *Paul Cosgrove*; and *David Edmonds*. The only remaining *CCI* defendant, *Han Yong Kim*, is considered a fugitive after his failed motion for leave to file a special appearance, and U.S. officials continue to seek his extradition. Meanwhile, a total of sixteen individuals were sentenced: *Peterson*, the four *CCI* defendants who pleaded guilty this year, three from *Latin Node* (*Manuel Caceres*, *Juan Pablo Vasquez*, *Manuel Salvoch*), three from *KBR* (*Wojciech Chodan*, *Jeffrey Tesler*, *Albert Jackson Stanley*), three from *Haiti Telecom* (*Robert Antoine*, *Jean Rene Duperval*, *Patrick Joseph*), one from *ABB* (*Fernando Maya Basurto*), and one from the *SHOT-Show* cases (*Richard Bistrong*). Sentences ranged from one year probation for *Chodan* to nine years imprisonment for *Duperval*. *Antoine*, who was originally sentenced to four years, received a reduced sentence of eighteen months after prosecutors filed a motion to reduce Antoine's prison term for his cooperation with law enforcement. *Cosgrove* and *Hong Carson* also received reduced sentences comprised only of home confinement and respective fines, with the sentencing judge taking into account Cosgrove's serious health issues, and the fact that Hong Carson "was born in China and lived there until age 26, lacked the American education and early business training of her co-defendants." The DOJ also requested leniency for *Bistrong*, who was involved in the ill-fated *SHOT-Show* cases that were dismissed in their entirety early this year. However, in spite of the government's request for no jail and a "combination of probation, home confinement, and/or community service," the court (the same court that dismissed the charges

[1] There have been foreign officials convicted of offenses where the underlying facts reflected bribery (such as Pavlo Lazarenko, the former Prime Minister of Ukraine who was convicted of laundering money obtained through extortion and bribery), but none of those cases have involved underlying or related FCPA charges.

against most of the *SHOT-Show* defendants) sentenced Bistrong to 18 months in prison followed by 36 months' probation.

Types of Settlements

As in the past, all of the corporate settlements were in the form of deferred or non-prosecution agreements, with no corporation pleading guilty to an offense. In the *Guide*, the DOJ outlined a range of settlements—plea, DPA, NPA, and declination. Strangely, although the FCPA specifically authorizes the DOJ to bring a civil action for injunctive relief against domestic concerns and "other persons" (non-U.S. companies and nationals), the *Guide* wholly fails to mention such actions as an option. (Maybe this is not so surprising, as the last such action was in 2001 against KPMG's Indonesian affiliate and there have been only six such cases since the statute was enacted.)

Unfortunately, the *Guide* does not provide any specific guidance as to what factors influence the government to choose among the various options. Instead, the *Guide* simply lists the resolution options available to the DOJ and SEC and describes their effect. Indeed, even though the *Guide* provides six examples of matters the government declined, the factors it cites are almost identical to those that resulted in any of the other options. While some of the declination examples in the *Guide* offer subtle distinctions, whether these points of comparison are significant is doubtful. Unfortunately, the *Guide*'s attempt to provide more detail to the settlement process, particularly with respect to declinations, has done little to illuminate the government's enforcement policy.

Take for example the case of *Biomet*, a medical products distributor which settled the DOJ's claims through a deferred prosecution agreement in 2012. When making the agreement, the DOJ considered the following factors: (1) timely and voluntary disclosure of the misconduct to the DOJ and SEC; (2) an internal investigation into the misconduct and subsequent disclosure of the investigation's findings to the DOJ and SEC; (3) continued cooperation with the DOJ and SEC; (4) the agreement to and implementation of an enhanced compliance program; (5) continued cooperation with the DOJ and SEC, as well as foreign authorities, into related investigations; and (6) the possible negative repercussions of an indictment. The factors are largely the same cited in other deferred and non-prosecuted agreements entered by the DOJ in 2012, including *Orthofix* and *Pfizer*. By way of comparison, the *Guide*'s declination examples recite almost the same factors: (1) the company discovered the misconduct; (2) the company took prompt remedial actions, terminating the relevant contracts and firing the employees who were involved; (3) the company initiated an internal investigation following the discovery and voluntarily disclosed the results to the DOJ and SEC; and (4) the company took substantial steps to improve its compliance program. Little else needs to be said about the lack of contrast between the factors used in the deferred prosecution agreement context and the declination context.

The year introduced an additional factor into the mix, when the DOJ agreed to end *Pride International*'s DPA one year early, to reward the company "for good behavior" in its compliance efforts. This marks the first time the DOJ has terminated a DPA before its term, but the DOJ's motion to dismiss does not provide meaningful clues as to why *Pride* was singled out for special treatment. The DOJ's motion to

dismiss said simply that Pride "adhered to its compliance undertakings required by the DPA" by (1) instituting and maintaining a compliance and ethics program designed to prevent and detect violations of the FCPA; (2) maintaining internal controls, policies and procedures to ensure that books, records, and accounts are fairly and accurately made and kept; and (3) reducing its reliance on third parties and subjecting third parties to appropriate due diligence requirements. This is virtually identical to the requirements imposed on most companies that settle FCPA violations. We surmise that the answer may lie in the fact that Pride was acquired by Ensco plc in 2011, and the DOJ has found Ensco's assumption of control and responsibility relevant to determining whether further supervision was necessary. This is somewhat reminiscent of *InVision*, where the regulatory investigations of potential violations of the FCPA took place when InVision was about to be acquired by General Electric. The DOJ entered into a two-year NPA with InVision, backed up with a letter of understanding with GE limiting the term of the NPA and its monitorship to sufficient time to ensure that GE had completed its acquisition of InVision and fully integrated the company into its compliance program.

Elements of Settlements

Monitors. Only three of the twelve corporations charged in 2012 had independent monitors imposed on them, and in only one case, *Marubeni*, did the DOJ impose a monitor for the full term of the agreement. In two other cases, *Smith & Nephew* and *Biomet*, the companies agreed to a hybrid monitor in which the monitor's term was only eighteen months followed by eighteen months of self-reporting. *Orthofix* appears to be allowed to self-monitor, although the DOJ agreement refers to an "independent review" of its compliance program. In the rest of the cases, the DOJ agreed to allow the companies to self-report and self-monitor for the term of the agreement.

When the DOJ will impose a monitor remains a matter of some mystery. The *Guide* does not provide any particular insight, and recites only generic factors such as seriousness of the offense, pervasiveness and duration of the conduct, adequacy of remediation, etc. How these factors will be applied in a particular case is difficult to predict. For example, *Tyco* had been previously subject to an FCPA enforcement action in 2006. However, when prosecuted a second time, in 2012, the government did not impose a monitor on the repeat offender even though it was charged with a series of illicit schemes operating within approximately twenty different countries. Instead, in spite of the extensive allegations, as well as the guilty plea by one of its subsidiaries, Tyco was permitted to self-monitor.

We have not, of course, heard any companies complain about being allowed to self-monitor as opposed to having an independent monitor imposed on them. However, although self-monitoring clearly provides companies with advantages in terms of managing costs and scope, there are some potential risks: without an independent monitor as an interlocutor the government may play a more proactive role in evaluating the company's monitoring, remediation, and compliance design and implementation. Indeed, *Pfizer's* DPA provides, "If the Department in its sole discretion determines that Pfizer has not fulfilled the commitments outlined in Attachments C.1, C.2, and C.3 [the compliance and monitoring provisions], any such failure may be considered, in the sole discretion of the Department, to be a breach of the Pfizer HCP

DPA . . . ." This specific reference to the DOJ's active review of the compliance commitments is a departure from the typical language the DOJ uses in its NPAs and DPAs.

Discount. Most of the companies received a generous discount from the Sentencing Guidelines as a reward for their cooperation and settlement. In the medical device cases, two of the three companies received a 20% discount from the bottom of the applicable Guidelines range (*Orthofix* is again the outlier here, with no discount), and *BizJet*, *Data Systems & Solutions*, and *Pfizer* each received a 30% discount to reflect the companies' "extraordinary" cooperation and remediation in their respective cases. *Marubeni* and *Tyco* did not receive discounts, perhaps because the former was the last of the *TSKJ* entities to settle and the latter was a recidivist FCPA defendant. *Biomet* and *Orthofix* yield an interesting comparison: on the one hand, Biomet received a 20% discount even though it only made a "partial" voluntary disclosure but received explicit credit, both in the Guidelines calculation and in the discount, for its substantial assistance in prosecuting other unnamed entities. On the other hand, Orthofix made a full voluntary disclosure, for which it received credit in the Guidelines calculation, but no discount was applied.

Ability to Pay. In *NORDAM*, the DOJ agreed to a reduced penalty on the basis of the company's potential insolvency. According to the NPA, the DOJ agreed to impose a financial penalty of $2 million, "substantially below the standard range" under the Sentencing Guidelines (although it is not clear by how much), because the company fully demonstrated that a penalty exceeding $2 million would "substantially jeopardize the company's continued viability." In the past, the government has allowed for payments of FCPA-related corporate penalties in installments, presumably accounting for the financial health of the company. For example, in the case of *Technip*, the company agreed to pay a $240 million penalty in eight equal installments of $30 million. After we published our last *Trends & Patterns*, some of our readers pointed out that the DOJ had recommended a departure from the Sentencing Guidelines (which the judge granted) in *Innospec* due to economic hardship and potential insolvency. Thus, the criminal fine dropped from $101 million to $14.1 million, certainly a substantial reduction. However, the government likely took into account that the aggregate fine, including amounts imposed by the SEC and the U.K. Serious Fraud Office, was over $40 million—approximately 40% of the potential criminal fine. In contrast, potential insolvency seems to have been the only rationale behind the "substantial" discount granted in *NORDAM*.

Collateral Consequences. The DOJ settlements continue to reflect a sensitivity to the collateral consequences of a conviction. In the past, *e.g.*, in *Siemens*, the government carefully chose the entity to charge with bribery, apparently to minimize the risk that the entire corporate family would be debarred from public contracting in the U.S. or in the E.U. In two of the three medical device cases this year (*Biomet* and *Smith & Nephew*), the government explicitly noted as a justification for resolving the cases through deferred prosecution agreements that, "[w]ere the Department to initiate a prosecution . . . and obtain a conviction, instead of entering into this Agreement to defer prosecution, [the company] would potentially be subject to exclusion from participation in federal health care programs . . . ."

Admissions. In January, Robert Khuzami, the Director of the SEC's Division of Enforcement, announced that the SEC would no longer allow companies to settle on a "neither admit nor deny" basis in certain circumstances, notably where there are parallel criminal enforcement actions in which the defendants

admitted to or were convicted of culpable conduct. Indeed, the defendants in three of the eight SEC corporate actions this year so far, *Biomet*, *Orthofix*, and *Tyco*, each had admitted to certain facts in their respective parallel DOJ actions, and thus none were permitted to settle the SEC actions on a "neither admit nor deny" basis.[2] Interestingly, however, the SEC did permit the companies to admit *only* to what they had admitted in the DOJ cases and not to admit to any of the allegations in the SEC's complaint that went beyond those admissions or addressed different conduct. In contrast, *Wyeth*, which settled with the SEC after it was acquired by Pfizer but whose conduct was not covered by the DOJ's *Pfizer* matter, settled with the traditional "neither admit nor deny," as did the defendants in the three SEC-only prosecutions, *Oracle*, *Allianz*, and *Eli Lilly*.

Approval of Settlements. SEC civil settlements against companies for FCPA violations tend to be approved within thirty days, but in December 2012, a federal judge warned that he wouldn't "rubber stamp" *IBM*'s pending $10 million settlement (which had been signed twenty-one months earlier in March 2011). The SEC settlement with *Tyco*, entered into this year, is also pending approval. Both of these cases are in front of U.S. District Judge Richard Leon, who, during a hearing in December 2012, questioned SEC settlement policies in general and warned that he was among "a growing number of district judges who are increasingly concerned" by these policies. Judge Leon insisted that IBM should be required to report to the court and the SEC annually on (1) its efforts to comply with the FCPA, (2) any future violations of the FCPA, and (3) any new criminal or civil investigations. IBM said that it was willing to comply with the first requirement but that the others were "too burdensome," and the SEC backed IBM's position. Both of these cases have, in fact, been subject to considerable controversy: *IBM* for the disgorgement imposed on an action that alleged only books-and-records violations, and *Tyco* for its status as a recidivist FCPA defendant after its settlement with the SEC in 2006. Moreover, Judge Leon's caution may stem from his experience presiding over the *SHOT-Show* cases (during which he "became intimately acquainted with the corrosive effect of the FCPA on corporate culture") that were dismissed in their entirety this year after two years of mistrials and acquittals. Judge Leon said that he would need to review the data about the cost of the additional reporting requirements, to evaluate whether they would be "too burdensome." With that being said, all three of those reporting requirements were imposed in *Pfizer*'s DPA with the DOJ, so it remains to be seen whether future enforcement actions will reflect Judge Leon's view, or the SEC's seemingly more lenient position.

Dodd-Frank Whistleblowers

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act added Section 21F to the Exchange Act, providing incentives and protections for whistleblowers who provided information concerning violations of the securities laws, including the FCPA, by issuers. Section 21F directs the SEC to

[2] The SEC enforcement action against *Smith & Nephew*, filed on February 6, 2012, is an exception here—while it did admit to certain conduct in the parallel criminal action, it was allowed to settle on a "neither admit nor deny" basis, presumably because negotiations took place (and the settlement finalized) before Khuzami's January announcement.

provide monetary awards to eligible whistleblowers who voluntarily provide original information leading to a successful SEC enforcement action that results in sanctions exceeding $1 million. Awards range from ten percent to thirty percent of the monetary sanctions collected by the government.

Given the relatively large monetary sanctions frequently associated with FCPA enforcement actions, and because the award is based on a percentage of the *total* sanctions imposed in all related actions, the incentives for whistleblowers are quite significant. In 2012, the SEC released the first Annual Report on the Dodd-Frank Whistleblower Program providing statistical information concerning the 3,001 whistleblower tips received during the program's first year. During that period, the SEC received 115 FCPA related tips, accounting for 3.8 percent of total tips. Although the Report did not break down the FCPA tips by geography, it did note that the SEC received tips from all fifty states, the District of Columbia and Puerto Rico, and from forty-nine countries outside of the United States. Further, over a fifth (seventy-four) of a 324 total foreign whistleblower tips originated from the U.K. During the fiscal year (October 2011 to September 2012), the SEC's Office of the Whistleblower posted 143 notices of enforcement judgments and orders that potentially could qualify for a whistleblower award.

The SEC issued its first award under the whistleblower program in August 2012. The whistleblower provided documents and other significant information related to an ongoing multi-million-dollar fraud and received the maximum award of thirty percent. Motions for additional judgments are currently pending before the court and additional collections resulting from the first action or any increase in sanctions will increase the amount paid to the whistleblower.

Perennial Statutory Issues

Jurisdiction

The expanding scope of the FCPA's territorial jurisdiction over seemingly non-U.S. activity has been a controversial issue in the past few years, but the enforcement actions brought in 2012 were well within the established limits. However, there were some interesting developments in 2012, involving one action brought previously and one matter apparently still under investigation. In late 2011, the SEC sued three former employees at *Magyar Telekom Plc* (*Elek Straub*, *Andras Balogh*, *Tamas Morvai*, all Hungarian citizens) for violations of the FCPA. The defendants filed a motion to dismiss partly based on jurisdiction grounds. While much of the subsequent briefing focused on the personal jurisdiction due process angle (concerning whether the defendants had the requisite minimum contacts with the U.S.),[3] the defendants also argued that the SEC's claim was insufficient for failure to meet the FCPA's territorial jurisdiction requirement for the anti-bribery counts. The defendants argued that the SEC's sole allegation of allegedly territorial acts—that one defendant sent and received email messages in furtherance of the bribery scheme

[3] Herbert Steffen (German citizen and former Siemens executive also sued in 2011) also filed a motion to dismiss, but only on personal jurisdiction grounds.

"from locations outside the United States but [] routed through and/or stored on network servers located within the United States"—was insufficient as a matter of law. As we noted in last year's *Trends & Patterns* when analyzing the case against *Magyar Telekom* itself, this was an unprecedented expansion of what constitutes territorial acts, and the defendants argued that "the unforeseen and unforeseeable transit of purely foreign email traffic through a U.S. server, guided by a data manager for technological reasons separate and apart from anything the defendants could know, let alone intend, is insufficient to meet the United States interstate commerce element of the FCPA bribery provision, which requires the defendant to 'make use of' those instrumentalities 'corruptly.'" The SEC responded simply that "it is beyond dispute that the use of the internet is an instrumentality of interstate commerce" and that the "corrupt" requirement applies only to the payment, and not to the alleged use of the instrumentalities. The court has not yet ruled.

Litigation is rare in FCPA enforcement actions, and there is very little precedent that might indicate how the courts will determine these issues. However, the courts may consider the acquittal of *Pankesh Patel* (a U.K. citizen) in the *SHOT-Show* cases, where grounds for asserting criminal jurisdiction against Patel were based on a DHL package that Patel sent from the U.K. to the U.S. containing purchase agreements for an allegedly corrupt deal. Following the close of the government's case, Judge Leon dismissed *Patel,* apparently rejecting the government's jurisdictional theory without requiring any briefing, calling it a "novel" interpretation of the FCPA's anti-bribery provisions. As we have previously noted, it is not clear whether Judge Leon's ruling turned on the limits of the FCPA's territorial jurisdiction or was related to the fact that the recipient of the package was a government informant, not a co-conspirator.

Yet another jurisdictional challenge may result if the SEC and DOJ decide to pursue an anti-bribery case against Net 1 UEPS Technologies, Inc. ("Net 1"), a South African company listed on the Nasdaq. Net 1 announced in an SEC filing that it is under investigation for payments to South African government officials that may have violated the FCPA. While Net 1 is clearly subject to the FCPA's accounting provisions, it will be interesting to see whether the authorities have a sufficient territorial jurisdictional hook to bring bribery allegations—after all, the SEC filing appears to indicate that the conduct under question involved a bribe paid in South Africa by a South African employee of a South African company to a South African official of a South African government agency!

Parent/Subsidiary Liability

We have previously expressed concern about the SEC's stretching to holding parent companies liable under the FCPA's anti-bribery provisions for corrupt payments by their subsidiaries, as opposed to the more clearly applicable books-and-records provisions, when the facts alleged in its pleadings do not establish any authorization, direction, or control of the subsidiaries' conduct. Several cases from 2012 demonstrate the issue. In *Biomet*, the SEC charged that the parent company and its subsidiaries paid bribes, and it alleged in detail facts that established the parent's authorization, direction, and control of the subsidiaries' conduct. These allegations included that the parent company was aware of the bribes being paid to doctors yet made no effort to stop them. In contrast, in *Smith & Nephew* the SEC alleged

that the parent issuer had, "*through its subsidiaries*, violated [the FCPA] by making illicit payments to foreign government officials in order to obtain or retain business." This flat allegation, repeated in several places in the complaint, is not supported anywhere in the factual allegations, which describe in detail a complex scheme of payments entirely orchestrated solely by the subsidiaries and their employees. Similarly, in *Tyco*, the SEC charged the parent company, Tyco International, with bribery, alleging that the parent company "exerted control" over its subsidiaries by "utilizing dual roles for its officers"; *i.e.*, Tyco International's officers served as directors or officials of Tyco subsidiaries. On that thin reed, the SEC characterized a now-divested subsidiary as the parent's agent, alleging that the "dual roles" for its officers demonstrated that it controlled the subsidiary—*even though none of the dual-listed officers had any involvement or, by the SEC's own admission, knowledge of the bribery*.

It is difficult to reconcile these cases with the "authorization, direction, or control" requirement although it might be sufficient for control person liability (which was not charged). This is even more so given that in *Pfizer/Wyeth* the SEC did not bring anti-bribery charges against the parent, stating that the illicit payments made by the controlled Wyeth subsidiary were made "without the knowledge or approval of officers or employees of [parent company] Pfizer." The SEC has not explained the difference between the circumstances in *Tyco* and in *Pfizer/Wyeth*, but it is possible that they chose a different approach because Wyeth was newly acquired by Pfizer and not yet fully integrated into Pfizer's controls.

We have speculated for some time that the SEC was applying an agency theory to the parent-subsidiary relationship that was more expansive than the traditional mantra of "authorization, direction, and control."[4] For example, in a previous SEC enforcement action against *United Industrial Corp.* ("*UIC*") (whose facts are summarized in the *Guide*), the SEC brought anti-bribery charges against the parent company for the actions of its subsidiary, relying on the following: 1) that the CEO of the subsidiary had a "direct reporting line" to the CEO of the parent, UIC, and was identified in the parent's SEC filings as a member of UIC's "senior management; 2) that UIC's corporate legal department approved the retention of the agent responsible for the bribes; and 3) that an official at UIC approved an unusual advance to the agent without inquiring into its purpose. These allegations, without more, however, fail to establish an "authorization, direction, and control" standpoint by UIC where the SEC failed to allege UIC's knowledge of any of the allegedly unlawful payments and seems to have relied solely on the parent's general control over the subsidiary.[5]

In the *Smith & Nephew* pleadings, the SEC does not even attempt to allege "authorization, direction, and control," and the recently issued *Guide* confirms that the government, at any rate, considers the agency theory to be sufficient without more. In the *Guide*, the government asserted that a parent company may be liable for a subsidiary's conduct in two ways: (i) where the "parent . . . participated sufficiently in the

---

4 For further discussion on this issue, you may wish to refer to our prior client publication, available at Shearman & Sterling, *The Other FCPA Shoe Drops: Expanded Jurisdiction over Non-U.S. Companies, Foreign Monitors, and Extending Compliance Controls to Non-U.S. Companies* (July 19, 2010).

5 For further discussion on this issue, you may wish to refer to our prior client publication, available at Shearman & Sterling, *Internal Control Failures Lead to Parent Liability for a Subsidiary's FCPA Violations* (June 2, 2009).

activity to be directly liable for the conduct," *or* (ii) "under traditional agency principles." The *Guide* stands by the notion that the "fundamental characteristic of agency is control"—"including the parent's knowledge and direction of the subsidiary's actions, both generally and in the context of the specific transaction." Thus, the government seems to be saying that it will first determine whether the subsidiary is an agent of the parent, focusing not only on the formal relationship but also on the practical realities of how the parent and subsidiary actually interact, and then apply "traditional principles of *respondeat superior*" to hold the parent liable for the acts of the subsidiary, whether or not specifically authorized, directed, or controlled by the parent. This would, in our view, be a significant departure from existing practice and indeed from generally applicable corporate principles.[6]

Obtain or Retain Business

The "obtaining or retaining business element," also called the business nexus, was largely uncontroversial for the majority of cases in 2012. However, in the *O'Rourke*, *Ruehlen*, and *Jackson* cases against former *Noble* executives, the SEC filed suit on the basis of payments made to officials to avoid import duties. In the *Ruehlen* and *Jackson* case, the court recently denied the defendants' motion to dismiss, relying on *United States v. Kay*, in which the Fifth Circuit held that bribes paid to reduce the tax obligations of a company *could* satisfy the business nexus requirement *if* the payments resulted in reduced operating expenses in a manner directly tied to the company's obtaining or retaining business. As in *Kay*, the court's decision puts the burden on the government in the trial to demonstrate more than a mere reduction in expenses or increase in profits; the government must link the benefits obtained by bribery, here reduced duties, to obtaining or retaining business.

In past *Trends & Patterns*, we have expressed concern that the government had veered away from the important lesson of *Kay* that not every bribe met the business purpose test, and indeed the *Guide* confirms that the business purpose test is "broadly interpreted"—though it does refer to *Kay* for specific guidance. Fortunately, none of the actions brought in 2012 went beyond the scope delineated in *Kay*. Indeed, in many cases the business nexus was very closely related to securing contracts or sales—or was simply a variation thereof. *Pfizer* involved payments that were allegedly made to ensure the registration and reimbursement by government health insurance programs of Pfizer products or the inclusion of Pfizer products in tenders or government-recommended treatment algorithms. In *Pfizer/Wyeth*, employees allegedly used bribes to influence doctors at state-owned hospitals to recommend Wyeth nutritional products, ensure that the products were made available to new mothers at the hospitals, and to secure the release of promotional materials for Wyeth nutritional products, which were held in a port because Wyeth failed to secure the required government-issued certificate. Meanwhile, in *Tyco*, the business nexus

[6] *See, e.g., Matter of Morris v. N.Y. State Dep't of Taxation & Fin.*, 82 N.Y.2d 135, 141 (1993) ("Generally, however, piercing the corporate veil requires a showing that: 1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and 2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury.").

consisted of removing manufacturing plants from various "blacklists" or "holds," winning specific bids, and obtaining product approval.

Facilitation Payments

Not unexpectedly, *Ruehlen* and *Jackson* raised the facilitation payments exception as a defense against the SEC's complaint, arguing that the payments in question—to accept false documentation allowing drilling rigs to remain in-country without payment of duties—were facilitation payments and, moreover, that the SEC's complaint was deficient as a matter of law because it had failed to allege that the payments were *not* facilitation payments.

The SEC appears to have attempted to anticipate this defense, although somewhat sideways. In its complaint, it notes that Noble Corporation's policy defined a facilitation payment as a "small payment to assure or speed the proper performance of a foreign official's duties that does not involve a discretionary action by such official." It then alleges, "By its terms, the definition excludes large payments, all payments connected with discretionary acts and all payments to induce foreign officials to process and approve false documents." Although the Noble Corporation's definition is consistent with those we have seen in many other companies' policies, notably it is *not* the one found in the statute itself, which provides only that such payments must be "to expedite or to secure the performance of a routine governmental action" and "does not include any decision whether, or on what terms, to award new business or to continue business." *See* 15 U.S.C. § 78dd-1(b), (f)(3)(B). By the time it responded to defendants' motion to dismiss, the SEC appeared to no longer rely on the size of the payments but instead on the non-discretionary nature of the bribe, one of the factors reflected in the 1977 legislative history but not incorporated into the statutory exception in the 1988 amendments. The SEC also argues that "lying on official documents" and basing decisions on "known false documents" cannot be construed as "routine government action."

In denying *Ruehlen* and *Jackson*'s motions to dismiss, the court rejected the defendants' contention that the facilitation payment exception was an affirmative defense, but nevertheless held that the SEC bore the burden of negating the "facilitating payments" exception in its complaint. The court concluded that the exception "is best understood as a threshold requirement to pleading that a defendant acted 'corruptly'" (but made clear that it was not holding that negating the "facilitating payments" exception was *all* that is required to plead that a defendant acted corruptly). The court found, however, that even though the SEC had not affirmatively pled that the payments were not facilitation payments, its allegations that the payments were made to obtain permits based on false documents were sufficient to support the inference that the defendants knew that they were seeking to obtain the permits in an illegal manner and that the payments were therefore not facilitation payments. Interestingly, the court did not reject the SEC's "discretionary act" theory, but it found that the SEC's conclusory allegations were not sufficient to establish the discretionary nature of the foreign official's duties. The court gave the SEC leave to amend its complaint to cure this defect.

Of course, as the *Guide* makes clear, merely labeling a bribe as a "facilitation payment" does not make it one. For example, in *Pfizer/Wyeth* an illicit payment was recorded as a facilitation payment when its

actual purpose was to secure the release of promotional items that were held in port because Wyeth had failed to secure a required Saudi Arabian Standards Organization Certificate of Conformity. Overlooking the failure to meet customs requirements likely would not fall under the category of "routine government action," so "facilitation payment" was a misnomer at best, and an active attempt to conceal a bribe at worst. The *Guide* also emphasizes the exception's focus on the *purpose* of the payment. In *Eli Lilly*, false contracts were signed for services such as "immediate customs clearance" or "immediate delivery" of products. However, according to the SEC, Eli Lilly failed to inquire into how the private third parties intended to perform services that required interaction with government officials, such as expedited customs clearance, and, most importantly, the contemporaneous documents made clear that the Eli Lilly employees viewed the payments as necessary to obtain business.

Instrumentalities

The debate over what constitutes an instrumentality of a foreign government continues.[7] As we noted previously, the argument that, as a matter of law, such instrumentalities are limited to agencies of foreign governments and do not encompass state-owned entities has thus far failed in every instance in which it was presented to a court. It is currently before the Eleventh Circuit in the appeals by *Joel Esquenazi* and *Carlos Rodriguez* in the *Haiti Telecom* case.

The district courts have uniformly held that the nature of the instrumentality is a matter of fact to be decided by the fact-finder, and they have drafted jury instructions to that effect. The results under these instructions have thus far been fairly consistent: the juries in *Lindsay* and *Esquenazi* and *Rodriguez* (*Haiti Telecom*) clearly found the relevant state-owned entities were instrumentalities as part of their verdict, as did the judge in approving the plea in *Nexus* (the court dismissed the *O'Shea* case before it went to the jury).

In the meantime, the government does not appear to have been deterred by the debate. Indeed, in the *Guide*, both the DOJ and SEC reaffirmed the government's prior position that the term "instrumentality" is broad and encompasses both state-owned and controlled entities. The *Guide* reiterates the fact-specific, factor-based analysis previously used by the enforcement authorities and the courts and highlights the need for a flexible analysis that can take into account the variety of manners in which governments are organized and operate through state-owned or controlled entities. While the *Guide* did note that an entity is unlikely to qualify as state-owned or controlled if the government did not own or control a majority of its shares, it also emphasized that there could be exceptions, particularly where the government holds status as a "special shareholder" or where most senior company officers were political appointees. However, the fact of minority ownership appears to weigh against finding that an entity is an instrumentality, absent other factors to tip the balance.

---

[7] For further discussion on this issue, you may wish to refer to P. Urofsky & J. Bartlett, *Definition of "Foreign Official" Irrelevant to Compliance Efforts*, Bloomberg BNA/ACCA Compliance Manual: Prevention of Corporate Liability (Dec. 17, 2012).

In most of the cases brought in 2012, the relevant government officials were employed by "instrumentalities" such as state health insurance plans (*Orthofix*), a state-owned nuclear plant (*Data Systems & Solutions*), government hospitals (*Biomet*, *Smith & Nephew*, *Pfizer/Wyeth* and *Eli Lilly*), a state-owned real estate development company (*Peterson*), a state-owned oil company (*Tyco*), state-owned airlines (*NORDAM*), and unspecified "state-owned entities" (*Allianz*). In each case, the government laid out with more or less detail facts that it believes are sufficient to meet the criteria established by the district courts. For example, in *Pfizer*, the government alleged that the government officials included doctors who held positions on registration committees and other employees of "hospitals, clinics, and pharmacies in countries with national healthcare systems."

Anything of Value

As in the past, companies have given a wide variety of benefits to government officials. Cash was by far the preferred vehicle, but travel and vacations featured prominently as well (*Biomet*, *Data Systems*, *Tyco*, *Pfizer/Wyeth*, *Orthofix*). Evidently to highlight the inappropriate nature of certain gifts and travel, the enforcement authorities at times referenced specific brands (a Cartier watch in *Data Systems*, BlackBerrys in *Pfizer/Wyeth*, a Volkswagen Jetta in *Orthofix*) or specific destinations (Florida and Hawaii in *Data Systems*; Paris in *Tyco*, "international travel" in *Pfizer/Wyeth*). By and large, general descriptions such as "gifts," "entertainment," and "travel" are common, but the three enforcement actions in the *Pfizer/Wyeth* cases contained a veritable laundry list of very specific items of value, including: televisions; cell phones; phone card credits; continuing medical education events; office equipment, such as monitors, photocopiers, and printers; renovations; "incentive trips" with "extensive recreational and entertainment activities"; "points programs" under which doctors could accumulate points to redeem for various gifts such as cell phones, tea sets, and reading glasses; and "donation of durable goods."

The most abstract of the "items of value" this year was perhaps the "exclusive distributorship" allegedly granted to a third party in *Pfizer/Wyeth*. Pfizer policy prohibited exclusive arrangements, but the third party stated that if it did not receive exclusive rights, Pfizer would not be able to sell products in Kazakhstan. Pfizer refused, but subsequently experienced substantial difficulty obtaining approval for the registration of its products. Once Pfizer entered into an exclusive distributorship agreement with the third party, the registration was approved—however, the pleadings do not make clear if anything of value was given to the Kazakh authorities who granted the approval.

Corporations tend to view this "anything of value" element with a degree of consternation, because of the mistaken perception that an innocent cup of coffee could trigger or require an FCPA investigation. Apparently recognizing this, the *Guide* addresses this issue thoroughly, emphasizing the importance of "corrupt intent" in distinguishing between a legitimate business expense and a bribe while giving several examples. We discuss this portion of the *Guide* in detail in the FCPA *Guide* section, below.

Recent Trends and Patterns in FCPA Enforcement

Modes of Payment

The means of raising funds to pay bribes have similarly been varied and imaginative. Companies entered into fictitious or inflated contracts with third parties (some of which were shell companies and some of whom were legitimate contractors) (*Orthofix*, *Data Systems*, *Smith & Nephew*, *Pfizer/Wyeth*, *Tyco*) or colluded with vendors to generate false invoices (*Pfizer/Wyeth*). Employees submitted fictitious expense reimbursements (*Pfizer/Wyeth*, *Orthofix*, *Tyco*) or artificially inflated customer invoices to offset the cost of the bribes (*NORDAM*). *Pfizer/Wyeth* included a particularly inventive scheme: what appeared to be a mechanism for providing the equivalent of indirect price discounts or in-kind benefits to government hospitals turned out to be a vehicle to make cash payments to individual government healthcare professionals to corruptly reward past (and induce future) purchases and prescriptions.

Oracle, however, may be perhaps the strangest case of the year. In its complaint, the SEC outlines in detail the steps the company took to "park" funds with distributors (*i.e.*, outside of its books and records) which were then paid to shell companies. In the end, however, the SEC was apparently unable to connect the dots, even under its lower standard of proof, and it does *not* allege that *any bribes* were paid—only that the company's practices created the *risk* of improper payments.

Compliance Guidance

The FCPA Guide

In November, the DOJ and the SEC released the long-promised *Resource Guide to the U.S. Foreign Corrupt Practices Act*. For the most part, the *Guide* does not break new ground and instead confirms and consolidates the agencies' previous interpretations of the FCPA's scope and terms.[8] The *Guide* does, however, provide some useful insight into what the government expects when it comes to critical elements of compliance programs, such as due diligence in M&A transactions and gifts and entertainment.

"Enhanced" Compliance

In recent cases such as *Noble Corp.* and *Daimler*, the government has referred to the defendant as having adopted an "enhanced" compliance program as part of its pre-settlement remedial actions. For the most part, these programs are substantially similar to the "Appendix C" programs mandated by all DOJ settlements. In *Pfizer*, however, we see what is truly a significantly more expansive program. In addition to an Appendix C.1 including standard compliance elements, the *Pfizer* DPA includes an Appendix C.2 detailing the company's "enhanced" compliance obligations as well as an Appendix C.3 with extensive reporting requirements. Under the provisions, Pfizer agreed, among other things, to select at least five

[8] For further discussion on this issue, you may wish to refer to our prior client publication, available at Shearman & Sterling, *The New FCPA Guide: The DOJ and the SEC Do Not Break New Ground But Offer Useful Guidance and Some Ominous Warnings* (Nov. 15, 2012).

markets with high corruption risk for proactive FCPA reviews each year and to conduct specified mandatory due diligence on all sales intermediaries at least once every three years. Particularly striking is the degree of specificity in the requirements that the DPA spells out for Pfizer, which appear to go beyond even those contemplated by the DOJ in the *Guide*'s "Hallmarks of Effective Compliance Programs."

Some of the elements of *Pfizer*'s enhanced compliance program were likely developed by the company itself to persuade the government of its commitment to FCPA compliance after the discovery of extensive violations. Their inclusion in the DPA with such specificity may, however, have been intended by the DOJ to strengthen the hand of Pfizer's internal compliance personnel and to ensure that the company maintained the same level of compliance resources in the face of economic headwinds.

Gifts and Entertainment

We have long advised that the FCPA doesn't forbid providing gifts, entertainment, and hospitality to customers, provided there are sufficient controls in place to ensure that the benefit cannot be construed as a *quid pro quo* for obtaining or retaining business.[9] This common-sense position has been echoed in the U.K. *Guidance* and now in the DOJ/SEC *Guide*.

The cases brought in 2012 do not materially add to the existing guidance from previous enforcement actions and FCPA Opinions, but they do provide some additional examples of when gifts and entertainment may cross the line from promotion to bribery. For example, in *Orthofix*, both the DOJ and the SEC alleged that the company had provided vacation packages, televisions, laptops, appliances, and a lease for an automobile to doctors to induce them to use the company's products. Similarly, in *Biomet*, the DOJ alleged that the company flew one Chinese official to Switzerland to visit his daughter and sent others on a "training trip" to Spain of which a substantial portion consisted of sightseeing and entertainment. *Tyco* also involved allegedly corrupt travel, including a "social trip" to Paris and a "factory visit" to Germany. In *BizJet*, the DOJ's pleadings refer to one instance in which the company gave an official a cell phone and cash. In *Data Systems & Solutions*, the DOJ criminal information contains reference to paying for officials' vacations and giving an official a Cartier watch worth $2,664.74. Finally, in *Pfizer/Wyeth*, in addition to providing gifts directly, the company allegedly used "bonus programs" or "points programs" which, in effect, rewarded doctors for writing Pfizer prescriptions, with items such as cell phones, tea sets, free products, international travel support, or even cash.

The year also brought an example of using charitable donations as a front for alleged bribery. In *Eli Lilly*, the company sought the support of the top official of a Polish regional government health authority to place Eli Lilly drugs on the government's insurance reimbursement list. To that end, the company made payments to the Chudow Castle Foundation, a charitable foundation founded and administered by that very official. The name of the foundation may provoke a sense of déjà vu for our readers, as it is the same

[9] For further discussion on this issue, you may wish to refer to P. Urofsky, *Ten Strategies for Paying for Government Clients to Attend the Olympics or Other Sporting Events Without Violating the Foreign Corrupt Practices Act*, The FCPA Report (June 6, 2012).

foundation that was used to funnel bribes in the 2004 SEC enforcement against *Schering-Plough*. The same official was likely involved as well, as both actions cover the period between 2000 and 2003.

In each of these cases, the gifts and entertainment were of a type and amount, or were accompanied by explicit agreements, that tied the gift to obtaining or retaining business. Where, on the other hand, such promotional expense was truly *bona fide* and legitimately tied to promoting the company, its products, or even its individuals (*i.e.*, networking), or for community outreach (in the case of charitable contributions), gifts and entertainment, hedged with appropriate controls and accurately recorded in the company's books, should not run afoul of the statute.

Indeed, the *Guide* makes clear that "corrupt intent" is what distinguishes a bribe from a legitimate business expense. In an apparent attempt to assuage concerns and criticisms regarding the potentially nebulous distinction, the *Guide* notes that "it is difficult to envision any scenario in which the provision of cups of coffee, taxi fare, or company promotional materials of nominal value would ever evidence corrupt intent." The "corrupt intent" requirement thus protects companies that "engage in the legitimate promotion of their business while targeting conduct that seeks to improperly induce officials into misusing their positions."

With that being said, the distinction between legitimate and corrupt will always be a fact-specific issue requiring careful investigation, particularly if the gifts or entertainment occur with such frequency that they may be viewed as a systemic course of conduct that could evidence corrupt intent. Further, of course, legitimate gifts and entertainment can still be subject to the FCPA if they are not properly recorded and accounted for. Apparently with such concerns in mind, Harris Corp., a communications technology company, recently disclosed that it is investigating "certain entertainment, travel, and other expenses which may have been incurred or reported improperly" at Carefx, a company it acquired in 2011.

M&A Due Diligence and Successor Liability

The FCPA *Guide*, as well as actions brought over the past year, emphasize the importance of engaging in adequate pre-acquisition and post-closing due diligence in M&A transactions. When a company acquires or merges with another company, the acquiring entity assumes all liabilities of the predecessor company. The *Guide* emphasizes that successor liability (an "integral part of corporate law") applies to all kinds of civil and criminal liabilities, including FCPA violations. The DOJ and SEC note, however, that they have almost never prosecuted the acquiring company for the pre-acquisition acts of the acquired company and have held an acquiring company responsible only for post-acquisition continuation of unlawful conduct that it failed to prevent after it took control of the acquired company. This may be of some comfort to the acquiring company, but the government also notes that it has charged the predecessor company itself, now a subsidiary of the acquiring company, for pre-acquisition conduct. The acquiring company, therefore, still bears the financial burden resulting from its new acquisition's pre-acquisition conduct even if it is not held directly liable.

Recent Trends and Patterns in FCPA Enforcement

Recent actions over the past year reinforce the SEC and DOJ's expectation that companies involved with mergers will conduct pre-merger and post-merger due diligence and undertake measures to address existing FCPA issues. For example, in *Pfizer*, the government charged the company with having paid approximately $2 million in improper payments to government officials in Bulgaria, Croatia, Kazakhstan, and Russia. The improper bribes were made by a Pfizer subsidiary, Pharmacia & Upjohn, which Pfizer acquired in 2003. This conduct clearly continued well past the acquisition; the DOJ and the SEC thus found Pfizer liable for its subsidiary's pre-acquisition conduct.

In contrast, at the same time as the DOJ and SEC actions against *Pfizer* and its subsidiary *Pfizer HCP*, the SEC brought an action against *Wyeth LLC*, which Pfizer acquired in 2009. Wyeth subsidiaries in China, Indonesia, Pakistan, and Saudi Arabia allegedly made improper payments to foreign officials (including employees of state-owned hospitals) to procure business and falsely recorded those payments as promotional expenses, "Miscellaneous Selling Expenses," "Trade Allowances," "Entertainment," and "Give Aways and Gifts." Similar to the earlier acquisition of Pharmacia, the Wyeth conduct occurred both before and after its acquisition by Pfizer, but the government noted that this time Pfizer's pre-merger due diligence of Wyeth included a global review of Wyeth's internal controls and an immediate integration of Wyeth into Pfizer's internal controls systems. Following the closing of the deal, Pfizer also performed a worldwide, risk-based FCPA due diligence of Wyeth's operations, while fully cooperating with an SEC investigation. The DOJ made clear that Pfizer's exhaustive internal investigation and cooperation were significant factors influencing its decision not to pursue criminal action for the pre-acquisition violations committed by Wyeth subsidiaries, while the SEC pursued only books-and-records against Wyeth and not Pfizer for Wyeth's violations.

In terms of further guidance for FCPA compliance in the merger context, the *Guide* encourages companies to conduct pre-acquisition due diligence and to improve compliance programs and internal controls after acquisition for reasons such as accurate valuation and risk management. Of particular interest to companies, however, will be the possibility that the enforcement authorities might decline prosecution of successor companies on the basis of proper due diligence. The *Guide* expressly states that the SEC and the DOJ have declined to take action against companies that voluntarily disclosed and remediated conduct and cooperated with the DOJ and the SEC in the M&A context. From the corporate compliance perspective, perhaps the most useful guidance is found in the "Practical Tips to Reduce FCPA Risk in Mergers and Acquisitions." In that section, the *Guide* recommends seeking an FCPA Opinion from the DOJ in anticipation of a potential acquisition, similar to FCPA Opinion Release 2008-02 given to Halliburton opinion mentioned above. As we have noted before, the requirements of that Opinion are near-draconian, but the *Guide* makes it clear that conducting thorough pre-acquisition due diligence may result in concrete benefits. Thus, the *Guide* expressly states that those who take the following actions will be given "meaningful credit" and, in appropriate circumstances, may qualify for a declination:

- conduct thorough due diligence;
- ensure that the newly acquired or merged business is promptly integrated into the company's code of conduct and compliance policies and procedures;

- conduct an FCPA-specific audit of all newly acquired or merged businesses as quickly as practicable; and
- disclose any corrupt payments discovered as part of its due diligence of newly acquired entities or merged entities.

Due Diligence on Third Parties

The *Guide* contains a discussion of due diligence on third parties, along with a case study and two hypotheticals on third party vetting. Though the *Guide* does not contain any surprises—it emphasizes that third party due diligence should be risk-based and will thus necessarily vary based on industry, country, size and nature of the transaction, and historical relationship with the third party—it also provides several universal guiding principles. First, companies should always understand the qualifications and associations of their third party partners; second, companies must understand the business rationale for including the third party in the transaction; and third, companies should monitor third party relationships on an ongoing basis. The *Guide* also provides a set of common red flags well known to followers of the FCPA, including excessive commissions or unreasonably large discounts to third party distributors. The *Guide* uses a discussion of third party payments to reiterate that "knowledge" of a corrupt payment under the FCPA includes willful blindness and awareness of a high probability that improper payments are being made.

Best Practices

Many critics of the FCPA have called for a "compliance program defense." This seems unlikely, particularly in the wake of the recent Wal-Mart bribery scandal in Mexico, which was the subject of a series of investigative articles in *The New York Times*. The *Times* articles, if accurate, provide a vivid example of how an extensive bribery scheme may occur even in companies that appear to have relatively well-established compliance programs. Nevertheless, while rejecting the concept of an adequate procedures defense similar to that of the U.K. Bribery Act, the U.S authorities have sought to provide incentives for companies to establish strong compliance programs.

In April 2012, in the *Morgan Stanley* matter, the government provided its strongest incentive to date, by showing that a strong compliance program could completely shield a company from liability relating to the actions of a single employee. There the DOJ and SEC brought actions against *Garth Peterson*, a former managing director of Morgan Stanley Real Estate Group's Shanghai office, for bribery in China but did not charge Morgan Stanley itself, noting its strong compliance program and the lengths to which Morgan Stanley went to train and remind Peterson of FCPA compliance. In its press release, the DOJ specifically stated, "After considering all the available facts and circumstances, including that Morgan Stanley constructed and maintained a system of internal controls, which provided reasonable assurances that its employees were not bribing government officials, the Department of Justice declined to bring any

enforcement action against Morgan Stanley related to Peterson's conduct. The company voluntarily disclosed this matter and has cooperated throughout the department's investigation." The SEC similarly stated in its press release that Peterson was a "rogue employee" (which may represent the first government acknowledgement that there are such animals) and that "Morgan Stanley, which is not charged in the matter, cooperated with the SEC's inquiry and conducted a thorough internal investigation to determine the scope of the improper payment and other misconduct involved."

As a cautionary note, we note that the elements of Morgan Stanley's program, as described in the government's pleadings, are relatively indistinguishable from those of many companies that have been prosecuted. Thus, we cannot rule out that other factors may have influenced the government's decision nor provide any assurance that companies adopting similar programs will be assured of similar treatment.

Private Litigation

The year saw a slew of private litigation related to FCPA investigations and enforcement. While most were the usual derivative and securities class action lawsuits that follow FCPA disclosures (with several arising from the Wal-Mart scandal), one of them was a rare FCPA-related malpractice case. *Watts Water Technologies Inc.*, which had settled FCPA allegations last year concerning an acquisition of a Chinese entity in 2005, launched a malpractice suit against its legal advisor on the Chinese acquisition, Sidley Austin LLP. Watts Water alleged that Sidley Austin failed to warn it about possible corruption issues, even though its review of the transaction had uncovered "a suspicious document." Watts Water also alleged that it would not have executed the acquisition if it had known about the Chinese company's written policy of paying kickbacks to Chinese government officials—which Sidley Austin allegedly uncovered but did not reveal to Watts Water. Sidley Austin found these allegations "preposterous" and filed a motion to dismiss, stating that it was never asked to conduct anti-bribery due diligence and that it had conducted proper due diligence. The case failed to establish a precedent for future cases, however, as it was dismissed after the parties filed a joint stipulation of dismissal, which gives no explanation as to why the suit was terminated.

Going beyond malpractice, investors who suffered losses in the Allen Stanford Ponzi scheme have recently sued two law firms, Greenberg Traurig LLP and Hunton & Williams LLP, alleging, *inter alia*, that certain partners who acted as counsel to Stanford knowingly participated and facilitated Stanford's alleged bribery of officials in Antigua. Curiously, the investigation of the Stanford scheme had not resulted in any FCPA enforcement, despite the government's allegations of bribes Stanford paid to Antiguan officials in return for various business advantages. Stanford's investment company eventually imploded, with the SEC alleging a "massive Ponzi scheme of staggering proportions," and Allen Stanford was convicted on multiple (but not FCPA) counts and sentenced to 110 years in prison. The investors then sued the law firms for breach of fiduciary duty and unjust enrichment, alleging that Greenberg not only knew of and assisted in Stanford's bribery of Antiguan officials, but also advised Stanford on the implications of his bribery. After some of the Greenberg partners left for Hunton & Williams, the lawyers at Hunton allegedly "continued to assist Stanford with all aspects of his illegal operations," presumably including

bribery. These cases are examples of the different ways a person or corporation's corrupt activities can adversely affect the lawyers who advise them, and they highlight the need to detect and address corruption-related red flags, especially in transactions involving foreign government officials.

Enforcement in the United Kingdom

Enforcement in the U.K.

The past year has been one of some turmoil in the U.K. The management of the Serious Fraud Office ("SFO") changed in April 2012, which has led to a shift in the SFO's stated approach to the handling of bribery and corruption cases. Further, statements by the new Director of the SFO have indicated a distinct change of tone, emphasizing the prosecutorial role of the SFO in contrast to a consultative role concerning corporate compliance. On the other hand, while the U.K. government continues to explore adopting the Deferred Prosecution Agreement concept in the U.K., its enforcement authorities continue to use other tools to reach resolutions short of a criminal prosecution.

SFO Guidance

In March 2011, the U.K. Ministry of Justice ("MoJ") issued comprehensive guidance on the Bribery Act, mostly in relation to the new corporate offense (section 7 of the Bribery Act) and its adequate procedures defense. The SFO and the Crown Prosecution Service also issued joint enforcement guidance addressing the policies they would follow in evaluating issues such as facilitation payments (which, in the absence of an exception such as that written into the FCPA, are violations of the U.K.'s general prohibition on corrupt payments). The SFO also published on its website some of its own guidance on its approach to certain issues arising under the Bribery Act.

However, in September 2012 the SFO removed from its website its previous guidance, replacing it with statements referring to the Code for Crown Prosecutors, the Joint Prosecution Guidance of the Director of the SFO and the Director of Public Prosecutions, and the Joint Guidance on Corporate Prosecutions. The SFO also withdrew its guidance in respect of corporate self-reporting, which had suggested that the SFO might settle through a civil remedy, as opposed to criminal prosecution, if a company self-reported bribery and corruption issues. Subsequently, on December 6, 2012, David Green QC (the new Director of the SFO) published an open letter on facilitation payments, re-emphasizing that such payments are illegal under English law, regardless of their size or frequency.

These developments show a definite shift in approach by the SFO. The SFO appears to have made a conscious effort to step away from its previous stance, particularly with regard to self-reporting. Notably, Mr. Green has emphasized in his recent appearance before a House of Commons Justice Committee that the SFO is a "crime-fighting agency" as an investigator and prosecutor of serious fraud, bribery and corruption, not an adviser to corporates. If actions follow rhetoric, this may presage an increase in prosecutions under the Bribery Act in the near future.

Recent Trends and Patterns in FCPA Enforcement

Deferred Prosecution Agreements in the U.K.

Even though the SFO has withdrawn its guidance on voluntary disclosures and civil remedies, earlier this year the U.K. took steps toward authorizing the SFO to enter into DPAs with corporations which are being investigated for bribery offenses. The MoJ published a consultation paper on DPAs in May. While DPAs have long been used by prosecutors in the U.S., the adoption of an alternative negotiated resolution in criminal matters would be a significant shift in the U.K. In the consultation paper, the MoJ invited interested parties to comment on its proposals to help determine whether they are sensible, proportionate, and likely to make a genuine difference.

Currently, prosecutors in the U.K. can either bring a formal prosecution against a commercial organization for committing a criminal offense or pursue a civil recovery order. Both of these options can be expensive, involve lengthy investigations, and in many instances are regarded as ineffective. The MoJ stated that DPAs would give prosecutors the "flexibility to secure appropriate penalties for wrongdoing, at the same time as achieving better outcomes for victims" without the costs, uncertainty, and risks involved in formal criminal prosecutions. The MoJ also hoped that the potential to settle through a DPA would encourage organizations to self-report economic crime, with the incentive for doing so being to defer, and possibly avoid, criminal prosecution. However, the MOJ emphasized that self-reporting by itself would not guarantee a decision not to prosecute.

Following the consultation period, the MoJ announced on October 23, 2012 that legislation would be introduced to allow DPAs in the U.K. for corporations. Similar to the practice in the U.S., the U.K. version of a DPA (as contemplated by the MoJ) will be an agreement between a prosecutor and a commercial organization[10] under which the prosecutor will bring, but not immediately proceed with, criminal charges against the organization. In a significant departure from U.S. practice, however, the MoJ's consultation paper contemplates substantial oversight and approval by the courts and a number of formal proceedings before the court approves the terms of the DPA. The agreed terms and conditions are likely to include financial penalties, reparation to victims, confiscation of the profits of wrongdoing, and measures to prevent future offending. Moreover, although the MoJ recognizes that the parties will need a level of certainty and confidentiality to be able to negotiate the details of a DPA, the public interest in ensuring that the DPAs are part of a robust prosecutorial approach requires that the final DPA will be made public in open court to ensure openness and transparency.

The MoJ noted that even if the proposed legislation is passed, the new remedy would have to be applied in a clear and practical manner and supported by guidance to ensure that all parties have a thorough understanding of how they operate. Thus, the Director of Public Prosecutions and the Director of the SFO will be required to develop and publish a "DPA Code of Practice for Prosecutors," setting out the factors to which prosecutors ought to have regard when considering whether to enter into a DPA; the Sentencing

---

10 While the consultation paper refers to "commercial organizations," the MoJ states that "many of the difficulties [referred to in the consultation paper] apply with equal force to large partnerships or trusts." However, it appears that the SFO will not be able to enter into DPAs with individuals.

Council will need to produce sentencing guidelines on offenses likely to be encompassed by DPAs, providing transparency and certainty for the parties and the court; and Criminal Procedure Rules will have to be developed to enable the DPA process to operate effectively and efficiently.

The introduction of DPAs would come at a time when companies in the U.K. are more open and transparent about investigations and their approach to bribery and corruption allegations. For example, Rolls-Royce is facing the possibility of prosecution after a probe by the SFO which prompted an internal investigation into allegations about corruption and bribery in Indonesia, China, and other overseas markets. Rolls-Royce has stated that it will appoint an independent senior figure to review its compliance regime and report to the board's ethics committee. The company has also stated that it has strengthened its compliance procedures in recent years, including by the establishment of a new ethics code.

Anti-Bribery Controls

On March 29, 2012, the U.K. Financial Services Authority ("FSA") published the findings of its thematic review into anti-bribery and corruption systems and controls in investment banks. The FSA examined the effectiveness of the anti-bribery and corruption controls of eight global investment banks and seven other smaller firms offering investment banking or similar activities. The FSA's findings included the following:

- Most of the group had not yet properly taken account of the FSA's existing rules relating to anti-corruption controls;
- Nearly half the group did not have an adequate anti-corruption risk assessment;
- Information provided on anti-corruption by the group to senior management was generally poor; and
- Most of the group had not yet devised mechanisms for reviewing or monitoring the effectiveness of their anti-corruption policies and procedures.

Overall, the FSA concluded that the investment banking sector has been "too slow and reactive in managing bribery and corruption risk." The FSA is now considering possible regulatory action against some members of the group, and it has also launched a consultation on changes it is proposing to make to its guidance in this area.

Enforcement Actions

Although, as described above, the new Director of the SFO has withdrawn the SFO's guidance insofar as it suggested that voluntary disclosures would result in civil recovery orders as opposed to criminal prosecutions, there have been several matters this year that have been resolved in that way. Indeed, none of the enforcement actions against companies in 2012 were resolved through a formal criminal prosecution.

Oxford Publishing Ltd

In July, Oxford Publishing Ltd ("OPL"), a wholly owned subsidiary of Oxford University Press ("OUP"), agreed to pay almost £1.9 million under a civil recovery order. This amount reflected sums generated through unlawful conduct related to OPL's subsidiaries in Tanzania and Kenya. The two subsidiaries have also been excluded from competing for World Bank contracts for three years. OUP has offered to contribute £2 million to not-for-profit organizations in sub-Saharan Africa and will be subject to a compliance monitor who will report to the SFO on compliance in twelve months' time.

This case represents an example of how, even without the availability of DPAs, the SFO has some flexibility in reaching alternative resolutions with cooperating corporations. In this case, it determined that the case was appropriate for a civil recovery order instead of a criminal prosecution because: (1) OUP met the criteria set out in the then-applicable SFO guidance on self-reporting matters of overseas corruption (which, as explained above, has now been superseded); (2) the settlement terms ensure all gross profit from any tainted contract will be disgorged; and (3) there was no evidence of board-level knowledge or connivance in relation to the business practices which led to the case being referred to the SFO. Thus, in announcing the settlement, the Director of the SFO stated that "[t]his settlement demonstrates that there are, in appropriate cases, clear and sensible solutions available to those who self-report issues of this kind to the authorities."

Abbot Group Limited

The Crown Office (the agency responsible for prosecution of crime in Scotland) announced on November 23, 2012 a £5.6 million civil recovery against the Scotland-based drilling company Abbot Group Limited. Abbot admitted that it had benefited from corrupt payments in relation to a contract between one of its overseas subsidiaries and an overseas oil and gas company. The sum to be paid by Abbot represents the profit made by the company under the contract which was entered into in 2006 and the payments made in 2007. Abbot had instructed an investigation to be carried out by solicitors and accountants that it had appointed and subsequently self-reported the results of that investigation to the Crown Office.

Mabey & Johnson

In 2009, Mabey & Johnson, an international construction company, pleaded guilty to corruption charges and agreed to pay £6.5 million in fines and reparations to foreign governments. In January of this year, the SFO obtained a civil recovery order against Mabey & Johnson's parent company, requiring it to pay back dividends exceeding £130,000 which were gained as a result of bridge-building contracts in Iraq obtained through unlawful conduct. The director of the SFO stated that this represented "the final piece in an exemplary model of self-reporting and cooperative resolution. This is the approach I would like to foster across the wider business community when it comes to the self-referral processes the SFO has created. The process should provide clarity, confidence and, ultimately for the business concerned, a resolution to the problem."

Swift Group

On December 17, 2012, the SFO charged four employees of Swift Technical Energy Solutions Ltd (the Nigerian subsidiary of the Swift Group of companies) with two offenses of conspiracy to corrupt. The Swift Group provides workers for the gas and oil industry worldwide. The charges relate to alleged payments amounting to around £180,000 which were said to have been made in 2008 and 2009 to tax officials in Nigeria to avoid, reduce or delay paying taxes on behalf of the workers that Swift sent to Nigeria. There will be a preliminary hearing on February 22, 2013. The Swift Group has been cooperating with the SFO investigation and is currently not facing criminal charges.

OECD Working Group on Bribery

According to the OECD Working Group on Bribery, fourteen (out of thirty-eight) OECD members have prosecuted 210 individuals and ninety entities since the OECD Convention entered into force in 1999, with sixty-six individuals being sentenced to imprisonment. Moreover, the OECD reports that there are over 170 ongoing criminal proceedings in thirteen Parties, and over 300 ongoing investigations by twenty-six Parties (although half of those appear to be in the U.S.). Enforcement is not, of course, uniformly distributed, with a significant number of Parties reporting no cases, no proceedings, and no investigations. Nevertheless, it does appear that, even if other countries are not publicizing their enforcement actions to the extent done in the U.S. (and thus perhaps losing the deterrent value of such prosecutions); there are a growing number of cases being brought outside the U.S.

The OECD data is subject to a several qualifications as to accuracy and methodology that make it hard to compare countries meaningfully. For example, unlike our approach above of aggregating cases against related entities and not double-counting civil and criminal cases against the same individuals, this data counts each entity and each action separately and thus potentially overstates the extent of enforcement. However, the five most active countries are the U.S., Germany, Italy, Hungary, and Korea. Several others have a few cases. Perhaps most surprising is that two countries not viewed as being particularly active in this area, Japan and France, have both allegedly brought six and seven cases, respectively!

The OECD, however, did recently issue a report on the situation in France[11] in which it severely criticized France for its lack of bribery prosecutions and convictions. It noted that the French authorities have obtained only five convictions that involved a company in the past twelve years. The report also criticized the sanctions in France as not sufficiently dissuasive, and it emphasized that more effort should be made to confiscate proceeds from bribery or corruption. The report recommended that France focus on reforms leading to greater independence for its prosecutors, that it clarify the law on corruption and bribery to aid prosecutors' interpretation of it, and that it encourage officials to report suspected cases of foreign bribery without fear of retaliation. The report also notes some positive developments in France, such as steps toward greater impartiality for prosecutors and the introduction of whistleblower protection into the law.

[11] Organisation for Economic Co-operation and Development, *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in France* (Oct. 2012).

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.

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Philip Urofsky
Washington, D.C.
+1.202.508.8060
philip.urofsky@shearman.com

Danforth Newcomb
New York
+1.212.848.4184
dnewcomb@shearman.com

Stephen Fishbein
New York
+1.212.848.4424
sfishbein@shearman.com

Patrick D. Robbins
San Francisco
+1.415.616.1210
probbins@shearman.com

Paula Howell Anderson
New York
+1.212.848.7727
paula.anderson@shearman.com

Richard Kreindler
Frankfurt
+49.69.9711.1000
rkreindler@shearman.com

Richard Kelly
London
+44.20.7655.5788
richard.kelly@shearman.com

Markus S. Rieder
Munich
+49.89.23888.2615
markus.rieder@shearman.com

Jo Rickard
London
+44.20.7655.5781
josanne.rickard@shearman.com

Brian C. Wheeler
Tokyo
+81.3.5251.0206
brian.wheeler@shearman.com

Brian G. Burke
Hong Kong
+852.2978.8040
brian.burke@shearman.com