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SEC Settlement with Layne Christensen Raises New Questions on the Government's Understanding of the Business Nexus Element of the FCPA

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

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

Stephen Fishbein
New York
+1.212.848.4424
sfishbein@shearman.com

Danforth Newcomb
New York
+1.212.848.4184
dnewcomb@shearman.com

Patrick Robbins
San Francisco
+1.415.616.1210
probbins@shearman.com

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

Claudius Sokenu
New York
+1.212.848.4838
Washington D.C.
+1.202.508.8030
claudius.sokenu@shearman.com

Last week the SEC settled charges against Layne Christensen for various violations of the FCPA. While a relatively unremarkable case at first glance, the SEC's charges against Layne Christensen reflect a troubling approach by enforcement agencies to disregard the "business nexus element" of the FCPA's anti-bribery provisions. These recent practices appear to contradict the Fifth Circuit's opinion in *United States v. Kay* and create greater uncertainty as to the scope of the statute.

SEC Settlement with Layne Christenson Raises New Questions on the Government's Understanding of the Business Nexus Element of the FCPA

On October 27, 2014, the Securities Exchange Commission settled charges against Layne Christensen Company, the Texas based global water management, construction, and drilling company, for violations of the US Foreign Corrupt Practices Act. In particular, the SEC accused Layne Christensen of bribing officials in several African countries in exchange for the reduction of tax liability and customs duties resulting in "benefits of approximately $3.9 million." In settling the SEC's charges, Layne Christensen agreed to pay over $5 million in sanctions.

Although a seemingly unremarkable case in a field known for blockbuster settlements, *Layne Christensen* illustrates a troubling practice by the SEC and US Department of Justice to disregard the "business nexus element" of the FCPA. Specifically, the FCPA states that to violate the anti-bribery provisions of the law, the defendant must pay a bribe "to assist the issuer in obtaining or retaining business . . . ." While it is often the case that bribes are paid on a *quid pro quo* basis in exchange for the award of valuable contracts, there are additional scenarios, like that seen in *Layne Christensen*, where the bribes merely assisted the

Contacts (cont.)

Brian Burke
Hong Kong
+852.2978.8040
Beijing
+86.10.5922.8140
brian.burke@shearman.com

Masahisa Ikeda
Tokyo
+03.5251.1601
mikeda@shearman.com

Robert Ellison
São Paulo
+55.11.3702.2220
robert.ellison@shearman.com

defendant to improve its profit margins. In *United States v. Kay*, the Fifth Circuit held that bribes made in exchange for a reduction in tax liability or customs duties did not *per se* violate the statute without proof that the increased profits were used to obtain or retain some form of business.

Layne Christensen is further evidence that the DOJ's and SEC's current approach to the "business nexus element" of the FCPA flies in the face of Kay. By charging companies (often under extreme pressure to settle the case against them) with facts that do not show how the bribes were used to assist in obtaining or retaining business, the DOJ and SEC have created significant uncertainty as to the scope of the FCPA.

I. *United States v. Kay*

In *United States v. Kay*, the DOJ charged two executives with violating the FCPA for their involvement in a bribery scheme related to the exportation of rice to Haiti by American Rice, Inc. The bribes in that case were paid to Haitian customs officials to induce them to accept false shipping documents that under-reported the amount of rice onboard ocean-going barges, thus reducing the amount of customs duties and sales taxes that would otherwise have had to be paid by American Rice.

On appeal to the Fifth Circuit Court of Appeals, the defendants argued that bribes paid in exchange for favorable tax treatment were not within the scope of the FCPA because they were not made to "obtain or retain business." According to the defendants, the FCPA's business nexus element restricted the law to only those circumstances where bribes are intended for "the award or renewal of contracts." The Fifth Circuit disagreed, holding that the FCPA was not limited to bribes paid for purposes of contact awards or renewals. Instead, the Fifth Circuit explained that "bribes paid to foreign officials in consideration for unlawful evasion of customs duties and sales taxes *could* fall within the purview of the FCPA's proscription." Importantly, however, the court added that improper payments meant to avoid customs duties or sales taxes would not automatically violate the FCPA and that it was the prosecution's burden to allege facts that the savings generated were "to assist in obtaining or retaining business." Specifically, the Kay court explained:

> Although we recognize that lowering tax and customs payments presumptively increases a company's profit margin by reducing its cost of doing business, it does not follow, *ipso facto*, – as the government contends – that such a result satisfies the statutory business nexus element. . . . [I]f the government is correct . . . the FCPA's language that expresses the necessary element of assisting [in] obtaining or retaining business would be unnecessary, and thus surplusage – a conclusion that we are forbidden to reach.

In short, although the court settled any questions as to the scope of the FCPA and whether the law was only intended to prohibit bribes in relation to contact retention, it also established a class of bribe payments which would not, per se, violate the statute. Specifically, where bribe payments have the effect of increasing a defendant's profit margins, without further allegations that the increased profits were used to obtain or retain business, the illicit payments would not constitute a violation of the FCPA.

II. *Panalpina*

The issue of reduced tax liability and customs duties arose again in a group of cases from 2010 related to bribery schemes executed by the international freight forwarding and logistics company Panalpina Inc., on behalf of various oil and gas companies with operations around the world. In *Panalpina*, the freight forwarder paid bribes to various tax and customs officials to reduce tax and regulatory liabilities associated with transporting its customers' equipment and freight across borders. These savings were passed along to Panalpina's customers, many of whom cooperated with the scheme and knew that funds they supplied to Panalpina would be used as bribes. As part of an industry sweep, not only was Panalpina charged with violating the FCPA, Panalpina's various customers were also alleged to have violated the law by using Panalpina as a conduit for bribe payments as well as making their own improper payments to foreign customs and tax officials.

In the government's case against Panalpina, the enforcement agencies alleged facts sufficient to show that the reduction in customs duties and tax liability helped Panalpina retain business from its various customers. However, in a number of cases, the charges levied against Panalpina's customers failed to link the reduction of customs duties and tax liabilities to obtaining or retaining business for those companies. For example, in the case against Pride International Inc., the DOJ alleged that improper payments (through Panalpina) were made to Mexican customs officials "to avoid taxes and penalties for alleged violations of Mexican customs regulations." The SEC's allegations against Pride International also included bribes paid to an Indian customs, excise, and service tax judge in exchange for favorable rulings. Similarly, in the SEC's case against GlobalSantaFe, the enforcement agency alleged that the company made bribe payments in excess of several hundred thousand dollars to Nigerian customs officials to avoid customs regulations, saving the company millions of dollars in operating costs and generating significant revenues. In both instances, the DOJ and SEC failed to allege precisely how the companies' increased profitability assisted them to obtain or retain business.

III. *Layne Christensen*

The SEC's case against Layne Christensen demonstrates that the government continues to follow the practice seen in the *Panalpina* cases, treating the "business nexus requirement" as a seemingly unnecessary feature of the FCPA. In setting forth its allegations in a cease-and-desist order procured through an administrative proceeding, the SEC stated:

> Layne Christensen violated Section 30A of the Exchange Act by paying bribes, through its wholly-owned subsidiaries and their agents, to foreign officials in multiple African countries in order to obtain or retain business. From 2005 through 2010, with knowledge and approval of one of its corporate officers, Layne Christensen paid over $1 million in bribes to foreign officials in order to, among other things, obtain favorable tax treatment, customs clearance for its equipment, and a reduction in customs duties. Layne Christensen funded many of these improper payments by transferring money from its US bank accounts to its wholly-owned subsidiaries who, in turn, funneled cash to foreign officials through agents that the subsidiaries retained.

Strikingly, short of simply parroting the language of the statute, the SEC made no effort to allege facts as to what specific business was obtained or retained as a result of the reduced tax liability and customs duties. Such a pleading is clearly at

odds with the Fifth Circuit's opinion in *Kay* which stated that while bribes in exchange for increased profitability *could* violate the FCPA, they would not, *per se*, constitute criminal conduct without an allegation that the increased profits were used to obtain or retain business.

IV. *Conclusion*

Such seemingly deficient pleadings result in lingering questions concerning the DOJ's and SEC's approach to the business nexus element of the FCPA. In fact, the 2012 FCPA Guide, prepared by the DOJ and SEC, states: "bribe payments made to secure favorable tax treatment, to reduce or eliminate customs duties . . . satisfy the business [nexus] test." Such comments, combined with *Panalpina* and *Layne Christensen*, all but solidify the understanding that the DOJ and SEC fundamentally believe that bribes which increase a defendant's profitability, *per se*, "assist in obtaining or retaining business"—in direct opposition to *Kay*

Whether the DOJ's and SEC's approach to the business nexus element of the FCPA stems from a misinterpretation of Fifth Circuit's opinion or an active attempt to challenge *Kay* remains to be seen. Nevertheless, the lack of clarity ultimately disadvantages defendants who may be pressured to settle charges over conduct which does not necessarily constitute a crime.

Whether right or wrong, the breadth of the government's approach means that companies will have to remain vigilant in preventing and detecting bribery in all circumstances, even where the connection to obtaining or retaining business may be tenuous at best. Developing and implementing effective compliance programs and responding appropriately to potential violations will remain key to limiting a company's exposure to potential criminal or civil liability. However, in the event a factual scenario such as the one seen in *Layne Christensen*, the *Panalpina* cases, and *Kay* presents itself, companies may have an additional card to play when negotiating a settlement.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069