

The Foreign Corrupt Practices Act



**Recent Enforcement Activity and  
Compliance Developments**

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**Overview of Program**

- Overview of the Foreign Corrupt Practices Act
- Update on Enforcement Trends and Their Implications for Companies and Their Foreign Operations
- Monitoring a Global Anti-Corruption Program: An In-House Perspective
- Discussion of Real World Hypothetical Situations

## Overview of the Foreign Corrupt Practices Act

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### FCPA History

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- Foreign Corrupt Practices Act of 1977
  - December 20, 2007 marked the 30<sup>th</sup> anniversary
  - Amended in 1988 and 1998
  - Passed following Congressional hearings addressing corporate slush funds, illegal campaign contributions and international bribery
  - Securities and Exchange Commission reported in 1976 that 95 companies voluntarily disclosed questionable or illegal payments
  - First aggressive anti-bribery statute among developed nations

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## FCPA Elements: Anti-Bribery

- Anti-bribery elements:
  - Offer, payment, promise or authorization to pay
  - Anything of value
  - To any foreign official
  - For purposes of influencing any act or decision
  - In order to obtain or retain business

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## FCPA Elements: Anti-Bribery (cont.)

- Bribe payments may result in criminal or civil charges
- Exception: Small “grease” payments to facilitate routine activities are not prohibited:
  - Example: Obtaining permits, licenses or other official documents to qualify a person to do business in a foreign country
- Affirmative defense for reasonable and bona fide expenditures, such as travel and lodging

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## FCPA Elements: Accounting Provisions

- Section 13 of SEA – the “Books and Records” Provision
- Broader scope and purpose than preventing corporate slush funds and other bribery practices; no allegations of bribery are required
- Accounting Provisions Requirements
  - Maintain accurate books and records; and
  - Devise and maintain a system of internal accounting controls
  - “Knowingly” falsifying any book, record or account may result in criminal prosecution

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## Jurisdiction: FCPA Anti-Bribery Provisions

- Domestic
  - All US “issuers” and private companies (“domestic concerns”) using instrumentalities of interstate commerce
  - Any US corporation or national for any foreign bribery-related conduct
- Foreign
  - Foreign corporations subject to SEC regulation (e.g., via ADRs) and using instrumentalities of interstate commerce
  - All foreign corporations when in US territory, whether or not they use instrumentalities of interstate commerce
- Includes directors, officers, employees, and agents of entities subject to the statute

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## Jurisdiction: FCPA Accounting Provisions

- US public companies; and
  - Foreign subsidiaries where Issuer has majority equity ownership
    - Chiquita Brands
    - Dow Chemical
  - “Good faith” effort required to ensure compliance by foreign affiliates (<50%)
- Foreign companies with ADRs listed on US exchanges

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## Who Enforces the FCPA

- Criminal violations prosecuted by the Department of Justice (DOJ)
- Civil violations enforced jointly by Securities and Exchange Commission (SEC) and DOJ
  - DOJ enforces against firms/persons where SEC lacks jurisdiction, such as “domestic concerns”
- Close coordination between SEC and DOJ
- Increasing international focus on coordination between US and international authorities
  - International Conventions
  - Multilateral investigations
  - International financial institutions rules

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## Penalties: Criminal and Civil

- Corporate sanctions:
  - Fines of up to \$2 million for each violation of the anti-bribery prohibition
  - Fines of up to \$25 million for violation of accounting provision
  - Record \$44.1 million monetary sanction (*Baker Hughes*)
  - Disgorgement of proceeds associated with improper payments
  - Injunction to prevent future violations
  - Suspension and debarment

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## Penalties: Criminal and Civil (cont.)

- Individual sanctions:
  - Up to \$250,000 per criminal violation
    - Government prohibits indemnification for fines
  - Up to 5 years imprisonment
    - Recent sentences: 36 months, 18 months, 6 months
  - Equitable remedies: injunction, bar from serving as director or officer

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## How Bribes are Paid

- Cash / credit
  - Direct cash payments:
    - Slush funds
    - Contractual relationships
    - Petty cash
  - Credit to third party – pools funds for later distribution to government officials
- Other things of value
  - Payments for fictitious goods or services
- False invoices to generate funds
- Family members of government officials
  - Spouses, children, cousins

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## How Bribes are Paid (cont.)

- Consultants / third parties / intermediaries
  - Special consultants or standard professional service providers may pay a portion of their fee to government officials
  - Liability even for payments made without the knowledge of the corporation
- Kickback schemes
  - Contract award may contain kickback components operating as payments to government officials
    - Example: Iraq UN Oil-for-Food Program

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## Importance of Corporate Compliance Policy

- Deter and prevent potential violations
- Detect and mitigate actual violations
- Reduce potential exposure
  - ABB Ltd. (2004: \$16.4 million)
  - Titan Corp. (2005: \$28.4 million)
  - Vetco Gray (2007: \$26 million)
- Suspension or debarment from government contracting
- Sarbanes-Oxley Act of 2002

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## Top Ten Elements of an Effective Compliance Program

1. Instill a corporate culture of compliance
2. Issue a written compliance policy
3. Promulgate specific compliance measures
4. Assign senior oversight and implementation responsibility
5. Provide training and ready access to legal advice
6. Require periodic self-certification of compliance
7. Maintain compliance records
8. Apply disciplinary measures as appropriate
9. Conduct periodic internal and external compliance audits
10. Adjust the compliance program to current risk assessment

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## Due Diligence: Mergers & Acquisitions

- Due diligence: the rationale
  - The spectre of successor liability
  - The opportunity to resolve potential liabilities
  - The determination of transaction structure and value
  - The assessment of corporate integration issues
  - Proposed Lockheed – Titan merger: scuttled
- Due diligence: the process
  - Risk assessment
  - Compliance assessment

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## Due Diligence: Third Party Intermediaries and Joint Venture Partners

- Agents, third party consultants and potential joint venture partners
- Due diligence before engagement
- Written contract
  - Agree to comply with FCPA
  - Document all payments
  - Audit rights
  - Certificate of compliance

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## Update on Enforcement Trends and Their Implications for Companies and Their Foreign Operations

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### Update

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- Trends
- Increased enforcement activity
- Industry-wide investigations
- Investigations of world-wide activities of single company

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## Recent Enforcement Activity

- September 2007: *“People have to think beyond simple bribes. Any authorization of a payment by an employee or third party to a government official or employee of a state-owned enterprise is illegal.”*

~ Mark Mendelsohn  
Deputy Chief, DOJ Fraud Section

- More resources dedicated to FCPA investigation and prosecution than ever before
- 2006: 8 criminal prosecutions
- 2007: 18 criminal prosecutions
- Current status:
  - Over 50 open FCPA investigations
  - Industries under scrutiny include: Petrochemical, telecom, insurance, aerospace, oil exploration, agriculture, and pharmaceutical

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## 2007 – Year in Review

- *El Paso Corp.* – February 7, 2007
  - Amount of alleged bribes: approx \$5.5 million
  - Financial penalties: \$7.65 million (\$5.4 million in disgorgement and a \$2.25 million civil penalty).
- *Baker Hughes Inc.* – April 26, 2007
  - Amount of alleged bribes: \$15.4 million
  - Financial penalties: \$44 million (about \$22 million for disgorgement and pre-judgment interest, a \$10 million civil penalty for violating a prior cease-and-desist order, and an \$11 million criminal fine).
- *Delta & Pine Land Co.* – July 26, 2007
  - Amount of alleged bribes: \$43,000
  - Financial penalties: \$300,000 civil penalty

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## 2007 – Year in Review (cont.)

- *Textron Inc.* – August 23, 2007
  - Amount of alleged bribes: about \$650,000
  - Financial penalties: \$4.5 million (over \$3 million in disgorgement and pre-judgment interest, an \$800,000 civil penalty, and a \$1.15 million fine).
- *Bristow Group, Inc.* – September 26, 2007
  - Amount of alleged bribes: over \$423,000
  - Financial penalties: Nil.
- *York International Group* – October 1, 2007
  - Amount of alleged bribes: about \$7.5 million
  - Financial penalties: \$22 million (over \$10 million in disgorgement and pre-judgment interest, a civil penalty of \$2 million, and a \$10 million fine).

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## 2007 – Year in Review (cont.)

- *Ingersoll-Rand Co. Ltd.* – October 31, 2007
  - Amount of alleged bribes: over \$1.5 million
  - Financial penalties: \$6.7 million (over \$2.2 million in disgorgement and pre-judgment interest, a \$1.95 million civil penalty, and a \$2.5 million fine).
- *Chevron Corp.* – November 14, 2007
  - Amount of alleged bribes: over \$20 million
  - Financial penalties: \$30 million (\$25 million in disgorgement, a \$3 million civil penalty, and a \$2 million penalty to the Office of Foreign Asset Controls of the US Department of Treasury).

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## 2007 – Year in Review (cont.)

- *Akzo Nobel NV* – December 20, 2007
  - Amount of alleged bribes: \$280,000
  - Financial penalties: \$2.9 million (over \$2.2 million in disgorgement and a \$750,000 civil penalty).
- *Lucent Technologies* – December 21, 2007
  - Amount of alleged bribes: at least \$1.3 million
  - Financial penalties: \$2.5 million (\$1.5 million civil penalty and a \$1 million fine).

» <http://fcgablog.blogspot.com/>

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## Recent Corporate Settlements

- *ABB / Vetco Gray Cases (2007)*
  - Pair of cases in 2004 and 2007 arising from conduct at Vetco Gray, former UK and US subsidiaries of ABB Ltd., Swiss company
  - Total fines: \$30.5 million in criminal penalties; \$5.5 million disgorgement
  - Key point: Jurisdiction
    - Swiss parent company traded ADRs on NYSE; conduct of UK sub United States
  - Key point: Due diligence in acquisition
    - When ABB sought sale to private equity buyer, due diligence identified continuing FCPA problems
  - Key point: Recidivism
    - Same Vetco Gray sub hit with higher fine in 2007
  - Key point: Prosecution of individuals
    - SEC case against three executives; settled for penalties/disgorgement

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## Recent Corporate Settlements (cont.)

- Baker Hughes (2001)
  - Payments to influence tax or customs treatments in Indonesia or Haiti
  - Key point: “Business Nexus”
    - Broad definition of payments “to obtain or retain business”
    - May include payments to reduce tax obligations
    - Interpretation confirmed by Fifth Circuit in *American Rice* (2004)
    - First joint civil action by SEC and DOJ

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## Recent Corporate Settlements (cont.)

- Baker Hughes (2007)
  - Payments through agents to obtain oil services business in Kazakhstan
  - Books and records / internal controls violations related to Indonesia, Nigeria and Angola
  - Significant monetary penalty: \$44.1 million
    - \$11 million criminal fine
    - \$33.1 million disgorgement, fine and prejudgment interest
  - Key point: Recidivism
    - Harsher sanctions for repeat offenders

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## Recent Corporate Settlements (cont.)

- Textron Inc. (2007)
  - Initiated as Oil-for-Food investigation, but broadened to include review of improper payments in India, Indonesia, Bangladesh, Egypt and UAE.
  - Key point: Cooperation and voluntary disclosure
    - No criminal charge, and no monitor.
    - Still a total monetary sanction of \$4.65 million

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## Recent Corporate Settlements (cont.)

- York International (2007)
  - Initiated as Oil-for-Food investigation but broadened to include review of payments to obtain government contracts in Bahrain, Egypt, India, Turkey and UAE
  - FCPA violations discovered prior to merger with another company (acquiring company was not name in SEC suit or DOJ filing)
  - Key points:
    - Large monetary sanction: \$22 million
    - Companies closed deal offer providing preliminary report to DOJ and SEC agreeing to continue the investigation and cooperation

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## Recent Corporate Settlements (cont.)

- Travel and Entertainment
  - Lucent Technologies, Inc. (December 2007)
    - Lucent acknowledged spending over \$10 million on approximately 315 trips involving over 1,000 employees of Chinese companies
    - According to the government, Lucent improperly recorded expenses for the trips and failed to maintain adequate internal controls to monitor the travel
    - Joint disposition: SEC civil complaint, \$1.5 million civil penalty, and DOJ non-prosecution agreement (2 years), \$1 million fine

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## Travel & Entertainment – DOJ Opinion Releases

- DOJ opinion releases 07-01 and 07-02
- 07-01 – DOJ concluded it would not take enforcement action against domestic company that wished to cover domestic travel expenses – including transportation, lodging and meals – expected to be incurred by six-person delegation of foreign government visiting requestor's US sites
  - Conduct fell within "promotion expense" affirmative defense
  - Highlights
    - Officials making the trip selected by the foreign government
    - Air transportation was "economy class"
    - Requestor obtained legal opinion that sponsorship and travel did not violate laws of the foreign country
    - Requestor would not provide or host any entertainment or leisure activity
    - Requestor would not pay for expenses of family members or guests of the officials

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## Recent Corporate Settlements (cont.)

- Delta & Pine Land Co. and Turk Deltapine – July 2007
  - From 2001 – 2006, Turk Deltapine made payments of approx \$43,000 to officials in Turkish Ministry of Agriculture and Rural Affairs to influence them in providing company with regulatory approvals.
  - Company learned of payment in 2004; characterized payments as permissible “facilitating payments” and not in violation of the FCPA.
  - In pre-merger due diligence performed by Monsanto, payments came to light. Monsanto required company to report payments to SEC and DOJ.
  - Company paid civil penalty of \$300,000.

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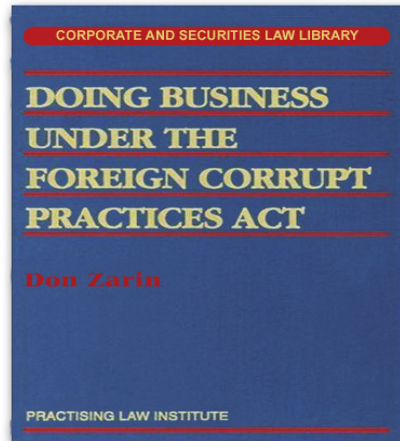
## Five Questions That Can Lead to Effective FCPA Compliance Solutions

1. Are there written controls and procedures covering access to cash, expense reimbursements, commission payments, and other disbursements?
2. Does your internal audit plan include an assessment of your company’s FCPA compliances policies?
3. Has your internal audit department developed a risk assessment for FCPA compliance and an audit plan for the areas of the business facing FCPA risk?
4. Does your company have a stand alone published FCPA compliance policy that has been distributed both domestically and abroad?
5. Does FCPA compliance remain a key focus after a business merger?

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***Doing Business Under the Foreign Corrupt Practices Act***

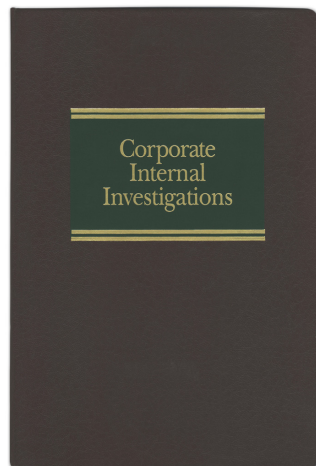
by Don Zarin published by *Practising Law Institute*



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***Corporate Internal Investigations***

by Dan K. Webb, Robert W. Tarun, and Steven F. Molo  
published by *Law Journal Press*



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http://www.usdoj.gov/criminal/fraud/fcpa



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http://www.oecd.org



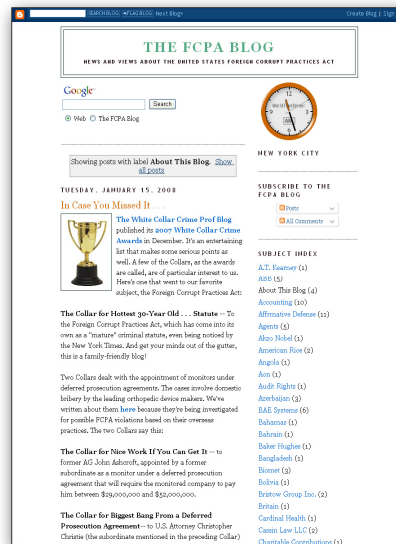
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http://www.transparency.org



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Monitoring a Global Anti-Corruption and  
Compliance Program: An In-House  
Perspective

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## Baxter International Inc.

- At Baxter, one of our primary goals is to save and sustain lives worldwide.
- Every day, our products and services help treat thousands of people around the world with some of the most complex conditions — from hemophilia to cancer and immune disorders to kidney disease.



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## Company Snapshot

- More than 75 years of market leadership driven by a well-recognized global brand
- \$10.4 billion global market leader
- More than \$1.5 billion invested in R&D every day
- Over 50% of sales outside the United States
- Approximately 70% of sales from products with leading market positions



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## Global Presence

- More than 45,000 employees around the world in more than 250 facilities
- Manufacturing facilities worldwide
- Local expertise drives competitive advantage in more than 100 countries



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## Baxter FCPA Compliance Program Snapshot

1. Policies
2. Training
3. Compliance Assessments

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## Compliance Assessment Goals

- Ensure sustainable business model
- Make conscious, informed decisions on risk profile
- Improve efficiency of operations and controls
- Identify educational opportunities
- Share best practices across regions and world

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## Compliance Assessment Process

1. Understand Business
  - Interviews
  - Audit documentation
2. Analysis
  - FCPA / Applicable local laws
  - Baxter policies
3. Design Remedial Measures (where necessary)
  - Remedial Measures designed in conjunction with local management
4. Execute

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## Panel Discussion

- Creating a top down compliance culture
- Challenges doing business overseas
- Internal challenges in creating a culture of compliance
- Managing FCPA compliance for corporations with multiple but divergent business units
- Resources, tools and techniques to maintain an anti-corruption compliance program
- Role of audit committees in creating a compliance program
- Role of the legal department in creating and maintaining a compliance program
- Role of the compliance department in creating and maintaining a compliance program
- Real world compliance issues faced by in-house counsel
- Gifts, entertainment, and travel

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## Fact Patterns / Practice Tips

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## Fact Pattern – Facilitation Payments

- Houston based, NYSE-listed company, seeks drilling license renewal in Brazil
- Entitled to license renewal upon application, with nominal fee (less than \$1,000)
- Local consultant assisting with renewal application reports that government official found paperwork deficient and requires \$10,000 payment to approve the license
- License important to continue business in country
- Outside counsel advises that the exception for facilitation payments might apply where an approval requires no discretion, but that under this circumstance, needs to consult FCPA expert
- Country manager and Houston-based in-house counsel decide that this is a permissible “grease” payment and authorize payment to the consultant without seeking counsel
- Consultant’s invoice booked as “Consultant Services Rendered”

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## Facilitation Payments

- Specifically permitted under FCPA 15 U.S.C. §§ 78 dd-1(b), -2(b), -3(b), -(f)(3)(A)
- Anti-bribery provisions do not apply “to any facilitating or expediting payment to a foreign official, political party, or party official, the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official...”
- Specific exceptions:
  - Obtaining permits, licenses to do business
  - Processing government papers – visas
  - Police protection, mail delivery
  - Phone service, power, water supply, loading/unloading cargo, perishable products

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## Facilitation Payments

- DOJ steadfast in refusal to define grease payments
- You know it when you see it
  - Amount – Rule of thumb: less than \$1,000
  - Key factor: Purpose of payment – Is it truly ministerial?
    - Reduce a customs/tax obligation
    - Licenses/permits/registrations tantamount to obtaining/retaining business
    - Were you clearly entitled?
    - Where is \$\$ going?
- Example: *US v. Vitusa Corporation*
- Don't forget local law
- Business Nexus Rule – *US v Kay; SEC v. Baker Hughes*

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## Fact Pattern – Intermediaries

- Europe-based oil services firm maintains offices in Houston
- Team seeking oilfield development concession in Kazakhstan convenes a conference call among Europe, Astana and Houston
- Astana-based employee reports on a consultant that may assist securing the concession:
  - Little experience in the oil services industry, but well-connected politically
- Houston-based employee directs immediate retention of the consultant, including payment of significant retainer

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## Checklist for FCPA Compliance on Retention of International Intermediaries

- Retention process
  - Application, questionnaire and references
  - Prior experience
  - Background check
    - Financial Arrangements
    - Company Contact
    - Prior Work with Company
  - Embassy review
  - Written recommendations by business people and division management
  - Personal interview of consultant by compliance official outside division
  - Retention above division
  - Approval of management
  - Media search
  - Memorialize review process

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## Red Flags

- It is a red flag if your agent, distributor or representative
  - Has been accused of improper business practices
  - Has influence on buying decision and reputation for bribes
  - Has a family or other relationship that could improperly influence customer's decision
  - Approaches you near decision time and explains that he/she has "special arrangement" with an official
  - Insists on receiving commission payment before awarded decision
  - Requests that commissions or other payments be made in a third country or to another name
  - Asks for unusually large commission or other payments
  - Is "requested" by a specific customer

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## Red Flags II

- High risk countries – Transparency International Corporation Perception Index
- Experience and expertise in the business line
- Intermediary does not have adequate staff in size, experience, expertise
- Application has misrepresentation/inconsistencies
- Intermediary requires payment in cash or bearer bonds
- Intermediary uses shell corporations for payment
- Intermediary will not use written agreement, only oral agreement
- Intermediary requires vague description of scope of work
- Intermediary worked in same government office previously
- Intermediary has family members in government office
- Intermediary has financial relationship (past or present) with government official
- Intermediary was recommended by government official
- Intermediary refuses training or other standard contract terms
- Intermediary refuses to prepare monthly activity reports
- Reputation in business community
- Past legal problems

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## What Type of Information Is Required?

- A due diligence review should contain
  - Detailed company information
  - Business and technical qualifications
  - Company ownership and management
    - Does a government official have an ownership interest?
  - Family relationships of individuals, owners or managers
  - CVs
  - At least, 3 independent business references
  - Review of employees and third parties
  - Disclosures of private bankruptcies or law suits
  - Media search

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## Contractual Safeguards

- Contractual safeguards should include language to ensure that a Third Party:
  - Is not a foreign official or affiliated or related to a foreign official
  - Understands and will abide by FCPA, OECD and local law
  - Has not previously engaged in questionable conduct and will not in the future
  - Prohibition to make improper payment - Transparency
  - Agreeing to comply with Code of Ethics
  - Audit rights to books and records
- Should also include procedural safeguards
  - Mandatory provisions such as: annual compliance certifications; payment restrictions (check/wire only - no third-party payees or countries); termination rights; finite contract term (1-2 years)
  - Suggested provisions such as: notification of change of ownership; no assignments of rights or transferability.

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## Fact Pattern – Joint Ventures

- US-based tech company traded on NYSE (issuer) seeks to enter the Indian market through a 50% joint venture by a U.S. subsidiary (domestic concern) with an established Indian company
- Prior to identifying a specific JV partner, the tech company learns that it is common in India to receive requests for bribe payments to obtain sales licenses.
- Indian partner contributes ongoing contracts, management and personnel to JV
- Once the deal is complete and bribes are paid, does the parent (issuer), or U.S. subsidiary have potential FCPA liability under the anti-bribery or internal controls provisions?
- If domestic concern learns after completion of transaction that Indian JV partner has paid bribes to obtain contracts, is it liable under FCPA?
- Once the tech company identifies one or more potential JV partners, what due diligence is necessary to understand the risk?
- Once the risks are understood, what controls are necessary to manage the risk?

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## Joint Ventures

- Potential liability
- Issuer:
  - Anti-bribery – violation if evidence of knowledge of bribes
  - Internal controls – violation if evidence that issuer did not act in “good faith to use its influence, to the extent reasonable under the issuer’s circumstances to cause such domestic concern or foreign firm to devise and maintain a system of internal accounting controls ... Such circumstances include the relative degree of the issuer’s ownership of the domestic or foreign firm ...”
- Subsidiary – domestic concern
  - Anti-bribery – if sufficient evidence of knowledge
  - Internal controls – these provisions only apply to issuers.

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## Joint Ventures

- DOJ has issued one opinion letter regarding the formation of joint ventures. DOJ Opinion Procedure Release 2001-01.
- Full due diligence of joint venture partner
  - Principals
  - Government Contracts
  - Government licenses
  - Customs duties
  - Tax Obligations
  - Agents/Subcontracts/Distributors/Other intermediaries
  - Compliance program
  - See checklist below
    - Require joint venture partner to make representation of FCPA compliance for all contracts that are contributed to JV
    - Right to terminate JV agreement in event of discovery of FCPA violations
    - Require termination of any agent who does not satisfy due diligence
    - Enter new agreements with agents with rigorous anti-corruption provisions

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## Due Diligence Checklist for Prospective Joint Venture Partners

- High risk countries
- Evaluate JV partner's compliance program
  - Content
  - Training
  - Internal controls
  - Books and records
  - Compliance history
- Review business with government
- Due diligence of third parties on government business
- Public/proprietary databases

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## Fact Pattern – Travel and Entertainment

- US financial institution seeks to underwrite bond offering by the government of Azerbaijan.
- To obtain the underwriting business, government officials solicit travel, gifts and entertainment.
- Trips provided to US
  - Are side trips permitted? Super Bowl? Disney World?
    - Family members?
    - What level of entertainment is permitted? Frequency? Value?
    - What gifts are permitted?

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## Travel and Entertainment

- Affirmative Defense to Anti-bribery violation 15 U.S.C. § 78 dd-1(c)(2):
  - Company is permitted to pay “reasonable and bona fide” expenses of government officials “such as travel and lodging expenses” incurred in connection with either:
    - “Promotion, demonstration or explanation” of products or services
    - “Execution or performance of a contract with a foreign government or agency”
- Right Way: DOJ Opinion Procedure Releases 2007-01, 2007-02
  - Government officials selected by foreign country
  - Official had no decision-making authority regarding operations in country
  - Payments directly to service provider, not government official
  - Airline economy class
  - Sponsorship for U.S. visit complied with local law
  - No per-diem stipend
  - Reimbursement for incidental daily expenses with receipts
  - Souvenirs are nominal value
  - No expenses for family members
  - Modest tours permitted

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## Travel and Entertainment

- Wrong way: Lucent
  - 315 Trips
  - Value = \$10 million
  - “Side trips:” Las Vegas, Disney World, Hawaii, Niagra Falls
  - Spouses and children included
  - Per diem: \$500 - \$1,000
  - Traded trip for MBA tuition - \$21,000
  - Internal controls violations – lack of training
  - Books and records violations – “Factory Inspection Account” without factory tours.

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