

FCPA Update: Mid-Year 2014

The first half of 2014 has seen a number of significant developments for enforcement of the US Foreign Corrupt Practices Act (“FCPA”) and other anti-corruption laws around the globe. Although the number of US enforcement actions so far this year is below last year’s count, the US Department of Justice (“DOJ”) and US Securities and Exchange Commission (“SEC”) both continue to secure high-profile and large-dollar resolutions against corporations while they continue focusing on holding individuals responsible. Additionally, the year so far has also seen an increase in the activity of foreign regulators and the growth of international cooperation in investigating and prosecuting anti-corruption cases.

US Eleventh Circuit’s *Esquenazi* Case Defines “Instrumentality” Under the FCPA

In perhaps the most significant legal development in the first half of 2014, on May 16 the US Court of Appeals for the Eleventh Circuit became the first federal appeals court to provide guidance on the meaning of the term “instrumentality” as it is used in the FCPA. The FCPA prohibits the bribery of “foreign officials,” which term is defined as “any officer or employee of a foreign government or any department, agency, or *instrumentality thereof*.” The DOJ and SEC have long pursued FCPA cases under a broad definition of “instrumentality.”

The case involved two former executives of Terra Telecommunications Corp., who were found

guilty for their roles in a scheme to bribe officials at Haiti’s state-owned telecom company, Haiti Teleco. The defendants argued that “instrumentality” should be limited to entities that perform “traditional, core government functions,” and that, therefore, Haiti Teleco did not qualify as an instrumentality of Haiti’s government.

The Eleventh Circuit disagreed, instead holding that an instrumentality is any entity (i) “controlled by the government of a foreign country” (ii) “that performs a function the controlling government treats as its own.” Applying this two-part test, the court noted that what constitutes “control” or “a function the government treats as its own” are fact-based questions. While the court noted that “[i]t would be unwise and likely impossible to exhaustively answer them in the abstract,” it went on to provide a non-exclusive list of “some factors that may be relevant” to deciding those issues.

First, to decide if the government controls an entity, the court offered the following list of factors: (i) the foreign government’s formal designation of that entity; (ii) whether the government has a majority interest in the entity; (iii) the government’s ability to hire and fire the entity’s principals; (iv) how the entity’s profits and losses are managed; and (v) the length of time these factors have existed.

With respect to the second part of the two-part test—whether the entity “performs a function the government treats as its own”—the court held the inquiry should focus on whether: (i) the

entity has a monopoly over the function it exists to carry out; (ii) the government subsidizes the costs associated with the entity providing services; (iii) the entity provides services to the public at large in the foreign country; and (iv) the public and the government of that foreign country generally perceive the entity to be performing a governmental function.

Applying these four factors, the Eleventh Circuit held that the evidence was sufficient to support the jury's conclusion that Haiti Teleco was an instrumentality. In making its ruling, the court focused on several facts, including: (i) Haiti had granted Teleco a monopoly over telecommunications service and gave it various tax advantages; (ii) Haiti's national bank owned 97 percent of Teleco; (iii) Haiti's President chose Teleco's director general and appointed all of its board members; and (iv) the government offered expert testimony that Teleco belonged "totally to the state," "was considered ... a public entity" and "government, officials, everyone consider[ed] Teleco as a public administration."

The Value of Cooperation—Divergent Outcomes for Alcoa, HP and Marubeni

FCPA resolutions with Alcoa and Hewlett-Packard highlight the value prosecutors place on cooperation; both were able to pay fines well below the US Sentencing Guideline ("Guidelines") range due in part to their affirmative disclosures and extensive cooperation. On the other hand, Marubeni Corporation, which previously entered into a DPA for FCPA violations in 2012, agreed to pay a mid-Guidelines penalty of \$88 million after, according to the DOJ's press release, the company "refused to cooperate with the government's investigation."

Alcoa. The year started with the January 9, 2014 announcement of DOJ and SEC settlements with Alcoa Inc., the Pennsylvania-based aluminum giant and its majority owned sales company Alcoa World Alumina LLC ("AWA"). AWA pled guilty to anti-bribery

charges. The plea agreement's statement of facts describes AWA's participation in a scheme to pay commissions to a London-based consultant, from which the consultant paid more than \$110 million in bribes over a 20-year period to government officials in Bahrain, including members of the royal family, in order to maintain a key source of business.

The Alcoa companies agreed to a \$384 million penalty to resolve the DOJ and SEC actions, as well as committing to implement an enhanced global anti-corruption compliance program. In addition to the criminal plea by AWA, parent company Alcoa consented to the filing of a settled administrative proceeding charging Alcoa with violating the FCPA's anti-bribery, books and records, and internal controls provisions. The SEC claimed that Alcoa ignored multiple red flags over the life of the arrangement and that company lawyers approved the retention of the consultant without conducting any pre-retention due diligence or ongoing monitoring of the relationship.

The \$384 million in criminal penalties and disgorgement constitutes the fifth-highest combined penalty in FCPA history. While the penalty is indeed large, the DOJ departed significantly from the minimum base fine of \$446 million, as calculated under the Guidelines. The DOJ's press release, the plea agreement and related court filings all expressly credited Alcoa for its voluntary disclosure in 2008, its use of independent outside counsel reporting to a special board committee to investigate the allegations, its regular updates to the government and its efforts to voluntarily make employees available to the DOJ for interviews. The DOJ noted that Alcoa accepted responsibility for its misconduct and implemented remedial measures, including bolstering the company's compliance team and implementing improved due diligence and contracting procedures for third parties.

It is also noteworthy that the DOJ allowed the parent company, Alcoa, to escape a criminal

charge, NPA or DPA—the DOJ instead charged Alcoa’s subsidiary, AWA. Nevertheless, the plea agreement included binding obligations for Alcoa in several respects, including undertaking significant compliance improvements.

Although there was no allegation that an employee, officer, or director of Alcoa participated in, or even knew about the improper payments made by its subsidiaries, the parent company was held liable for FCPA violations under purported “agency” principles. The Alcoa resolution may be seen as a step towards a “strict liability” FCPA regime for parent companies.

Hewlett-Packard (HP). On April 9, California-based HP and four of its international subsidiaries agreed to a total payment of more than \$108 million to resolve allegations that the subsidiaries bribed officials in Russia, Poland and Mexico. HP’s Russian subsidiary pled guilty to four FCPA counts for creating an off-the-books slush fund to conceal over \$10 million in illegal payments to shell companies for the benefit of Russian officials in order to win contracts with the Office of the Prosecutor General of Russia. HP’s Polish subsidiary entered into a DPA to settle FCPA charges in connection with a contract with the Polish national police agency worth \$60 million. In that matter, the subsidiary allegedly paid bribes worth more than \$600,000 in gifts, travel and entertainment. And HP’s Mexican subsidiary entered into a NPA related to corrupt payments made to officials of Mexico’s state-owned oil company, Pemex, through a consultant retained for a \$1.41 million “commission.” These payments were hidden by inserting into the deal structure another third party, which HP had approved as a channel partner. HP Mexico paid the channel partner, which then forwarded the money to the consultant. The consultant ultimately paid \$125,000 in “influencer fees” (as described by HP Mexico Sales Managers at the time) to an entity controlled by Pemex’s Chief Information Officer. The parent company

resolved a separate SEC matter for violations of the FCPA’s internal controls and books and records provisions.

In total, the HP entities agreed to pay approximately \$76.8 million in criminal penalties and \$31.5 million in disgorgement and interest. As part of its subsidiaries’ criminal resolutions, HP also committed to implement an enhanced global anti-corruption compliance program. Like Alcoa, HP received a significant discount based on its “extensive” cooperation. HP’s criminal fine, totaling \$15.45 million, was approximately 25-30 percent below the Guideline range of \$19-38 million, and the Polish and Mexican subsidiaries avoided prosecution based on their extensive cooperation, compliance enhancements, disciplinary steps and other remedial measures. And like Alcoa, the resolution notably did not involve criminal charges of any kind against the parent entity.

Marubeni Corporation. By contrast, the DOJ stressed a relative lack of cooperation from Japanese trading firm Marubeni as a factor supporting a middle-range fine of \$88 million when it announced on March 19 that Marubeni had pled guilty to one count of conspiracy to violate the anti-bribery provisions of the FCPA, and seven substantive bribery counts.

The allegations concerned Marubeni’s role in a scheme to bribe high-ranking Indonesian government officials to secure a \$118 million power project for itself and its Connecticut-based consortium partner, widely reported to be Alstom Power Inc. According to the pleadings, to win the contract, Marubeni paid bribes through two consultants to a member of Parliament and two officials at Indonesia’s state-owned electricity company. The DOJ’s press release discussed employee emails demonstrating that the consultants were hired with the express purpose of bribing foreign officials.

Under the plea agreement, Marubeni agreed to implement an enhanced global anti-corruption

compliance program and to cooperate with the DOJ's ongoing investigation. Marubeni's plea agreement and the DOJ's press release both expressly note Marubeni's failure to disclose and refusal to cooperate, as well as its lack of an effective compliance and ethics program when the offense occurred. The DOJ may have viewed Marubeni's lack of cooperation more negatively because this was the company's second FCPA violation in recent years—in January 2012 Marubeni entered a two-year DPA for its alleged role in the Bonny Island bribery scheme in Nigeria, agreeing to pay a \$54.6 million criminal penalty, retain an independent compliance consultant and enhance its compliance program.

Corporate Declinations in the First Half of 2014

While the DOJ and the SEC do not generally publicly report when they close an investigation without pursuing charges, in the first half of 2014, at least four companies reported that authorities closed an FCPA investigation without taking action:

- **Lyondell Basell Industries N.V.**, a multinational chemical company, announced in a Feb. 2014 SEC filing that in March 2010 it voluntarily disclosed to the DOJ an agreement related to a former project in Kazakhstan involving a \$7 million payment that had raised compliance questions within the company. The company reported that in January 2014 DOJ informed the company that it “had closed its investigation into this matter” and “[n]o fine or penalty was assessed.”
- **Baxter International.** The Illinois-based pharma company reported in a February 2014 SEC filing that both the DOJ and the SEC had closed their investigations into payments made by a Chinese joint venture operated by the company. According to accounts published in the Wall Street Journal, Baxter disciplined the venture's leadership, conducted additional compliance training

and enhanced its internal controls. The government declined to take any further action.

- **SL Industries Inc.** of New Jersey reported in its March 2014 annual report that the DOJ was closing an investigation into gifts and entertainment provided to government officials by three of its Chinese subsidiaries. SL Industries also reported that the company hired an outside consultant to implement an FCPA compliance program to be completed annually by all employees and engaged outside consultants to perform annual compliance tests. The SEC has not indicated the status of its inquiry.
- **Smith & Wesson.** The Massachusetts based firearms maker announced in June 2014 that the DOJ had ended an investigation into the company's operations in Africa that started with a sting operation in 2010. The company's former VP of sales was one of 22 individual defendants swept up in the 2010 sting and ultimately exonerated in 2012 when DOJ dismissed the charges and ended the prosecution after three co-defendants were acquitted and the jury deadlocked on 10 others. In the SEC filing, Smith & Wesson reported that the DOJ investigation caused the company “to make substantial changes in our foreign sales personnel and foreign representatives, modify our processes, and cease sales in certain foreign countries.” In the same disclosure, the company reported that a resolution with the SEC is “close.”

Continued Focus on Individual Prosecutions

Patrick Stokes, Head of the DOJ's FCPA unit, said on March 7, 2014, “Prosecuting individuals as well as institutions is a significant focus for the FCPA unit, and it's a trend that's going to continue.” Consistent with this pronouncement, the DOJ announced FCPA charges against 11 individuals in the first half of 2014. These included charges against two former senior

executives and the former general counsel of British Virgin Islands-based oil & gas company **PetroTiger Ltd.** DOJ alleged that the executives paid more than \$330,000 to an official at a Colombian state-owned oil company in exchange for the approval of a \$40 million oil services contract. Two of the defendants have already pled guilty and one awaits trial.

On April 2, 2014, DOJ announced FCPA and related charges against five foreign defendants associated with British Virgin Islands company **Group DF** in connection with a scheme to bribe government officials in India in order to obtain titanium mining rights. A sixth defendant—a former member of the Indian parliament who allegedly accepted bribes—was charged with RICO and money laundering offenses, highlighting the fact that, although foreign officials fall outside the FCPA’s anti-bribery provisions, there are alternative charging theories under US law. As its jurisdictional basis, the indictment alleges transfers of corrupt payments through US bank accounts, email accounts hosted in the United States, use of cell phones operating on US interstate networks and several meetings held in the United States in contemplation of potential Group DF sales of titanium products to unidentified US-based companies. Thus, these charges demonstrate the DOJ’s willingness to prosecute conduct that does not involve a US issuer or domestic concern where the alleged bribery has some connection to the United States.

This year has also seen more charges announced against former managers of **Direct Access Partners**: former CEO Benito China and Global Markets Group Managing Partner Joseph DeMeneses. We described other prosecutions in this long-running case in our FCPA Update: Year End 2013, available at <http://www.mayerbrown.com/FCPA-Update-Year-End-2013-01-23-2014/>.

Increased Activity by Foreign Regulators

The first half of 2014 saw significant developments in foreign anti-corruption laws and provided reminders that foreign regulators are stepping up efforts to enforce their own regulations and coordinating with US authorities. The DOJ’s press release in the Alcoa resolution indicated cooperation with numerous international agencies, including the UK Serious Fraud Office (“SFO”), the Swiss Office of the Attorney General, Guernsey authorities and the Australian Federal Police. In connection with the HP resolution, DOJ noted the “significant assistance provided by ... the Polish Anti-Corruption Bureau, the Polish Appellate Prosecutor’s Office, the Public Prosecutor’s Office in Dresden, Germany, and ... law enforcement partners in other countries involved in this matter.” And in connection with the Marubeni resolution, the DOJ noted the “significant cooperation provided by ... law enforcement colleagues in Indonesia at the Komisi Pemberantasan Korupsi (Corruption Eradication Commission), the Office of the Attorney General in Switzerland and the [SFO].”

There has also been an increase in anti-corruption enforcement by foreign authorities in their own rights. By way of example, on July 14, 2014, the UK’s Serious Fraud Office announced that it had launched a formal criminal investigation concerning allegations of bribery related to the construction of a hospital in Morocco by a UK-based company, Sweett Group. The Polish Anti-Corruption Bureau and German prosecutors announced individual prosecutions of HP employees in connection with the allegations resolved by HP in the United States. In May 2014, Canadian authorities won the first prison sentence for a defendant convicted under Canada’s anti-bribery law, the Corruption of Foreign Public Officials Act. And, as has been widely reported in the press, Chinese authorities are in the midst of a significant crackdown on domestic corruption.

One of the most significant foreign legal developments was Brazil's new anti-bribery law, known as the "Clean Company Act," which went into effect on January 29, 2014." We discussed this significant development in our August 7, 2013 Legal Update, "Brazil's New Anti-Corruption Legislation" available at <http://www.mayerbrown.com/Brazils-New-Anti-Corruption-Legislation-08-07-2013/>.

Also significant are two recent developments that strengthen the United Kingdom's enforcement of its Bribery Act. In January, the Sentencing Council for England and Wales issued sentencing guidelines for the punishment of offenses under the Bribery Act that include provisions specifically covering corporations. In February, the SFO formally adopted principles that authorize it to negotiate DPAs with corporations. This guidance was highly anticipated, and may suggest a new era in the United Kingdom's treatment of Bribery Act enforcement.

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