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Clarifying Travel and Entertainment Under the FCPA

On Dec. 21, 2007, in one of the rare standalone travel and entertainment Foreign Corrupt Practices Act (the FCPA) cases, the Securities and Exchange Commission (SEC or the commission) and the Department of Justice (Justice Department) filed and settled charges against Lucent Technologies Inc. (Lucent), a wholly-owned subsidiary of Alcatel-Lucent, a French company with headquarters in Paris.

Lucent was alleged to have violated the books and records and internal controls provisions of the FCPA by authorizing and failing to properly record $10 million in travel and related expenses, for approximately 1,000 Chinese foreign officials who were employees of Chinese state-owned or state-controlled telecommunications enterprises (collectively, SOE). With the exception of the *Metcalf & Eddy Inc.* case, the author is unaware of any other prominent FCPA enforcement action that is focused solely on travel and entertainment practices.[1] Perhaps fittingly, with the *Lucent* settlement, the commission and the Justice Department closed 2007 with yet another landmark case in the FCPA enforcement area.

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Record-Breaking Year

In what can be fairly described as a record year for FCPA enforcement, the commission and the Justice Department combined to celebrate the 30-year anniversary of the FCPA by breaking all previous enforcement records.

First, the commission and the Justice Department combined to file a record 18 cases in 2007.

Second, in February 2007, the Justice Department imposed a record $26 million criminal fine against three wholly owned subsidiaries of Vetco Gray International companies, Vetco Gray Controls Inc., Vetco Gray Controls Ltd., and Vetco Gray UK Ltd (collectively, Vetco Gray).[2]

Third, in April 2007, the commission and the Justice Department imposed a record $44 million in combined civil and criminal penalties against Baker Hughes Inc.[3]

Fourth, the commission and the Justice Department commenced an unprecedented industry-wide investigation against oil and oil services companies with ties to Panalpina World Transport (Holding) Ltd. (Panalpina). Panalpina is believed to be the "major international freight forwarder and customs clearance agent" that was referenced in the criminal information filed against Vetco Gray.

Fifth, in what is conceivably the largest international anticorruption investigation ever, the United Nations Oil-for-Food Program (OFFP) investigation conducted by the former chairman of the Federal Reserve, Paul Volcker, implicated 2,253 companies worldwide and $1.8 billion in alleged "kickbacks" to the Iraqi regime of Saddam Hussein.[4] The OFFP investigation, with follow-on investigations by the Justice Department, the commission, two U.S. Attorney's offices, four congressional committees, the Manhattan District Attorney's Office, the Department of Treasury's Office of Foreign Asset Control, the United Nations, and at least six foreign governments, to date, has led to four Justice Department and six commission FCPA actions in 2007 alone.

Sixth, 2007 also saw the government up the stakes in FCPA enforcement by filing an unprecedented 15 cases against individuals; by a country mile, the largest number of individual prosecution in any one given year in the entire 30-year history of the FCPA.

Seventh, the SEC and Justice Department made inroads in confirming the extensive jurisdictional reach of the FCPA. For example, foreign subsidiaries of U.S. issuers that were expressly excluded from the FCPA, can now be brought in as "agents" of U.S. issuers.[5]

Last, the ongoing investigations of Siemens AG and British Aerospace also demonstrate the extensive reach of the FCPA.

'Lucent' Settlement

According to the Justice Department's nonprosecution agreement, and the commission's settled civil injunctive action, from 2002 to 2003, Lucent allegedly spent over $10 million in travel, lodging, entertainment and related expenses for approximately

1,000 employees of Chinese SOE to which Lucent was seeking to sell its equipment and services, or from which Lucent was seeking business. *SEC v. Lucent Tech. Inc.*, Civ. Act. No. 1:07-cv-02301 (D.D.C. filed Dec. 21, 2007); Litigation Release No. 20414 (Dec. 21, 2007); DOJ Press Release 07-1028, "Lucent Technologies Inc. Agrees to Pay $1 Million Fine to Resolve FCPA Allegations" (Dec. 21, 2007).

The traveling SOE employees, who qualify as foreign officials under the FCPA,[6] were identified as "decision makers" with respect to the awarding of new business for which Lucent was bidding or planned to bid. Id. at 1. Ostensibly, the purpose of the approximately 315 trips were for the SOE employees to inspect Lucent's factories and to train in using Lucent equipment.

In reality, however, the SOE employees visited tourist destinations throughout the United States, such as Hawaii, Las Vegas, the Grand Canyon, Niagara Falls, Disney World, Universal Studios, and New York City, where the Chinese officials spent little or no time visiting Lucent's facilities. Id. at 6. In fact, some of these trips were to cities where Lucent did not have factories. Id. at 12.

Employees of Lucent China, a Lucent subsidiary, based in Lucent's New Jersey headquarters, arranged the trips' itineraries, which were reviewed and approved by Lucent China executives based in China. The approximately 315 trips were generally categorized as either "pre-sale" or "post-sale," depending upon whether Lucent was seeking new business from the SOE (pre-sale visit) or performing obligations under an existing contract (post-sale visit). Id. at 4.

Pre-Sale Trips

Concerning pre-sale trips, Lucent, from 2000 to 2003, allegedly provided about 330 SOE employees of various levels with all-expense paid visits to the United States and elsewhere to participate in conferences or seminars held or attended by Lucent employees, visit Lucent facilities, and engage in sightseeing, entertainment, and leisure activities.

For these trips, Lucent spent more than $1 million on at least 55 pre-sales trips. In one such pre-sale trip, in April 2001, Lucent supposedly paid for six officers and engineers of an existing SOE customer to visit the United States for two weeks in order to negotiate a memorandum of understanding. In its books and records, the April 2001 pre-sale trip, which cost more than $73,000, was described as a "gold[en] opportunity for Lucent to introduce [its] network operation center to [the SOE]" and improperly recorded as "[t]ransportation [i]nternational." Id. at 8.

During the trip, the SOE employees spent five days visiting Lucent facilities and nine days sightseeing to places such as Hawaii and the Grand Canyon. Id. at 11. Other similar trips were improperly recorded as "[s]ervices [r]endered-[o]ther [s]ervices."

Post-sale trips were typically required by provisions in the contracts between Lucent and its SOE customers. These contracts typically obligated Lucent to provide its SOE customers with expense-paid trips to the United States and other countries for "factory inspections" or "training" purposes. Id. at 4. Pursuant to these contracts, from 2000 to 2003, Lucent allegedly spent more than $9 million on approximately 260 post-sale trips for more than 850 individuals. Id.

Certain of these post-sale "factory inspection" trips occurred in countries where Lucent had no existing factories and consisted of entertainment and leisure activities. Id. at 2. Similarly, the "training" visits involved no legitimate training. Id. at 12. For example, in June 2001, Lucent paid for six SOE employees to go sightseeing in Niagara Falls, Las Vegas, and elsewhere as part of a "factory expense" amounting to more than $46,854. This trip was recorded on Lucent's books and records as a "[l]odging" expense.

These pre-sale and post-sale trips were funded through Lucent China's sales department. In booking a trip, a Lucent employee would prepare a "Customer Visit Request Form" that provided information about the proposed trip. The Customer Visit Request Form called for the disclosure of information about the identity of the travelers, the purpose of the trips, information about whether the travelers are "decision-makers" or "decision-influencers," and whether "sightseeing/entertainment" was "required." Id. at 5. Completed Customer Visit Request Forms were then sent to Lucent China executives for approval. Upon approval, Lucent China employees based in Lucent's U.S. headquarters arranged the logistics of the trips.

The nonprosecution agreement, but not the commission's complaint, included allegations that Lucent paid or offered to pay for educational opportunities for relatives or associates of Chinese government officials, some of whom were in a position to influence China's use of Lucent-compatible technologies. These educational opportunities included: (i) payment of over $71,000 to cover tuition and living expenses of an employee of a Chinese government ministry who was obtaining a master's degree in international management from the Thunderbird School of Management Training in Beijing, China; (ii) payment of $21,687 for a deputy general manager of an SOE to obtain an MBA at Wuham University in China; and (iii) providing a paid internship to the daughter of a Chinese government official, who was described in an e-mail as "Lucent's key contact in China," working at the Chinese embassy in the United States. Lucent spent $5,000 to fund the internship and paid the official's daughter's travel expenses, lodging expenses, and a $3,600 stipend.[7]

Government Charges

In authorizing payments for these trips, Lucent, the government charged, violated the books and records and internal controls provisions of the FCPA in that it lacked the proper internal controls to detect and prevent trips intended for sightseeing, entertainment and leisure, rather than business purposes and improperly recorded many of these trips on its books and records. Id. at 2. For example, in addition to improperly recording pre-sale and post-sale trips as "lodging," "[t]ransportation [i]nternational," "[s]ervices [r]endered-[o]ther [s]ervices," over 160 trips were booked to "[f]actory [i]nspection [a]ccount" even though the customers did not visit a Lucent factory at any time during the trip. Id. Allegedly, Lucent's use of these expense, and other, accounts to credit expenses did not conform with the purpose of the account.

Lucent was charged with failure to devise, maintain, and implement a system of internal accounting controls sufficient to provide reasonable assurances that payments were made in accordance with management's general or specific authorization. Id. at 14. Additionally, notwithstanding the fact that the SOE employees were identified by name, organization, and title in the Customer Visit Request Forms, Lucent China's internal controls provided no mechanism for assessing whether any of the trips violated the FCPA. Indeed, Lucent employees allegedly made little or no inquiry into whether the SOE employees were government officials, or whether the Lucent-funded entertainment and leisure activities constituted "things of

value" under the FCPA. Id. at 6.

These violations, the government charged, occurred because Lucent failed to properly train its employees to comprehend and appreciate the nature and status of its Chinese customers under the FCPA. Id. at 2.

Supposedly, this level of improper training and knowledge permeated Lucent's ranks. Indeed, the chairman and president of Lucent China and other Lucent China executives authorized and funded these trips without appropriate oversight. Id. Thus, Lucent lacked the internal controls to detect and prevent trips intended for entertainment and leisure, rather than legitimate business purposes.

Final Judgment

In settling the commission's books and records injunctive action, Lucent, without admitting or denying the allegations in the complaint, consented to the entry of a final judgment permanently enjoining it from future violations of the securities laws, and agreeing to pay a civil penalty of $1.5 million.

In its nonprosecution agreement with the Justice Department, Lucent admitted to all of the alleged conduct, as well as other instances of providing travel opportunities to Chinese government officials, and to the improper recording of those expenses in its corporate books and records. DOJ Press Release 07-1028 (Dec. 21, 2007).

In addition, Lucent agreed to pay a monetary penalty of $1 million to the U.S. Treasury.

The nonprosecution agreement further required Lucent to adopt new, or modify existing, internal controls, policies and procedures so as to ensure that it can make and keep fair and accurate books, records, and accounts.

Additionally, Lucent agreed to implement a rigorous anticorruption compliance code, standards, and procedures designed to detect and deter violations of the FCPA and other applicable anticorruption laws.[8]

Conclusion

An ideal FCPA compliance program designed to detect travel and entertainment-related violations should include mechanisms to: (1) identify the recipient of the company-funded trip and note whether he/she is a foreign government official; (2) if he/she is a foreign government official, ensure that the trip has a legitimate business purpose, and is comprised of business-related activity; (3) confirm that the trip is accurately recorded in the company's books and records; (4) ensure that the trip receives the proper authorization from the company's legal and/or compliance departments; and (5) document the approval process.

Now more than ever, simply implementing these internal controls is not enough. In *Lucent*, it was alleged that a lack of training and education contributed largely to the FCPA violations.

As a result, companies doing business with foreign officials must not only implement rigorous FCPA internal controls, but must be certain that employees with responsibilities for areas that deal with foreign government officials are trained to appreciate the FCPA and its broad scope.

By taking steps to train and educate employees, a company doing business with foreign government officials will be on the road to ensuring FCPA compliance.

In addition, two recent Justice Department opinion releases dealing with the appropriate ways to handle travel and entertainment are instructive. FCPA Op. Proc. Rel. 2007-02 (2007); FCPA Op. Proc. Rel. 2007-01 (2007).[9]

Perhaps what is remarkable about the *Lucent* case, and the reason the government was compelled to bring it, was the size of the alleged bribe.

Moreover, the pervasiveness of the illicit conduct was one that the government, in the current environment, could not leave unpunished.

While the *Lucent* case was not charged as a bribery case, the facts as described indicate that the government viewed these payments as bribes. One can only speculate as to how Lucent's remedial measures and cooperation with the government's investigation influenced the settlement.

The *Lucent* settlement also shines a light on noncontroversial issues such as who qualifies as a "foreign official" and what it means to give "anything of value." With respect to who is a "foreign official," the *Lucent* case does not break new ground. It merely confirms that the FCPA broadly defines the term "foreign official."[10] Concerning what qualifies as "anything of value," one can hardly argue that $10 million worth of travel is not something of value.[11]

Along with the recent Justice Department's opinion letters on travel and entertainment, the *Lucent* settlement should be instructive to companies looking for guidance on how to structure or review their internal policies and procedures with respect to travel, lodging, and entertainment.

1. *United States v. Metcalf & Eddy Inc.*, No. cv-99-12566 (D. Mass. filed Dec. 14, 1999) (alleging unspecified travel advances and accommodation upgrades for the organization's chairman, his wife and two children for two trips to Europe and the United States).

2. "Three Vetco International Ltd. Subsidiaries Plead Guilty to Foreign Bribery and Agree to Pay $26 Million in Criminal Fines," DOJ Press Release No. 07-075 (Feb. 26, 2007).

3. *SEC v. Baker Hughes Inc.*, No. H-07-1408 (S. D. Tex. filed April 26, 2007); see also Litigation Release No. 20094 (April 26, 2007).

4. Independent Inquiry Committee into the United Nations Oil-for-Food Programme, Manipulation of the Oil-for-Food Programme by the Iraqi Regime, available at http://www.iic-offp.org/story27oct05.htm.

5. *United States. v. DPC (Tianjin) Co. Ltd.*, No. CR 05-482 (C.D. Cal. filed May 20, 2005).

6. 15 U.S.C. §78dd-1(f)(1).

7. See Letter from Mark F. Mendelsohn, Deputy Chief, Fraud Section Criminal Division, Dep't of Justice (Nov. 14, 2007) (setting forth the Lucent Technologies Inc. Non-Prosecution Agreement).

8. Id.

9. The only meaningful distinction between the two opinion releases is that one requester indicated that it intended to reimburse incidental expenses incurred by the visiting foreign officials "up to a modest daily minimum, upon presentation of a written receipt," and provide a "modest four-hour city sightseeing tour" for the officials. Compare FCPA Op. Proc. Rel. 2007-02 (2007) with FCPA Op. Proc. Rel. 2007-01 (2007).

10. *SEC v. Srinivasan*, 07-CV-01699 (D. D.C. filed Sept. 25, 2007) (imposing liability where the foreign officials were senior employees of two Indian energy companies that were partly government-owned); *United States. v. Young*, Crim. No. 07-609 (D. N.J. filed July 25, 2007) (defining employees of state-owned telecommunications carriers as foreign officials under the FCPA); *United States v. DPC (Tianjin)*, supra note 7, (classifying physicians and laboratory workers at government-owned hospitals as "foreign official[s]").

11. The term "anything of value" is not defined in the FCPA, and the statute's legislative history is not illuminating. The term, however, has been broadly construed and can include not only cash, but other tangible and intangible benefits given to a foreign official including (as in the *Lucent* matter) the payment of nonbusiness travel expenses. See *United States v. Wooh*, No. 07-CV-957 ST (D. Or. filed June 27, 2007); DOJ Press Release 07-474 (June 29, 2007); *SEC v. Wooh*, No. 07-CV-957 ST (D. Or. filed June 27, 2007); Litigation Release No. 20174 (June 29, 2007) (finding perfume to be a thing of value); see also *United States v. York Int'l Corp.*, No. 07-CV-01750 (D. D.C. filed Oct. 1, 2007); DOJ Press Release 07-783 (Oct. 1, 2007); *SEC v. York Int'l Corp.*, No. 07-CV-01750 (D.D.C filed Oct. 1, 2007); Litigation Release No. 20319 (Oct. 1, 2007) (laptop computers and electronics considered to be "things of value").