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Recent Oil-for-Food Program Cases Show the Government's Willingness to Pursue "Improper" Payments Outside the FCPA's Antibribery Provisions, Call Attention to Foreign Enforcement

In recent months the Department of Justice (DoJ) and the Securities and Exchange Commission (SEC) have continued to bring enforcement actions and seek substantial fines against companies accused of making improper payments in the course of their involvement with the United Nations' Oil-for-Food Program ("OFFP") and the Government of Iraq. Among other things, these actions illustrate the utility of the accounting provisions of the FCPA in reaching payments that fall outside the scope of the Act's antibribery provisions, but violate other laws, such as OFAC-administered sanctions and general fraud statutes. They reflect continued inter-agency and, indeed, inter-governmental, cooperation in prosecuting cases. Several of the cases also illustrate the tendency of investigations that begin with one type of payment focus to turn up other issues – in this case, FCPA antibribery issues. The theory of prosecution in these cases is consistent with the government's past position in FCPA cases regarding "qualitative accuracy" of the books and records and internal control requirements.

Background to the Oil-for-Food Program

The United Nations Security Council established the OFFP pursuant to Resolution 986, entering into an implementing memorandum of understanding with Iraq in 1996 as part of a larger sanctions program imposed against it in the wake of the 1991 Gulf War. This regime generally prohibited UN member states from transacting in Iraqi goods and commodities, but instituted the OFFP to allow certain civilian goods to enter the country on humanitarian grounds, funded by Iraqi oil sales.[1]

Under the Program, the Iraqi government had to devote proceeds from the oil sales to purchase certain enumerated civilian products. The terms allowed the Iraqi government, through its State Oil Marketing Organization (SOMO) to award "allocations" of oil to purchasers, which would pay into an UN-administered escrow account to be used solely for humanitarian purposes in Iraq; payments to any other accounts were explicitly prohibited. The Iraqi government used its allocations authority to extract payments from would-be purchasers, variously called "surcharges," "commissions," "consultancy payments," and "sales fees." The sanctions, and the OFFP, ceased in 2003. The next year, Secretary General Kofi Annan established the Independent Inquiry Committee (IIC) to investigate reports of wide-scale corruption involving the OFFP. The UN Security Council endorsed the IIC in Resolution 1538 (2004), and called for the full cooperation of all member states.

In tandem with and pursuant to the IIC's investigation, which ended in December 2006, numerous countries, including the United States, Australia and the United Kingdom, began their own investigations into corruption surrounding the OFFP and involving their nationals.

The United States now has brought roughly a dozen cases under the FCPA for making improper kickback payments under OFFP contracts.[2] In keeping with its practice since its first OFFP case against a major public corporation, brought against El Paso Corporation in February 2007, the US Government has not cited the antibribery provisions of the FCPA, as the payments went not to a "foreign official," but rather the Government of Iraq. (In fact, as discussed further below, the payments initially were directed to several Iraqi government officials' private accounts, but were then transferred to the Iraqi treasury.) Settlement in these cases reflects a range of penalties, from a high of $30 million in the *Chevron* case to a low of $4.65 million in *Textron*.

Chevron

In November 2007, the SEC agreed with Chevron Corporation to settle charges that Chevron inaccurately entered payments into its books and records in violation of the FCPA's antibribery provisions. The settlement resolved the SEC's allegations that Chevron engaged in 36 transactions from April 2001-May 2002 involving payment of US$20 million to third parties for their shares of Iraqi oil allocations, despite knowing or having reason to know that the accompanying "surcharges"—additional payments above the market price—were destined for the Government of Iraq, outside of the OFFP account.[3]

Although Chevron had instituted a compliance policy specifically addressing the OFFP surcharge issue, the SEC found that Chevron failed adequately to implement it or police it with a system of internal controls. The company's policy prohibited such charges, requiring management to scrutinize and approve all transactions company traders proposed involving Iraqi petroleum. The SEC found that Management failed to thoroughly review these transactions, however, in one case green-lighting a purchase from a company with no known assets, operations or experience.

Chevron further failed to implement sufficiently the financial controls in its compliance policy—even with information that higher per-barrel prices of oil purchased from its sellers followed reports of Iraq's surcharge demands in the fall of 2000. Despite the jump in prices, Chevron management regularly allowed its traders to proceed with Iraqi oil purchases.

The SEC's civil action charged that Chevron failed to accurately characterize the surcharges it paid on OFFP purchases as payments to the Iraqi government, instead describing these simply as "premiums," in violation of the FCPA's requirement that US issuers keep accurate books, accounts and records. Because the surcharges ended up in Iraq government coffers, the antibribery provisions presumably did not apply.

Chevron ultimately consented to a permanent injunction from future violations of the accounting provisions and agreed to disgorge $25,000,000 in profits. This amount was to be divided between the US Attorney for the Southern District of New York and the New York District Attorney. In addition, it also agreed to a civil penalty of $3,000,000 for the accounting violations and a penalty of $2,000,000 to be paid to the Office of Foreign Assets Control for its violation of OFAC regulations. As part of this package settlement, Chevron also entered into a non-prosecution agreement with the DOJ, which had alleged wire fraud as the basis of its criminal theory.[4] The level of these fines should make companies aware that the FCPA's books and records provisions can result in fines that far exceed the amount of penalties US companies would pay solely for an underlying violation of US sanctions laws.

Ingersoll-Rand

A similar deployment of the FCPA's accounting provisions occurred when the SEC in October 2007 brought charges against Ingersoll-Rand ("Ingersoll") accusing it of failing to take action upon notice that several of its foreign subsidiaries had been paying kickbacks to the Iraqi government. The SEC found that Ingersoll, either itself, through its subsidiaries or third parties, authorized kickbacks in the form of hidden "after sales service fees" ("ASSFs") in contracts it with the Iraqi government and submitted to the "661 Committee" charged with managing the OFFP. Frequently these ASSFs involved no actual after-sale services. Further, these payments were made knowingly in violation of the OFFP and US law. By not classifying these payments accurately in "reasonable detail," or as "unlawful kickbacks" to the Iraqi regime, the SEC found that Ingersoll did not accurately detail its accounts.

The DoJ as well as the SEC also brought charges against Ingersoll-Rand for the conduct of an Italian subsidiary, Ingersoll-Rand Italiana SpA ("IR Italiana"). DoJ alleged that IR Italiana conspired to violate the FCPA's books and records provisions by paying some $20,000 in travel and entertainment expenses for eight Iraqi officials for a training visit to the company's facilities. Six of the officials, however, were strictly on vacation, and attended to no business during their stay. IR Italiana conspired to conceal these

payments on its books and records, resulting in Ingersoll Rand making false statements in its own financial accounts.

Like Chevron, Ingersoll faced no FCPA bribery charges for these payments. With respect to the OFFP payments, the anti-bribery provisions presumably did not apply due to the fact that the payments went to the Iraqi government.[5] For the travel and entertainment expenses, however, the absence of antibribery charges requires another explanation, perhaps of a jurisdictional nature due to the lack of a nexus of the sponsorship activity carried out on behalf of the foreign subsidiary to the United States.

Ingersoll consented to a three-year non-prosecution agreement and a $2.5 million criminal penalty with the DoJ; the company settled with the SEC for over $4 million, split between profit disgorgement and civil penalties. The OFFP side of this case closely models that of *Textron*, settled last August with SEC for $3.5 million and the DoJ for $1.15 million, for similar use of ASSF-labeled kickbacks by a fifth-tier French subsidiary.

Flowserve

More recently, the government settled FCPA accounting and internal controls violation charges with Flowserve Corporation, a maker of large-scale water pumps, for entering into contracts containing ASSFs in a manner similar to those described above with respect to Ingersoll. The SEC's complaint alleged that two of Flowserve's foreign subsidiaries, one in France and one in the Netherlands, entered into a total of twenty contracts providing for kickbacks amounting to some $820,246. Ultimately, $604,651 of this amount actually was paid, while $173,758 was outstanding at the time of the 2003 US invasion of Iraq. The DoJ focused only on French subsidiary's contracts (comprising nineteen of the twenty) charging that Flowserve had conspired to violate the US wire fraud statutes and the FCPA's books and records provisions.

The SEC found that Flowserve's French subsidiary, Flowserve Pompes, created two different covers to conceal these payments. One involved the creation of records showing payments to a Jordanian agent for installation services and commissions when no such services were ever in fact rendered, and the other, in its contract reimbursement requests to the UN, marking up the unit price of its equipment to cover the ASSF payments. Flowserve Pompes also signed a letter with the Iraq government committing to pay the 10% ASSFs. Flowserve's Dutch subsidiary, Flowserve B.V. entered into only one contract involving a kickback, termed a "special project discount," that was passed through an agent to the Iraqi-government-owned South Gas Company with which the contract was made.

Flowserve consented to the entry of final judgment enjoining it from violating the internal controls or books and records provisions of the FCPA, as well as ordering it to pay a civil penalty of $3,000,000. In addition, it agreed to disgorge approximately $3,500,000 million in profits and pre-judgment interest. Further, under a deferred prosecution agreement with the DoJ, Flowserve agreed to pay a $4,000,000 criminal penalty in respect of an asserted conspiracy to commit wire fraud and criminal books and records violations involving the French subsidiary's alleged violations, as to which the DoJ filed a criminal information against that subsidiary, Flowserve Pompes.[6] Flowserve B.V., the Dutch subsidiary, will also enter into a criminal disposition with the Dutch Public Prosecution.[7]

FCPA Accounting Provisions Reach Non-Official/Non-Governmental Payments

Enforcement actions employing the accounting provisions as an independent ground to reach improper payments, especially those not constituting bribery under the FCPA, are not limited to the OFFP context. In *Schnitzer Steel*, for instance, the government brought criminal charges under the books and records provisions for payments made to managers of privately owned steel mills in China and South Korea, accusing Schnitzer and its subsidiaries as falsely describing the payments as "refunds," "rebates," "sales commissions," or "commission to the customer."[8] These charges accompanied allegations that Schnitzer had also violated the antibribery provisions by paying managers at state-owned scrap metal customers.

These accounting provisions of the FCPA have also been applied to payments that were not commercial bribes or direct or indirect payments to a government, but which fell afoul of US sanctions law. In the *Chiquita* settlement, for example, the DOJ and SEC brought charges under the books and records provisions charging that a Chiquita subsidiary, with knowledge of senior management, misleadingly termed extortion payments it made to the United Self-Defense Forces of Columbia ("AUC")—a Foreign Terrorist Organization and a Specially-Designated Global Terrorist with which business transactions are prohibited— as charges for "security payments," "security services," or "security."[9] Where the government believes there is fraud or deliberate violations of law, these cases show it will not hesitate to bring criminal accounting charges.

From the bribery side, what is most interesting is the fact that in two of the OFFP cases— *Chevron* and *El Paso*—the payments were initially paid to individual Iraqi officials, though subsequently paid over to the government. The lack of FCPA antibribery charges presumably reflects the fact that the companies, in making the payments, intended to pay a fee to the government and not to improperly influence any individual actors. The fact that the government is systematically extracting payments in return for allocating benefits to all users of a system did not prevent the accounting charges.

Disclose or Defend: The Need for Accuracy in Accounting Entries

These prosecutions reinforce the need for issuers to make qualitatively accurate descriptions of their payments. Indeed, the SEC's characterization of these companies' alleged accounting mistakes suggests that had they described these payments differently, they might not have faced charges on these grounds, though they might well have exposed themselves to others.

The cases also reinforce the position that payments into government accounts do not trigger the antibribery provisions. And this, moreover, is the case even if they first *do* pass through officials' individual accounts (as in Chevron and El Paso), and so are arguably made *to* a government official, at least in the first instance. The converse, however—where a payment is made initially into a government coffer which is leaky—may not be outside the scope of the antibribery provisions, especially where that leakiness is known to the payor.

As to the former, such payments would, presumably, merely need to be described accurately (if otherwise incriminatingly) to fall outside the purview of the FCPA. The need for such accurate accounting also extends, of course, to grease payments made to facilitate transactions. Even if such payments are otherwise FCPA-compliant, their mischaracterization as something more innocuous could yet trigger the FCPA through the books and records requirements. These cases also illustrate the imperative of instituting and maintaining strict internal financial controls and compliance procedures, at every level of the corporate chain, from overseas subsidiaries all the way up to headquarters.

Developments in Foreign OFFP Enforcement

Other nations have also stepped up OFFP enforcement actions, some in conjunction with the United States. The Dutch specialty chemical company Akzo Nobel, for instance, recently avoided criminal charges in the US for kickbacks of $280,000 allegedly paid to the Iraqi Government by its Dutch-based subsidiaries through various middlemen it described as agents or consultants to facilitate its OFFP contracts. The DoJ reached a non-prosecution agreement with the company with the condition that it would pay a criminal fine of 381,000 Euros to the Dutch Public Prosecutor, or forfeit $800,000 to the US Treasury if it failed to do so.

The SEC, meanwhile, settled with Akzo Nobel for a civil penalty of $750,000, in addition to $2.2 million in disgorgement of profits, charging that Akzo Nobel had been reckless in failing to know that their subsidiaries engaged in this conduct, and for having a defective system of internal controls. Beyond issuing securities in the US market, Akzo Nobel had no ties to the United States. Akzo Nobel ceased its registration with the SEC during the course of the investigation.[10]

In the UK, the Serious Fraud Office in December 2007 requested the pharmaceutical manufacturers AstraZeneca, Eli Lilly and GlaxoSmithKline, as well as other drug companies, to provide documents pertaining to their participation in the program. The investigation is said to be one of the SFO's largest, estimated to cost some 22 million British Pounds.[11] It is unclear what the SFO will find, but the reported scale of the request and the size of the requested companies suggests that much could be swept up in its wake.

In Australia, the Securities and Investments Commission recently initiated charges against six former managers of the Australian Wheat Board that had steered the Board's OFFP business. They are charged with failing to act with "due diligence" and with failing to act in "good faith and for a proper purpose."[12] Due to a shorter statute of limitations, the Commission is proceeding with these cases prior to possible criminal charges. The civil charges carry potential fines of $150,000 each, with each defendant facing from seven to seventeen counts.[13]

Though less recently, India too has been embroiled in the OFFP scandal. A government investigation ending in August 2006 found that India's former foreign minister, Natwar Singh, had requested oil allocations from Iraqi president Saddam Hussein, setting up transactions similar to those in which El Paso and Chevron had engaged—paying per barrel surcharges to an intermediary that later went to the Iraqi government—and that eventually inured to the benefit of close associates, though not necessarily Mr. Singh himself.[14]

Some of these cases may result in challenges to the prosecution on the ground of the asserted legality of the surcharges under Iraqi law. This was not a defense to the US cases, given US sanctions prohibitions on dealings with the Iraqi government.

Iraq Continues to Provide Grist for the Anti-Corruption Mill

In addition to OFFP actions in the US and overseas, Iraq itself continues to provide fodder for a number of enforcement actions, arising out of Iraqi reconstruction efforts. By the end of 2007, US authorities had brought some 50 prosecutions relating to business activity in Iraq, most arising out of Special Inspector General for Iraqi Reconstruction (SIGIR) investigations, and many for bribery and associated conspiracy, fraud, money laundering and corruption charges. Only one completed Iraqi reconstruction case so far, *United States v. Salam*,[15] has involved the FCPA. Nevertheless, the momentum of assertive prosecution of the statute shows no sign of abating, and has proved adaptable to a wide variety of improper payments that the antibribery provisions do not cover. Just as the Oil-for-Food Program investigations began with investigations into individuals and then moved on to encompass large corporations, so may the efforts of SIGIR and other US authorities investigating activities in Iraq. Perhaps now more than ever, companies, whether with ties to Iraq or not, must be sure that their accounting descriptions encompass all relevant and material aspects of a payment, and that they have stringent internal control systems in place for not only FCPA but sanctions compliance as well.

We will continue to keep you apprised of developments related to FCPA enforcement. If you have any questions or for further information, please feel free to contact Lucinda Low at 202.429.8051; Erik Kitchen at 202.429.8132; Pat Norton at 202.429.8034; Jonathan Drimmer at 202.429.6477; Matt Herrington at 202.429.8164; Andrew Irwin at 202.429.8177; Julia Court Ryan at 202.429.6418; David Lorello at 44(0)20.7367.8007; Alexandra Baj at 202.429.6478; Tom Best at 202.429.8079; Owen Bonheimer at 202.429.6266; Negar Katirai at 202.429.8028; Sarah Lamoree at 202.429.6488; Michael Lieberman at 202.429.8064; or William Gordon at 202.429.8013.

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1. *United States v. Chiquita Brands International, Inc.* (D.D.C. 2007) (Information filed Mar. 14, 2007).

2. Independent Inquiry Committee website.

3. In addition to the cases discussed herein, see United States v. Sevan and Nadler (S.D.N.Y.) (Indictment of Jan. 10, 2007); United States v. York Int'l Corp. (D.D.C.) (Deferred Prosecution Agreement announced on Oct. 1, 2007); SEC v. York Int'l Corp. (D.D.C.) (Complaint of Oct. 1, 2007) (Relating to Oil-for-Food Program in Iraq).

4. SEC Lit. Rel. No. 20363 (Nov. 14, 2007); SEC v. Chevron Corporation (S.D.N.Y.) (Complaint of Nov. 14, 2007).

5. Letter from US Attorney, S.D.N.Y., to Mr. Charles M. Carberry (Nov. 8, 2007).

6. SEC Lit. Rel. No. 2035 (October 31, 2007); SEC v. Ingersoll-Rand Company Ltd., Civ. Action No. 107- CV- 01955 (D.D.C.) (JDB).

7. *United States v. Flowserve Corporation* (D.D.C.) (Criminal Information of Feb. 21, 2008).

8. *SEC v. Flowserve Corporation* (D.D.C.) (Complaint of Feb. 21, 2008); SEC Lit. Rel. No. 20461(Feb. 21, 2008); DoJ Press Rel. (Feb. 21, 2008).

9. *In the Matter of Schnitzer Steel Industries*, Exchg. Act Rel. No. 54606 (Cease-and-Desist Order of Oct. 16, 2006).

10. SEC Lit. Rel. No. 20410 (Dec. 20, 2007); SEC v. Akzo Nobel, N.V. (D.D.C.) (Complaint of Dec. 20 2007).

11. BBC, Firms Probed Over Iraq Cash (Dec. 30, 2007).

12. Tim Johnston, *Oil-for-Food Case Opens in Australia*, N.Y. Times (Dec. 21, 2007).

13. Id.

14. Amelia Gentleman, *India Finds Ex-Official Guilty in Oil Scandal*, N.Y. Times, Aug. 5, 2006; John Lancaster, *India's Foreign Minister Fired in Oil-for-Food Scandal*, Wash. Post, Nov. 7, 2005.

15. United States v. Salam (D.D.C.) (Complaint of Mar. 8, 2006.

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International Law Advisory

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Sight-Seeing Tiger, Hidden Dragon - Lucent Fined for Financing Sight-Seeing Trips for Chinese Officials

Capping off a year of record enforcement activity, on December 21, 2007, the Department of Justice ("DoJ") and Securities and Exchange Commission ("SEC") settled enforcement actions with telecommunications company Lucent Technologies Inc. ("Lucent"). Pursuant to the settlements, Lucent agreed to pay $1 million in fines and $1.5 million in civil penalties for asserted FCPA violations in connection with Lucent's sponsorship of officials of Chinese state-owned telecommunications companies to travel to the United States and other countries.[1] This settlement resolved a matter pending at least since August 2003, when Lucent first disclosed it was conducting an internal investigation into operations of its wholly-owned subsidiary, Lucent China. In April 2004, Lucent fired four Lucent China executives, including the president of Lucent's China operations and its chief operating officer. In May 2005, the SEC notified these former executives that it would not recommend enforcement actions against them.

The relatively low amount of Lucent's fines and penalties in relation to the amount of the questionable payments and number of violations – over $10 million spent in the course of several hundred trips, as discussed more fully below – is perhaps the most striking feature of the settlement. Press reports at one point indicated that the enforcement agencies were seeking a much larger fine, on the order of $25 million. Also noteworthy is the absence of a compliance monitor and disgorgement penalties.

The settlement terms may reflect the fact that not all FCPA shoes have dropped for Lucent, now merged with Alcatel, or the individuals associated with the payments. The activities in question predated the merger, which was consummated in November 2006. Lucent's deferred prosecution agreement with the DoJ extends only to its foreign sales activities prior to the merger, and enforcement authorities continue to investigate whether Alcatel and its affiliates violated the FCPA in connection with its mobile telecommunications business in Costa Rica and elsewhere.

Payments at Issue

From at least 2000 to 2003, in order to obtain contracts with various Chinese state-owned telecommunications enterprises on behalf of its subsidiary in China, Lucent China, Lucent spent over $10 million for the travel of approximately 1,000 Chinese foreign officials on at least 315 trips. These trips consisted primarily of sightseeing, entertainment, and leisure, and were approved with the consent of the highest officials at Lucent China. The trips were arranged by Lucent employees in the company's "China Operations Support Team", located at Lucent headquarters in New Jersey. Lucent's "Customer Visit Request Form" specifically asked if customers were "decision-maker/influencers" and provided space to request "sightseeing/entertainment" as well as to specify the quality of the requested accommodations.

Lucent alleged that the majority of the trips were designed to allow the Chinese foreign officials to inspect Lucent's factories, pursuant to contracts between Lucent and the Chinese parastatals. However, during many of these trips, the officials spent little or no time visiting Lucent's facilities and instead visited tourist destinations such as Hawaii, Las Vegas, the Grand Canyon, Disney World, Los Angeles, and New York City. Moreover, both the SEC and the DOJ noted that Lucent began outsourcing its manufacturing in 2001, leaving few factories to visit. Lucent also provided the officials with *per diems* of $500 to $1,000 per day, even though it provided all lodging, transportation, food, and entertainment expenses.

In one example highlighted by the SEC settlement, Lucent provided six delegates from a Chinese state-owned company with a $33,000, 11-day tour of the United States and Hong Kong that featured no factory visits, purportedly because the customers refused to travel to the East Coast in the wake of the September 11th, 2001 attacks on the World Trade Center. In an internal email, a Lucent representative described the customer as "a very special case" because Lucent had already received $50 million from the customer and estimated it could gain two to three billion more. Internal emails also revealed that Lucent employees were aware that trips did not involve "factory tours" but used the term to help Chinese customers obtain visas and get through US immigration controls.

Most of the trips were recorded in Lucent's books and records as "Marketing Expenses", "Services Rendered – Other Services", "Transportation International", and "Lodging Expenses", though none of these accounts was meant to record customer travel. In addition, Lucent recorded expenses for some customer's sightseeing trips in its "Factory Inspection" account though there had been no visit to a Lucent factory.

Enforcement Actions

Consistent with other recent prosecutions, the SEC charged Lucent with violations of the books and records and internal controls provisions of the FCPA, specifying that the latter were insufficient because they did not allow Lucent management to ensure the accountability of the company's assets or prohibit employees from accessing funds without proper authorization. Though the DoJ did not specify the FCPA charges against Lucent, Lucent admitted to and acknowledged responsibility for conduct constituting violations of the antibribery and accounting provisions of the FCPA in its deferred prosecution agreement with the DoJ, and agreed not to make any public statements contradicting the conduct described in the agreement.

In the SEC settlement, Lucent consented to an order permanently enjoining it from future violations of the books and records and internal controls provisions. The DoJ agreed to defer prosecution for two years as long as Lucent adopted improved "internal controls, policies, and procedures," including a "rigorous anti-corruption compliance code, standards, and procedures designed to detect and deter violations of the FCPA." The DOJ's primary list of "to dos" for Lucent is consistent with its pronouncements in other FCPA cases this year.

Compliance Lessons

Compliance Programs Must Provide Employees with the Training to Appreciate FCPA Risks. The SEC emphasized that "Lucent's violations occurred because Lucent failed, for years, to properly train its officers and employees to understand and appreciate the nature and status of its customers in China in the context of the FCPA." Many if not all of China's telecom companies are state-owned. Although the role of the state in today's China has receded somewhat, many enterprises remain state-owned or controlled. Companies in many businesses, not just telecommunications, may deal with customers where employees are "foreign officials" under the FCPA, as Lucent's were. Training local operations personnel as well as corporate personnel approving or arranging travel to recognize these issues is key.

Internal Controls Form Only One Part an Effective Compliance Program. Lucent's deferred prosecution agreement effectively requires it to establish an improved compliance program. This case demonstrates that without significant monitoring, even the most robust internal controls cannot detect and prevent FCPA violations. Travel was approved despite the red flags indicated on request forms. (In fact, the way the request forms were drafted brought out those red flags.) Monitoring is particularly important in the context of travel sponsorship. Beyond simply fielding questions, companies should critically review the underlying facts of sponsorships to determine if there is a legitimate business purpose and whether that purpose is the primary reason for the proposed travel. In addition, companies should maintain records that allow them to detect and prevent cumulative amounts of sponsorships to a particular government official or government body.

Improper Recording Prevents Detection of FCPA Violations. Proper and consistent recording of expenditures allows senior management and compliance personnel to review the activities of company operations. In Lucent, the recording of travel sponsorship in a scattering of account categories hampered the company's ability to monitor the magnitude of the sponsorship provided.

The Crouching Tiger, Hidden Dragon?

This settlement raises a question whether other FCPA allegations that have surfaced with respect to Lucent in recent years, such as the 2003 allegations regarding payments in Saudi Arabia, will ripen into enforcement action.

Moreover, Alcatel's FCPA problems appear to be far from over. In June 2007, former Alcatel executive Christian Sapsizian, a French citizen, pleaded guilty to participating in the payment of more than $2.5 million in improper payments to senior Costa Rican government officials in order to obtain a mobile telephone contract from that country's state-owned telecommunications authority, and enforcement authorities continue to look into Alcatel's pre-merger activities in Costa Rica as well as other countries. As part of his plea, Sapsizian agreed to cooperate in the ongoing investigation.

We will continue to keep you apprised of developments related to FCPA enforcement. If you have any questions or for further information, please feel free to contact Lucinda Low at 202.429.8051; Erik Kitchen at 202.429.8132; Ed Krauland at 202.429.8083; Pat Norton at 202.429.8034; Jonathan Drimmer at 202.429.6477; Matt Herrington at 202.429.8164; Andrew Irwin at 202.429.8177; Julia Court Ryan at 202.429.6418; David Lorello at 44(0)20.7367.8007; Alexandra Baj at 202.429.6478; Tom Best at 202.429.8079; Owen Bonheimer at 202.429.6266; Negar Katirai at 202.429.8028; Sarah Lamoree at 202.429.6488; Michael Lieberman at 202.429.8064; or William Gordon at 202.429.8013.

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1. *SEC v. Lucent Technologies Inc.*, Case No. 1:07-cv-02301 (D.D.C.) (Complaint and Order filed Dec. 21, 2007) and associated SEC Lit. Rel. No. 20414 (Dec. 21, 2007); Settlement Agreement between DoJ and Lucent Technologies Inc. (Signed Dec. 5, 2007), Including Statement of Facts and Setting out Compliance Obligations) and associated DoJ Press Release 07-1028 (Dec. 21, 2007).

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International Law Advisory

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Fifth Circuit Clarifies the Intent Requirements for a Criminal FCPA Conviction

Last week, the US Court of Appeals for the Fifth Circuit released a new opinion stemming from the Department of Justice ("DOJ") prosecution of David Kay and Douglas Murphy for payments to Haitian customs officials to reduce duties and taxes on importation of rice into Haiti. A rare addition to the relatively few judicial opinions interpreting the FCPA, the Fifth Circuit's second opinion in *Kay* holds that although an FCPA antibribery violation is a specific intent crime, the statute does not require a defendant to have actual knowledge that the FCPA prohibits his or her behavior, but only knowledge that his or her conduct was generally unlawful.

The district court had initially dismissed the indictment in the case on the grounds that the payments were not made to "obtain or retain business" within the meaning of the statute. In a 2004 opinion ("*Kay I*"), the Fifth Circuit held that the scope of payments made to "obtain or retain business" was not confined to payments made to secure or renew business contracts and could encompass payments to reduce customs duties and taxes.[1] The court stated that the "obtain or retain business" requirement is satisfied as long as there is a nexus between a payment to a foreign official and monetary savings or gain that aids an entity in carrying on its business in some way. The Fifth Circuit reversed the dismissal of the indictment and remanded the case to the district court. After a trial on remand, the defendants were convicted. The defendants appealed their convictions, arguing that the Fifth Circuit's first impression interpretation of the "obtain or retain business" requirement in *Kay I* could not be applied to them without violating their Due Process rights to fair notice of what the statute prohibits. The defendants further argued that "willfully," as used in the FCPA's criminal penalties provision, required proof that the defendants knew their conduct violated the FCPA, and that the jury had been incorrectly instructed on the "willfulness" element.

The Fifth Circuit rejected the defendants' fair warning argument. The court acknowledged it had concluded in *Kay I* that the FCPA's business nexus requirement was ambiguous as a matter of law, but ruled that "it does not follow that the standard requires guesswork or that the statutory language itself is vague."[2] The court noted that the business nexus element was only one of seven standards that may lead to conviction under the FCPA, and that a "technical interpretive question" as to the meaning of "obtaining or retaining" business did not draw a line so vague that defendants who paid foreign officials to reduce tax and duty burdens would not reasonably be aware of the potential illegality of such action under the FCPA.[3] Instead, the court concluded that a "man of common intelligence would have understood" that a company "bribing foreign officials . . . was treading close to a reasonably-defined line of illegality."[4] In this case, the Fifth Circuit held that it should have been clear to defendants that they were treading close to the line since trial testimony demonstrated that defendants believed that their bribes were necessary to compete with competitors in Haiti and thus "retain" business there.[5] The court further held that the government's failure to prosecute other companies for similar conduct did not excuse defendants' actions: "the fact that other companies were guilty of similar bribery during the 1990's does not excuse ARI's actions; multiple violations of a law do not make those violations legal or create vagueness in the law."[6]

Regarding the requirement of a "willful" violation in order to impose criminal penalties on individuals under the FCPA,[7] the court rejected the defendants' contention that they had to have known their conduct violated the FCPA, and ruled instead that the defendants need only have been aware that their conduct was generally unlawful. Taking guidance from the Supreme Court's decision in *Bryan v. United States,*[8] and the Second Circuit's decision in *Stichting*,[9] the Fifth Circuit held that the FCPA is not one of the

complex, highly technical statutes (such as tax statutes or money laundering statutes) for which the Supreme Court has "carved out an exception to the traditional rule that ignorance of the law is no excuse."[10] Instead, the court ruled that a showing, "that a defendant knew that he was doing something generally unlawful," that is, that "the defendant must have known that the act was in some way *wrong*," was sufficient to satisfy the "willfulness" requirement for a criminal violation of the FCPA.[11]

We will continue to keep you apprised of developments related to FCPA enforcement. If you have any questions or for further information, please feel free to contact Lucinda Low at 202.429.8051; Erik Kitchen at 202.429.8132; Ed Krauland at 202.429.8083; Pat Norton at 202.429.8034; Owen Bonheimer at 202.429.6266; Tom Best at 202.429.8079; or William Gordon at 202.429.8013.

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1. *United States v. Kay*, 359 F.3d 738, 756 (5th Cir. 2004) ("*Kay I*").

2. *United States v. Kay*, No. 05-20604, 2007 WL 3088140, at *7 (5th Cir. Oct. 24, 2007) ("*Kay II*").

3. *Kay II*, 2007 WL 3088140, at *8.

4. *Id.* at *9.

5. *Id.*

6. *Id.*

7. *See* 15 USC § 78ff(c)(2)(A).

8. 524 US 184 (1998).

9. *Stichting Ter Behartiging Van de Belangen Van Oudaandeelhouders In Het Kapitaal Van Saybolt Int'l B.V. v. Schreiber*, 327 F.3d 173 (2d Cir. 2003).

10. *Kay II*, 2007 WL 3088140, at *29 & nn.69-72; *see Cheek v. United States*, 498 US 192 (1991) (discussing complexity of federal criminal tax laws); *Ratzlaf v. United States*, 510 US 135 (1994) (concerning antistructuring provision of money laundering laws).

11. *Kay II*, 2007 WL 3088140, at *29.

International Law Advisory

October 29, 2007

The Kozeny Saga Continues: In Rare Court Opinion Highlighting Statute of Limitations Issues, Judge Dismisses Several Counts of an FCPA Indictment Against Individuals Allegedly Involved in the Azerbaijan SOCAR Scheme; Institutional Investor Gets Non- Prosecution Agreement Based on Weighing of McNulty Factors

On June 21, 2007, Judge Scheindlin of the Southern District of New York dismissed as time-barred several counts of the indictment of Frederic Bourke and David Pinkerton for FCPA and related violations in Azerbaijan.[1] The decision was based upon an interpretation of 18 U.S.C. § 3292, which provides that a statute of limitations can be tolled by a court for up to three years when the government is awaiting results of a request for information from a foreign government. The court held that the only way a court could suspend the statute of limitations under 18 U.S.C. § 3292 was if the statute of limitations was still running when it considered the government's application for tolling based upon efforts to gather foreign evidence. In this case, the U.S. government applied to the Netherlands in October 2002 for information relating to an investment scheme managed by Czech investment promoter Viktor Kozeny. Kozeny allegedly sought to secure investments from a consortium of institutional and individual investors and to use the funds to make improper payments to officials to secure the right to invest in the anticipated privatization of the State Oil Company of Azerbaijan (SOCAR).[2] Mr. Pinkerton is the former head of a private equity arm of American International Group (AIG). The government did not apply to the court for tolling of the statute of limitations until July 2003, and the court did not grant the application until July 22, 2003. Applying the five year statute of limitations for general federal crimes to the FCPA and several related counts, the judge found the statute of limitations expired between March and July 2003, after the application to the Netherlands but before the filing of the tolling application to the U.S. courts. The judge found that because the statute of limitations had run before the application to the court to extend it, there was no way for the court to toll the already-expired limitations period. The decision relied upon the plain meaning of section 3292, its legislative history, general statute of limitations policy considerations and the doctrine of constitutional avoidance.

The government appealed the June 21 decision in a brief filed August 21, 2007 in the Court of Appeals for the Second Circuit. The government argued that the lower court wrongly disregarded parts of section 3292, and argued any application for extension "filed before the return of an indictment" would be proper, regardless of whether the statute of limitations had already ran before the application. The government also argued that the court misconstrued the legislative history of section 3292, as well as the policy and constitutional considerations mentioned in the court's opinion. There will undoubtedly be more developments in this aspect of the FCPA jurisprudence as the appeal is fully briefed and argued, but a few observations about the case may be made at this stage:

- *Increased Foreign Cooperation Prolongs Investigations*. FCPA investigations today feature much greater cooperation by foreign authorities with U.S. authorities than was the case even a few years ago. The foreign evidence-gathering process is nonetheless one that takes significant time – often years, as the chronology of this case shows – that can substantially prolong the course of government investigations.

- *The Five-Year Statute of Limitations on Criminal FCPA Violations Still Can Be Tolled for Foreign Evidence-Gathering.* Companies doing business in foreign countries should remember that section 3292 is still a powerful tool of prosecutors, allowing them to apply *ex parte* to the court to extend the statute of limitations up to three years in FCPA cases. In addition, when a company is in voluntary disclosure mode or otherwise cooperating with enforcement officials, the issue may

be avoided by the execution of a tolling agreement. It should be noted that Section 3292 applies to the DOJ. Other enforcement agencies, such as the SEC, cannot avail themselves of the benefit of section 3292.

- *Use of Conspiracy Statute to Reach Back and Charge Conduct Occurring More Than Five Years Earlier*. In addition to the DOJ's ability to toll the statute of limitations for up to three years for foreign evidence-gathering, conspiracy charges can permit enforcement agencies to look back farther in time than direct use of the FCPA would permit. For conspiracy, long a favored tool of prosecutors in FCPA cases, if overt acts are performed within the limitations period, the charge can reach back to cover earlier conduct. Indeed, in this case, the court ultimately let stand the conspiracy charge for conduct that allegedly began in August 1997 because at least some of the conduct alleged to be part of the conspiracy occurred within the limitations period (i.e., after July 22, 1998).

Hedge Fund Gets Non-Prosecution Agreement Based on Weighing of McNulty Factors, After Adopting an FCPA Policy and Forfeiting $500,000

Omega Advisors, a U.S.-based hedge fund that was a major investor in Kozeny's consortium, has resolved its exposure in the case with a non-prosecution agreement.[3] The hedge fund invested over $100 million in the scheme to obtain interests in the privatized SOCAR. In 2004, a principal of Omega pleaded guilty to conspiracy to violate the FCPA and violating the FCPA. Omega's agreement included a $500,000 civil forfeiture penalty, as well as a requirement to continue to cooperate with authorities.

- *Continued Influence of the Thompson/McNulty Memorandum.* In its press release, the Department of Justice noted that its decision-making process was based on the "Principles of Federal Prosecution of Business Organizations" memorandum (commonly known as the Thompson or (successor) McNulty Memorandum). The department noted that Omega's cooperation, implementation of an FCPA compliance policy, lack of previous FCPA violations and the prosecution of the Omega principal were factors considered in reaching its non-prosecution decision.

- *Application of FCPA to Private Equity Firms and Other Institutional Investors.* This agreement highlights that enforcement authorities expect private equity firms to conduct FCPA due diligence in connection with their investments. The decision not to prosecute Omega relied upon Omega's adopting an FCPA compliance policy. Omega also had to agree to forfeit $500,000.

- *Tools to Resolve a Criminal Enforcement Action.* This case reflects the DOJ's continued use of a variety of tools to resolve FCPA cases. The outcome here, a non-prosecution agreement, carried fewer ongoing commitments than other possible dispositions might have. Here, apart from the forfeiture, Omega only was required to continue cooperating with the government. In contrast, deferred prosecution agreements typically have included a lengthy list of actions the company must take to avoid prosecution. It is unclear from the press release to what extent Omega's past cooperation included waivers or privilege or some of the other extraordinary steps highlighted in recent enforcement actions, such as *Baker Hughes*.

Of the other indictees in this case, the alleged mastermind, Victor Kozeny, remains in the Bahamas after a Bahamian court denied a U.S. extradition request. The United States plans to appeal that ruling. Hans Bodmer, a foreign lawyer that advised the consortium, was convicted previously, while Tom Farrell, who assisted the consortium, and Clayton Lewis, formerly of Omega, previously entered guilty pleas to certain charges. AIG, the institutional investor in the consortium for whom Pinkerton had worked, and Pharos Capital Management have not been the subject of any enforcement action.

For further information on this case, please feel free to contact Lucinda Low at 202.429.8051, Ed Krauland at 202.429.8083, Pat Norton at 202.429.8034, Erik Kitchen at 202.429.8132, Andrew Irwin at

202.429.8177, David Lorello at 44(0)20.7367.8007, Owen Bonheimer at 202.429.6266, Tom Best at 202.429.8079, Negar Katirai at 202.429.8028, or Sarah Lamoree at 202.429.6488. Read more about our FCPA/Anti-Corruption Practice.

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1. *United States v. Kozeny*, Case No. 05 Cr. 518, (S.D.N.Y) Opinion and Order dated June 21, 2007 (dismissing on statute of limitations grounds all counts except false statements charge); *United States v. Kozeny*, Case No. 05 Cr. 518, (S.D.N.Y) Memorandum Opinion and Order dated July 16, 2007 (reinstating FCPA conspiracy count, money laundering conspiracy count, and one count of FCPA violation).

2. For more information on the alleged scheme, *see U.S. Government Aggressively Prosecutes Individuals Allegedly Involved in Bribery Tied to Foreign Investment in Azerbaijan*.

3. DOJ Press Release, *U.S. Announces Settlement with Hedge Fund Omega Advisors, Inc. in Connection with Omega's Investment in Privatization Program in Azerbaijan*, July 6, 2007.

International Law Advisory

May 1, 2007

Baker Hughes Agrees to Pay Record $44.1 Million To Resolve DoJ and SEC FCPA Enforcement Actions

On April 26, 2007, to settle enforcement actions based upon findings of FCPA violations, Baker Hughes Incorporated ("Baker Hughes") entered into (1) a Deferred Prosecution Agreement with US Department of Justice ("DoJ") and (2) a civil settlement with the US Securities and Exchange Commission ("SEC"). In addition, Baker Hughes Services International ("BHSI"), a subsidiary of Baker Hughes with operations in Kazakhstan, entered into a plea agreement with the DOJ.[1] The FCPA charges relate to Baker Hughes' operations in six countries -- Kazakhstan, Russia, Uzbekistan, Indonesia, Nigeria, and Angola. Baker Hughes agreed to pay a record $44.1 million settlement amount. Baker Hughes also agreed to retain a compliance monitor for a period of three years. The DoJ recognized Baker Hughes' voluntary disclosure of the matter to enforcement authorities, its extensive and thorough internal investigation of business practices in Kazakhstan, and its significant remedial steps and controls enhancements.[2]

The case covers a wide range of substantive issues that have been addressed in other recent FCPA enforcement actions. Although the case does not break significant new substantive ground in terms of the practices at issue, the case is the first major recent FCPA enforcement action based upon violation of a cease-and-desist order or injunction. Both the DoJ and the SEC took into account the 2001 cease-and-desist order in determining the record settlement amount. The case also provides further data as to the penalty-mitigation benefits of FCPA voluntary disclosures.

The payments at issue

The core allegation in the case arises out of Baker Hughes' business in Kazakhstan. In September 2000, Baker Hughes retained an agent in connection with its bid for a business opportunity in the Karachaganak oil project in Kazakhstan. Within weeks, the company won the Karachaganak tender, which led to approximately $220 million in gross revenues for the company. From May 2001 to November 2003, Baker Hughes made 27 commission payments totaling approximately $4.1 million to the agent. Baker Hughes and BHSI recorded these payments as "commissions", "fees" or "legal services", though no identifiable services were performed by the agent for the company. According to the documents relating to the SEC settlement, a Baker Hughes operating subsidiary also retained another agent in connection with the award of a chemical contract in Kazakhstan, making payments of over $1 million to the Swiss bank account of that agent. The subsidiary made some of these payments after a company employee learned that the representative of the agent was a high-ranking official of the parastatal KazTransOil, which awarded business to the subsidiary.

The SEC settlement documents also state that Baker Hughes or its subsidiaries made questionable payments in both the procurement and operations contexts without obtaining adequate assurances that the payments would not be passed through to government officials.

- Questionable payments in the procurement context included (1) $5.3 million in commission payments between 1998 and 2004 to an agent who worked with state oil companies in Kazakhstan, Russia and Uzbekistan from which the company sought to obtain or retain business; and (2) payments of more than $11.5 million in commissions to agents in Angola between 1998 and 2003 without adequate assurances against pass-through payments to employees of the state-owned oil company, Sonangol, with which the company conducted business. Most of the latter payments went to an agent Baker Hughes inherited from a 1998 acquisition from Western Atlas Corporation.

- Questionable payments in the operations context included the following: (1) $60,000 to secure an option to lease a property in Kazakhstan from a company owned by a company affiliated with the agent Baker Hughes had retained for the Karachaganak project; (2) payments of unspecified amounts to freight forwarders in Indonesia between 2000 and 2003 without adequate assurances against pass-through payments to Indonesian customs officials who permitted importation of goods that bypassed customs; (3) payments of more than $2.5 million to customs brokers in Nigeria between 2001 and 2005 without adequate assurances against pass-through payments to Nigerian customs officials; (4) payments of approximately $90,000 to an agent in Nigeria in 2001 without adequate assurances against pass-through payments to Nigerian tax officials who had reduced a tax assessment levied upon a Nigerian subsidiary by 90-percent; and (5) payment of $9,000 in cash to a Kazakh individual some employees believed to be a Kazakh official in order to obtain a license required by Kazakh law to import tools with radioactive components.

Enforcement actions

Enforcement authorities brought several charges against Baker Hughes and its subsidiary, BHSI. Focusing on the $4.1 million paid to the agent for the Karachaganak project in Kazakhstan, the DoJ charged BHSI with conspiracy to violate the anti-bribery provisions of the FCPA, violation of the anti-bribery provisions of the FCPA, and with aiding and abetting Baker Hughes' violation of the books and records provisions of the FCPA. The SEC found that Baker Hughes violated the anti-bribery, books and records, and internal controls provisions of the FCPA, including by knowingly failing to implement a system of internal controls. The SEC also found that Baker Hughes violated the terms of a 2001 administrative cease-and-desist order barring it from violating the accounting provisions of the FCPA.[3]

The SEC complaint also named Roy Fearnley, a British national residing in Kazakhstan who formerly worked as the Baker Hughes Business Development Manager in Kazakhstan and later in Russia. The SEC alleged that Mr. Fearnley aided and abetted Baker Hughes' violation of the anti-bribery, books and records, and internal controls provisions of the FCPA, and that he knowingly circumvented the internal controls of Baker Hughes and falsified its books and records in violation of the FCPA. The SEC seeks disgorgement, civil penalties and an injunction against Mr. Fearnley. A filing by the DoJ identifies an individual believed to be Mr. Fearnley by title as a co-conspirator.

To resolve the enforcement action brought by the DoJ, Baker Hughes entered into a deferred prosecution agreement under which it agreed to appoint a compliance monitor for a term of three years and to cause its subsidiary, BHSI, to pay an $11 million criminal fine. To resolve the enforcement action brought by the SEC, Baker Hughes agreed to pay a $10 million civil penalty for violation of the 2001 cease-and-desist order and a record $23 million in disgorgement of profits and prejudgment interest. Baker Hughes also consented to a permanent injunction against violation of the anti-bribery and accounting provisions of the FCPA.The $44.1 million total settlement amount is the largest amount paid by a company to settle an FCPA enforcement action.

Compliance lessons

The *Baker Hughes* case underscores several trends in recent FCPA enforcement actions:

- **Higher settlements in follow-on enforcement actions.** In agreeing to settle the criminal enforcement action against BHSI for $11 million, the DoJ took into account the fact that the charged offenses took place within five years of the SEC cease-and-desist order.[4] The SEC settlement documents also cite a violation of the 2001 cease-and-desist order as a basis for a civil penalty of $10 million.[5] The Director of the SEC Division of Enforcement explained that this enforcement action "demonstrates that companies must adhere to Commission Orders and that recidivists will be punished."[6] This follow-on action against Baker Hughes comes on the heels of the February 2007 follow-on action against Vetco International Ltd. and its affiliates. The near-record $26 million total settlement amount in the *Vetco* case also was attributable to the fact that the violations occurred after the company had given significant compliance undertakings on behalf of the affiliates of Vetco International.[7]

- **Uncertainty regarding penalty-mitigating benefits of a voluntary disclosure.** According to the DoJ, it was not previously aware of the conduct that led to the present enforcement action,

which Baker Hughes voluntarily disclosed in May 2003. The 2001 enforcement action settled by Baker Hughes also resulted from a voluntary disclosure by Baker Hughes. Although enforcement authorities recently have been emphasizing the benefits of voluntary disclosures, perhaps in response to questions raised by the FCPA bar[8], the true benefit gained from making the disclosures often is difficult to quantify. In this case, using the Sentencing Guidelines' formula, the DoJ determined the criminal fine range to be from $19 million to $38 million.[9] The actual fine imposed -- $11 million -- is $27 million lower than the upper end of the calculated range. Nonetheless, some if not all of that difference may be attributable to other factors, such as the total SEC settlement amount of $33 million and the cooperation of Baker Hughes beyond making the voluntary disclosure.

- **Emphasis on FCPA due diligence in relationships with agents and other third parties including subcontractors.**

- *Agents.* The case against Baker Hughes highlights the last-minute retention of an agent, at the request of the parastatal Kazakhoil, on a commission basis, in connection with its bid for a business opportunity in the Karachaganak oil project in Kazakhstan. Hiring agents at the instruction of government officials, especially late in a procurement process on a commission basis without due diligence and without clarity as to the nature of the legitimate services they may provide, raises FCPA red flags. The SEC action sets a high bar for companies that encounter such red flags. The SEC recognized that Baker Hughes provided FCPA compliance procedures and materials to the employee responsible for retaining this agent. The SEC also noted that the employee stated that he would follow these procedures, use these materials and alert the company if any compliance issues arose. Nonetheless, the SEC found that the employee "failed to follow any of the FCPA procedures issued to him" and that the company "otherwise failed to follow up with [the employee]" until approximately two years later.[10] In part on that basis, the SEC determined that the company lacked the internal controls required by the FCPA. Enforcement authorities thus expect companies to monitor FCPA compliance by employees responsible for the retention of third parties that deal with foreign governmental bodies.

- *Subcontractors*. The DoJ deferred prosecution agreement calls for the company to adopt and monitor a detailed compliance program that extends not just to subsidiaries and affiliates, but also to joint venturers, contractors, and subcontractors.[11]

- **Continued Emphasis on FCPA issues outside the procurement area.** As discussed above, many of the types of questionable payments cited by the SEC fall outside the procurement context. The SEC also cited payments an agent in Angola for travel to Portugal by a senior-level employee of the state oil company Sonangol and his family without documentation of a legitimate business purpose.[12]

- **FCPA accounting requirements triggered by payments made without adequate internal controls.** Payments by public companies that result in a bribe charge almost invariably lead to a charge of violation of the accounting requirements. In this case, instances of bribery also led enforcement officials to scrutinize other payments to third parties ultimately found to have been made without adequate controls to ensure that no bribe was paid. Those findings and similar findings in other recent cases show that enforcement authorities find inadequate accounting treatment where the ultimate beneficiary of a payment is not recorded with certainty.[13]

- **Enforcement authorites continue to impose compliance program obligations with broad scope and preserve authority to request waiver of privileges.** Under the deferred prosecution agreement, Baker Hughes must establish and monitor an anti-bribery compliance program that covers not only the FCPA, but also US commercial bribery laws and foreign anti-bribery laws. Although this broad scope is becoming a standard feature of enforcement actions, it remains noteworthy that the *Baker Hughes* case did not raise allegations of violation of commercial bribery or foreign anti-bribery laws. In addition, in the deferred prosecution agreement, the Government

reserves the right to request that the company provide information that is subject to attorney-client privilege and work product protections and if that request is denied, to "consider this fact in determining whether [the company] has fully cooperated with the Department."[14]

- **Cooperation with foreign law enforcement authorities.** The DoJ and the SEC enforcement actions reflect the strengthening of cooperation between US and foreign enforcement authorities. Government press releases announcing the case emphasized assistance received from authorities in the United Kingdom, the Isle of Man, Guernsey, and Switzerland -- a list notable for its inclusion of several countries associated with secrecy. The DoJ deferred prosecution agreement emphasizes assistance it might provide to foreign authorities in the future, and secures Baker Hughes' consent to DoJ disclosure of information from the company to other government agencies, including agencies of a "foreign government".[15] The trend of close cooperation between US and foreign enforcement authorities under the existing network of mutual legal assistance treaties and agreements will only continue as countries around the world implement the U.N. Convention against Corruption, including its Chapter IV provisions on cooperation.

We will continue to keep you apprised of developments related to anti-corruption enforcement. If you have any questions or for further information, please feel free to contact Lucinda Low at 202.429.8051, Ed Krauland at 202.429.8083, Erik Kitchen at 202.429.8132, Andrew Irwin at 202.429.8177, David Lorello at 44(0)20.7367.8007, Owen Bonheimer at 202.429.6266, Tom Best at 202.429.8079, or Negar Katirai at 202.429.8028.

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1. *United States v. Baker Hughes* (S.D. Tex. 2007) (Deferred Prosecution Agreement of Apr. 11, 2007); *SEC v. Baker Hughes Incorporated and Fearnley*, Case No. H-07-cv-1408 (S.D. Tex.) (Complaint filed April 26, 2007); SEC Lit. Rel. No. 20094 (Apr. 26, 2007); SEC Press Release (Apr. 26, 2007); *United States v. Baker Hughes Servs. Int'l, Inc.*, Case No. H-cr-07-129 (Information and Plea Agreement unsealed Apr. 26, 2007).

2. DoJ Press Release (Apr. 26, 2007).

3. SEC Compl., paras. 90-120 (citing *In the Matter of Baker Hughes Incorporated*, Exchg. Act Rel. No. 34-44784 (Sept. 12, 2001)).

4. *See United States v. Baker Hughes Servs. Int'l, Inc.* (sentencing motion filed Apr. 20, 2007, at p. 19).

5. SEC Compl., para. 89.

6. SEC Press Release No. 2007-77 (Apr. 26, 2007).

7. *See* Steptoe's International Law Advisory from February 13, 2007.

8. *See* Lucinda Low, Owen Bonheimer, and David Lorello, The Uncertain Calculus of Voluntary Disclosures, Paper for the March 2007 American Conference Institute FCPA Conference.

9. *United States v. Baker Hughes Int'l, Inc.* (sentencing motion at p. 20).

10. SEC Compl., paras. 36-37.

11. Deferred Prosecution Agreement, para. 6.

12. SEC Compl., para. 60.

13. *See* Steptoe International Advisory, discussing use of FCPA accounting requirement in Oil-for-Food enforcement action.

14. Deferred Prosecution Agreement, para. 4.a.iii.

15. *Id.*, para. 4.d.

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International Law Advisory

February 13, 2007

International Law Advisory - DoJ Imposes Record 26 Million Penalty on Vetco Gray Companies for FCPA Violations Other Enforcement Developments

Last week, the US Department of Justice ("DoJ") announced a $26 million settlement with subsidiaries of Vetco International Ltd. relating to improper payments made through an agent to Nigerian customs officials. At the same time, the Securities and Exchange Commission ("SEC") and the DoJ also announced settlements with El Paso Corporation over allegations that El Paso had indirectly paid surcharges to Iraq through third party companies. These actions come on the heels of a DoJ Foreign Corrupt Practices Act ("FCPA") Opinion Procedure Release issued in late December 2006, in which the DoJ declined to take enforcement action against a company due to safeguards adopted in a commission-based engagement of a foreign law firm.

Vetco International Subsidiaries Plead Guilty to New FCPA Antibribery Charges, Agree to Pay $26 Million in Criminal Penalties

On February 6, 2007, the DoJ announced that three wholly-owned subsidiaries of the UK-based oil and natural gas equipment and services provider Vetco International Ltd.—Vetco Gray Controls, Inc., Vetco Gray Controls, Ltd. and Vetco Gray UK Ltd.—had pleaded guilty to violating, and conspiracy to violate, the antibribery provisions of the US FCPA by making more than $2 million in improper payments to officials of the Nigerian Customs Service ("NCS") over a period of almost three years.1 The Vetco Gray subsidiaries agreed to pay penalties of $6 million, $7 million and $13 million, respectively, and another subsidiary of Vetco International, Ltd., UK corporation Aibel Group, Ltd., entered into a deferred prosecution agreement relating to its participation in the scheme. Vetco International announced it would engage independent compliance monitors for all four entities for a period of three years. The $26 million total fine is the largest imposed by the DoJ in an FCPA enforcement action, and the second highest ever imposed to resolve FCPA charges. In 2005, Titan Corp. agreed to pay $28.5 million to settle charges brought by the DoJ and the SEC.

The plea agreements represent the second time that Vetco Gray companies have pleaded guilty to FCPA anti-bribery violations. In a previous prosecution announced in 2004, ABB Vetco Gray UK, Ltd. and its US affiliate, the former ABB Vetco Gray, Inc., based in Houston, Texas, admitted paying more than $1 million to officials employed by the Nigerian National Petroleum Investment Management Services ("NAPIMS"), the agency responsible for awarding oil and natural gas exploration and development rights in Nigeria including the award to ABB Ltd. of natural gas rights in the Bonga oil field project.2 Subsequently, ABB Ltd. sold the Vetco companies to a private equity firm. In the new enforcement action, the DoJ charged that between September 2002 and April 2005, Vetco Gray Controls, Inc. (the successor to ABB Vetco Gray, Inc.), Vetco Gray Controls, Ltd. and Vetco Gray UK Ltd. (the successor to ABB Vetco Gray, Ltd.), had conspired to make, and had authorized to be made on their behalf, payments of more than $2.1 million, on 61 separate occasions, to NCS officials, through a "major" but unidentified international freight-forwarder, in connection with the Bonga project.

According to the charging documents filed with Federal District Court in Houston, Texas, Vetco Gray employees in the United States, the United Kingdom and Nigeria knowingly authorized the payments to induce NCS officials to disregard their official duties. In entering into the plea agreement, the Vetco Gray

companies effectively admitted that the payments were not made to facilitate routine governmental action by customs officials. Rather, these payments were made for the purpose of securing customs clearance (a) for goods or equipment that was improperly or illegally imported into Nigeria; (b) for goods whose "documentation … was not in order"; (c) for goods delayed "due to the failure to post bonds with sufficient funds to cover duties and tariffs"; and (d) in instances in which other infractions of NCS laws committed by or on behalf of the Vetco Gray companies and/or the employees working on their behalf had taken place. The conduct came to light when the parent company, Vetco International, made a voluntary disclosure to the DoJ. The resolution of liability with the DoJ clears the way for the acquisition of the Vetco Gray division by GE.

The DoJ settlement highlights continuing trends in, and significant new aspects of FCPA enforcement:

- **Rapidly increasing fines**. The combined $26 million settlement amount paid by the Vetco Gray entities is the single largest penalty imposed by the DOJ in a criminal FCPA enforcement action to date. With increased enforcement activity, however, it is doubtful this case will hold this distinction for long.
- **Repeat offenders pay additional fines**. In imposing penalties of $13 million on Vetco Gray UK, Ltd. and $6 million on Houston-based Vetco Gray Controls, Inc. the DoJ took into account the fact that the most recent violations had taken place in breach of the significant compliance undertakings assumed by the companies and the private equity groups that had acquired the companies in 2004. Those undertakings were memorialized in the DoJ's opinion release of July 12, 2004, which stated that, as a condition of taking no further enforcement action against the Vetco Gray entities' new owners, the Vetco Gray businesses were obligated to adopt rigorous corporate anticorruption policies, standards and procedures, extensive FCPA and anticorruption training initiatives, extensive due diligence requirements for third-party service providers, and appropriate disciplinary procedures for employees engaging in corrupt practices. The failure of those efforts to identify and stop the instant conduct contributed to the large penalty in this case.
- **Continued imposition of compliance monitors with scope beyond the FCPA**. As a condition of the Vetco Gray companies' guilty plea, the DoJ has required an independent compliance monitor be attached to Vetco Gray's worldwide operations. The use of such monitors has become commonplace in settlements of serious FCPA antibribery charges where the government deems the violator's program to be ineffective. Recently, their role appears to be expanding. As in the October 2006 FCPA enforcement action against Schnitzer Steel and its subsidiary, US authorities have required that the Vetco Gray compliance monitor review compliance not only with the FCPA, but also with commercial bribery and foreign anti-bribery laws.
- **Increased enforcement action against non-US entities and conduct**. The enforcement action against Vetco Gray UK, Vetco Gray Controls, Ltd. and Aibel Group, Ltd. continues the trend of enforcement actions against, and successfully concluded plea agreements with, non-US entities for FCPA violations involving conduct taking place largely outside the United States.
- **Risk associated with payments to Customs authorities**. This case also vividly illustrates the risks the need for heightened care in relying upon the facilitating payments exception to the FCPA anti-bribery provisions. Even though many payments to NCS officials were for smaller amounts (less than US$1,000 in some instances), the DoJ alleged that the payments were made to induce NCS officials to ignore improper importations, improper or incomplete documentation, failure to post sufficient bonds or pay customs duties, or other infractions of Nigerian law. Accordingly, companies seeking to rely on the "facilitating payments" exception of the FCPA must ensure strict compliance with all local law requirements associated with the foreign government action they seek to facilitate. This can be especially difficult when the use of local agents is necessary, in light of the significantly reduced control over the facilitating payment process companies enjoy.
- **Enforcement scrutiny of third-party dealings**. This case highlights the need for FCPA compliance programs to cover dealings with third parties that have significant dealings with the government, such as customs agents and freight forwarders. Actions of such third parties can create significant risks for companies that engage them.

Criminal Prosecutions and Civil Litigation In Connection With Iraq-related Corruption Highlight Need for Strong Compliance Programs when Doing Business in Iraq

In recent weeks, several new US corruption cases were announced in connection with the UN-Iraq Oil for Food Program. These cases highlight the anti-corruption risks associated with doing business in Iraq, and the continued aggressiveness of US authorities in investigating and prosecuting corruption in Iraq.

El Paso Settlement Shows Cooperation with US Authorities Can Yield Significant Benefits, Penalties Remain Substantial

On February 7, 2007, the SEC announced the first US prosecution of a publicly-traded US company for violations stemming from the UN Oil-for-Food Program. The SEC filed a settled enforcement action alleging violations of the FCPA books and records and internal controls provisions by El Paso Corporation, the largest natural gas transmission company in the United States.3 The SEC alleged that, between June 2001 and June 2002, El Paso purchased Iraqi crude oil from third parties who had allegedly paid nearly $5.5 million in illegal surcharges to accounts in Jordan and Lebanon controlled by Iraq's State Oil Marketing Organization ("SOMO"), at a time when UN sanctions and US law prohibited payments to Iraq. The SEC alleged that these surcharges were factored into the price of the oil sold to El Paso by the inclusion of a premium. Because El Paso booked the entire purchase price as "cost of goods sold", the SEC alleged that the books and records of the company were inaccurate. The SEC also alleged that the internal controls at El Paso were inadequate to detect and prevent the payment of surcharges. Finally, although the SEC did not bring anti-bribery charges against El Paso, the SEC complaint alleges that El Paso knew, or was reckless in not knowing, that between 25 and 30 cents per barrel of crude oil purchased from Iraq during that time period was "kicked back" to the Iraqi government as a surcharge. The SEC alleged that written certifications El Paso had obtained from third party sellers representing that surcharges had not been paid were contradicted by statements made in recorded telephone conversations with El Paso oil traders.

To settle the charges, El Paso, whose shares are traded on the New York Stock Exchange, consented to the entry of a permanent injunction prohibiting future FCPA books and records and internal controls violations, requiring the disgorgement of $5.4 million in profits from the underlying transactions, and requiring the payment of a civil penalty of $2.25 million. The disgorgement obligations will be satisfied by paying an identical amount to the US Attorney's Office in the Southern District of New York, as part of a non-prosecution agreement with the DOJ relating to alleged civil violations of the Iraqi Sanctions Regulations. In statements to the media on February 7, 2007, US Attorney for the Southern District of New York Michael J. Garcia cited El Paso's continuing cooperation with the UN Oil-For-Food corruption investigation and the DOJ in its FCPA investigation, El Paso's voluntary cessation of its participation in the UN Program after June 2002 in part out of concern over the possibility of that illegal surcharges were being paid, and the company's confirmation that employees responsible for the offending conduct were no longer with the company as significant contributing factors to the DOJ's decision not to prosecute the company. Meanwhile, US authorities continue to pursue the criminal prosecution of former Chairman of Costal Corporation Chairman Oscar Wyatt and several of his associates for, among other alleged conduct, payment of kickbacks to Iraq during the UN Oil-for-Food Program.4 El Paso acquired Costal Corporation in 2001.

The enforcement action against El Paso shows that the SEC is using the FCPA accounting provisions to root out improper payments beyond bribery of government officials. In announcing the settlement with El Paso over indirect payments to the Government of Iraq, the Assistant Director of Enforcement at the SEC explained that the FCPA books and records and internal controls provisions are "important tools to combat illicit kickback schemes." The possibility of further extension of the FCPA accounting provisions to cover kickback schemes involving publicly-traded companies will be an important issue to monitor.5

Prosecutions of Individuals In Connection with Iraq Corruption Continues; Charges Not Confined to FCPA or UN Oil-For-Food Program

Further highlighting the continued prosecution activity in the United States with respect to business dealings in Iraq, in January US authorities in the Southern District of New York announced the indictment of Benon Sevan, the former director of the UN Oil-for-Food Program, and Ephraim "Fred" Nadler, a Sevan associate, for their role in the widespread corruption scheme involving the UN program and corrupt payments to the Saddam Hussein-led government of Iraq.6 The seven-count indictment, of which three apply to Sevan, charges wire fraud, conspiracy to commit wire fraud, engaging in prohibited transactions with the government of Iraq, and theft and bribery concerning a program receiving federal funds, among other US criminal charges.

Weeks later, the federal District Court for the District of Columbia sentenced Faheem Salam, a former US army civilian interpreter in Iraq, to three years in prison for violating the FCPA in connection with bribes paid to an Iraqi police official for the award of a contract to supply the Iraqi police. The sentencing comes shortly after the Special Inspector General for the Reconstruction of Iraq ("SIGIR") stated in January 18, 2007 to the House Armed Services Committee that it was investigating 87 cases of corruption in Iraq, with another 23 cases being investigated or prosecuted by the DoJ.

Civil RICO Suit against BNP Paribas and Australian Wheat Board Illustrates Risk of Exposure to Civil Suits Associated with Alleged FCPA Violations

In another example of a civil suit based upon allegations of foreign corruption, a group of Northern Iraqi citizens filed a civil action against BNP Paribas, a French multinational banking institution, and AWB Ltd., the Australian corporation which supplied large quantities of wheat to Iraq under UN Sanctions, under the US Racketeer Influenced and Corrupt Organizations Act ("RICO") on December 22, 2006 in the federal district court in the Southern District of New York.7 The complainants alleged that, as multinational corporations that coordinated their roles in the kickback scheme through their offices based in New York in connection with the UN Oil-For-Food Iraq Escrow account, which was administered by BNP in New York, BNP and AWB committed the predicate acts of violating the US Travel Act, money laundering offenses, FCPA violations and violations of the United States Iraq embargo as the basis of their RICO claim. On behalf of the class, they seek $200 million in damages for humanitarian assistance they were allegedly deprived of, which was instead diverted to the former Saddam Hussein regime and its officials in the form of kickbacks paid for lucrative wheat supply contracts granted to the AWB. Although the complaint does not specify precisely which Iraqi officials received illicit payments of transport charges associated with Australian wheat exports to Iraq, and instead names only trading and other companies used as fronts for, and conduits to, the Saddam Hussein regime, this case demonstrates that companies that did business with Iraq during the UN embargo can face civil litigation risks.

DoJ FCPA Opinion Procedure Release 06-02 Highlights FCPA Compliance Issues in Engagement of Foreign Law Firm

The second DoJ FCPA opinion release of 2006, DoJ FCPA Op. Rel. 06-02 (Dec. 31, 2006), illustrates the importance of addressing FCPA issues in the retention of third parties beyond agents and consultants. In this case, the retention involved foreign legal counsel. The DoJ FCPA opinion procedure release, issued at the request of an unnamed US company, stated that the DoJ did not intend to pursue enforcement action with respect to the proposed retention by the US company's foreign subsidiary of a foreign law firm to help obtain foreign exchange from a government agency in the foreign country. The law firm in question was to be compensated in part by receiving a 0.6% of the total currency exchange they were to help establish.

The US company in question made several representations in seeking the opinion, including the following: no improper payments were made, requested, or contemplated; it conducted due diligence in selecting the law firm, which has a reputation for honest dealings; and it implemented a variety of anti-corruption safeguards. These included contract provisions prohibiting the law firm from making improper payments, requiring the law firm to know and understand the US company's government relations policy, and granting audit rights to the foreign subsidiary. In addition, the employees of the law firm would sign

certifications stating that they have not and will not make any improper payments, and that they and their immediate family were not government officials in the last three years.

This opinion release confirms that more companies are conducting due diligence and establishing business policies and safeguards to ensure that activities of foreign counsel do not trigger US FCPA risks.

We will continue to keep you apprised of developments related to anti-corruption enforcement. If you have any questions or for further information, please feel free to contact Lucinda Low at 202.429.8051, Ed Krauland at 202.429.8083, Erik Kitchen at 202.429.8132, Andrew Irwin at 202.429.8177, David Lorello at 44(0)20.7367.8007, Owen Bonheimer at 202.429.6266, Tom Best at 202.429.8079, or Negar Katirai at 202.429.8028.

Read more about our FCPA/Anti-Corruption Practice.

1. *United States v. Vetco Gray Controls et al*., Case No. 07-cr-004 (S.D. Tex. 2007). *See also* Stephanie Kirchgaessner, Vetco hit by record fine for bribes, *Financial Times* (Feb. 7, 2007) at 14; Tom Fowler, Nigeria bribery charges settled; Vetco Gray will pay a record $26 million under plea agreements, *Houston Chronicle* (Feb. 6, 2007) (quoting Lucinda Low).
2. *United States v. ABB Vetco Gray (UK) Ltd. et al.*, Case No. 04-cr-279 (S.D. Tex. 2004).
3. *SEC v. El Paso Corporation*, Case No. 07-CV-899 (S.D.N.Y. 2007); SEC Lit. Rel. No. 19991 (Feb. 7, 2007). *See also* Warren Hoge, El Paso Corp. to Pay $7 Million as Settlement in Oil-for-Food Case, *N.Y. Times* (Feb. 8, 2007).
4. *United States v. Chalmers et al.,* Case No. 05-cr-59 (S.D.N.Y.) (Revised Indictment dated Sept. 18, 2006).
5. Foreign governments including in China recently announced a major investigation of kickbacks in the private sector. *See* David Barboza, Bribe Inquiry in Shanghai Aims at Firms from the West, *Herald Tribune* (Jan. 19, 2007) (citing Chinese investigation into private kickbacks involving McDonalds, Whirlpool, and ABB).
6. *United States v. Nadler and Sevan*, Case No. 05-cr-59 (S.D.N.Y. 2005) (unsealed Indictment filed Jan. 10, 2007).
7. *Karim, et al. v. AWB Ltd. and BNP Paribas*, Case No. 06-cv-15400 (S.D.N.Y. 2006) (complaint).

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