Third-Party Risk: Tailoring Contract Clauses, Covenants, and Certifications to Enhance Compliance in a Global Market

Minimizing FCPA and Related Anti-Corruption Risks and Maximizing Key Compliance Safeguards

WEDNESDAY, NOVEMBER 6, 2013
1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today’s faculty features:

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Agenda

• Why the Increase in Ethics & Compliance Clauses?
• Laws and Regulations that Require Clauses
• DOJ Guidance on Using Ethics & Compliance Clauses
• Example Ethics & Compliance Clauses, Certifications, and Audit Rights
• Impact of These Clauses, Certifications and Audits on Your Business
• Best Practices in Developing Your Own Ethics & Compliance Clauses and Certifications
The Landscape – Why the Increase in Ethics & Compliance Clauses
Global Commitment to Fighting Corruption

**United Nations:** "As the international community strives to achieve the Millennium Development Goals (MDGs) by 2015 and forge an agenda for economic and social progress in the years beyond, addressing the problem of corruption becomes all the more urgent."

*Ban Ki-moon Statement on Int’l Anti-Corruption Day*

**World Bank:** “Corruption undermines policies and programs that aim to reduce poverty, so attacking corruption is critical to the achievement of the Bank's overarching mission of poverty reduction.”

**OECD:** Est. 1961, French headquarters, 34 member countries

“Integrity is the cornerstone of good governance. Fostering integrity and preventing corruption in the public sector support a level playing field for businesses and is essential to maintaining trust in government.”
Corruption Enforcement has Increased Everywhere

**US Enforcement**
- Massive corporate fines fueled in part by voluntary disclosure process.
- DOJ and SEC have dedicated additional investigators to FCPA matters.
- FBI maintains a dedicated FCPA/anti-corruption squad.
- Obama administration is continuing focus on FCPA prosecutions.
- DOJ is increasing use of industry-wide investigations.
- Clear interest in both US and international/non-US companies.

**International Enforcement**
- Regulators outside the United States have also increased anticorruption enforcement efforts.
- Many countries are implementing and actively enforcing anticorruption legislation (discussed further below).
- Unprecedented cross-border cooperation between U.S. and foreign regulators.
US Foreign Corrupt Practice Act Actions

*Through June 30th
Top 20 FCPA Settlements (millions)

<table>
<thead>
<tr>
<th>Company</th>
<th>Settlement (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Siemens</td>
<td>$800</td>
</tr>
<tr>
<td>KBR/Halliburton</td>
<td>$579</td>
</tr>
<tr>
<td>BAE</td>
<td>$400</td>
</tr>
<tr>
<td>Total S.A.</td>
<td>$398</td>
</tr>
<tr>
<td>ENI S.p.A.</td>
<td>$365</td>
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<tr>
<td>Technip</td>
<td>$338</td>
</tr>
<tr>
<td>JGC Corporation</td>
<td>$219</td>
</tr>
<tr>
<td>Daimler</td>
<td>$185</td>
</tr>
<tr>
<td>Alcatel-Lucent</td>
<td>$137</td>
</tr>
<tr>
<td>Deutsch / Magyar Telekom</td>
<td>$95</td>
</tr>
<tr>
<td>Panalpina</td>
<td>$82</td>
</tr>
<tr>
<td>Johnson &amp; Johnson</td>
<td>$70</td>
</tr>
<tr>
<td>Pfizer / Wyeth</td>
<td>$60</td>
</tr>
<tr>
<td>ABB</td>
<td>$58</td>
</tr>
<tr>
<td>Pride International</td>
<td>$56</td>
</tr>
<tr>
<td>Marubeni Corporation</td>
<td>$54</td>
</tr>
<tr>
<td>Diebold</td>
<td>$48</td>
</tr>
<tr>
<td>Baker Hughes</td>
<td>$44</td>
</tr>
<tr>
<td>Willbros</td>
<td>$32</td>
</tr>
<tr>
<td>Chevron</td>
<td>$30</td>
</tr>
</tbody>
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# Severe US Jail Sentences for Individuals

<table>
<thead>
<tr>
<th>Name</th>
<th>Company/Position</th>
<th>Sentence</th>
</tr>
</thead>
<tbody>
<tr>
<td>David Kay</td>
<td>American Rice, Inc.</td>
<td>37 mo</td>
</tr>
<tr>
<td>John Warwick</td>
<td>Ports Engineering Consultants Corporation</td>
<td>37 mo</td>
</tr>
<tr>
<td>Robert Antoine</td>
<td>Haiti Telco</td>
<td>48 mo</td>
</tr>
<tr>
<td>Juan Diaz</td>
<td>Third party consultant To Haiti Telco</td>
<td>57 mo</td>
</tr>
<tr>
<td>Douglas Murphy</td>
<td>American Rice, Inc.</td>
<td>63 mo</td>
</tr>
<tr>
<td>Albert Jack Stanley</td>
<td>KBR</td>
<td>84 mo</td>
</tr>
<tr>
<td>Charles Paul Edward Jumet</td>
<td>Ports Engineering Consultants Corporation</td>
<td>84 mo</td>
</tr>
</tbody>
</table>
Non-US Governments Committing to Combat Corruption

**China:**
- New President said in first speech - Pressing problems facing China include graft and corruption;
- Seeing increased enforcement actions

**Brazil:**
- New anti-corruption law to take effective January 2014

**Russia:**
- Joined OECD Convention in Spring 2012
- New anti-corruption laws will became effective in January 2013

**India:**
- Protests and activism against corruption
Laws & Regulations That May Require Ethics & Compliance Clauses
FCPA – Must Manage Business Partners
15 U.S.C. §§ 78dd-1(a), 78dd-2(a), 78dd-3(a)

Your business or third party is prohibited from:

Offering, promising, authorizing anything of value for the purpose of obtaining or retaining business or to gain a government advantage:

• influencing a non-US official’s official act or official decision
• inducing non-US official to do or omit to do any act contrary to their lawful duty
• securing any improper advantage from a non-US official
• inducing a non-US official to use influence with a foreign government to influence the government’s act or decision
• more expansive than just securing a contract or sale
• includes – impacting tax liability; import/export costs; obtaining permits/licenses; beneficial interpretation of laws/regulations; non-public procurement information; extension of time to submit a bid; etc.
### The UK Bribery Act

| Comprehensive and Extra-Territorial | • Covers bribery in both public and private (commercial) sectors  
• Applies to conduct anywhere in the world if the company transacts business in the UK |
|-------------------------------|-------------------------------------------------------------------------------------------------------------------|
| Strict Liability              | • Importantly, contains a corporate offense with a strict liability standard for failure to prevent bribery by an “associated person.”  
• Includes third parties such as advisors, agents, consultants, distributors, etc. |
DOJ Opinions on Contract Clauses
Opinion 06-2, December 2006

• Company wanted to hire non-US law firm to assist it with filing government forms in country where law firm worked
• Firm would perfect certain government filings that had previously been accepted but now government was rejecting
• Contract Included:
  – Certified to no past improper payments and will not make improper payments in the future
  – Certified that no employees or their close family members had been government officials in the past three years
  – Firm would comply with FCPA by not making improper payments
  – Firm understood Company’s compliance policies
  – Company had audit rights
  – Firm required to make progress reports monthly
• Part of what DOJ used to opine the arrangement was acceptable
DOJ Opinions on Contract Clauses
Opinion 08-01, January 2008

- Fortune 500 company wanted to form a JV with a non-US entity
- Non-US entity had significant government ownership and the CEO was essentially a non-US government official
- US company was concerned about non-US entity and its leaders/owners engaging in corruption
- Substantial due diligence was conducted
- Contract included representations and warranties that:
  - Entity’s owners, employees, agents, directors and close family members had not violated FCPA and other relevant anti-corruption laws
  - They will not violate FCPA or other relevant anti-corruption laws in the future
  - They have an ongoing duty to comply with the FCPA and relevant anti-corruption laws
  - Right to dissolve JV in the event of corrupt actions
DOJ Opinions on Contract Clauses
Opinion 10-02, July 2010

- Non-profit that provided grants to local microfinance organizations, concerned about some particular grant recipients in non-US country
- Conducted extensive due diligence on ultimate grant recipient
- Grant terms included:
  - Ongoing monitoring by an independent monitor
  - Audit rights
  - Audit rights extended for 5 years, 2 years beyond the 3 year grant term
  - Prohibited bribes
  - Prohibited anything of value to a government official which could personally benefit the government official
  - Create an anti-corruption policy
  - Keep accurate books and records
  - Certify to compliance on request
  - Right to terminate agreement and recall funds if need be
FCPA Guidance on Handling Third Parties

- Guidance is not binding
- Expected to update third party due diligence regularly
- Exercise audit rights as needed
- Obtain annual compliance certifications
- Assure commitment to ethical and legal conduct
- Control quality of third parties – are they performing for what you paid?
Additional Laws & Regulations

**Campaign Finance**
- Campaign contributions may be either prohibited or restricted
- Government contracts may require compliance certification or require that contributions be disclosed

**Lobbying**
- Lobbying and business development with the government may be limited or restricted
- Government contract may require compliance certification or disclosure of certain communications

**Conflicts of Interest**
- Personal, professional and business relationships with government officials/employees may violate corruption or conflict of interest laws
- Must avoid conflicts of interest
- Government contract may require that relationships with government officials/employees be disclosed

**Gifts/Gratuities/Entertainment**
- May be prohibited or restricted
- Government contract may require compliance certification or disclosure of gifts and gratuities
US Federal Government Requirements

- FAR 52.203-13: Contractor Code of Business Ethics and Ethics
- FAR 52.203-3: Prohibition on gratuities to Federal Government officials and employees
- FAR 52.203-7: Anti-Kickback prohibitions
- FAR 52.203-11: Prohibitions and disclosures on using certain federal money to influence government award decisions
- False Claims Act: Representations to the federal government must be accurate, complete, and truthful
State & Local Government Requirements

Requirements can be statutorily mandated, required by Client’s internal policies, or both

Sample RFP/contract clauses:

- Neither party shall engage in any conduct or activity in the performance of this Agreement that constitutes a conflict of interest under applicable federal, state or local laws, rules and regulations.

- Consistent with Charter § 2604 and other related provisions of the Charter, the Admin. Code and the State Penal Law, no elected official or other officer or employee of the City, nor any person whose salary is payable, in whole or in part, from the City, shall participate in any decision relating to this Agreement which affects his or her personal interest or the interest of any corporation, partnership or other entity in which he or she is, directly or indirectly, interested; nor shall any such official, officer, employee, or person have any interest in, or in the proceeds of, this Agreement.

- The Contractor further represents and warrants that no payment, gift, or thing of value has been made, given, or promised to obtain this or any other agreement between the parties.

- Contractor shall ensure that employees abide by any applicable Client policies and regulations concerning behavior/conduct.
Business Response to Increased Enforcement– Clauses, Certifications, and Audits
Business Are Now Requiring these Clauses in Contracts With:

- Clients
- Subcontractors
- Joint venture partners
- Bidders
- Vendors
- Sales agents/business development agents
- Advisors
- Consultants
- Distributors
- Other third parties and intermediaries
Clauses, Disclosures and Certifications May Include

- Agreement to not engage in any corrupt or fraudulent behavior
- Disclose business relationships
- Disclose personal relationships
- Disclose conflicts of interest
- Disclose campaign contributions
- Disclose ongoing or past internal investigations
- Disclose ongoing or past government investigations
- Disclose non-public government or private settlements
- Certify that no gifts, meals, entertainment or favors have been provided to government officials
- Comply with the other party’s code of conduct or policies – even if you do not know them
- Agreement to engage in “ethical behavior”
- Certify to existing ethics and compliance program
Sample Ethics & Compliance Clauses

Clauses that do not define “conflict of interest” or track the applicable law:

• The Contractor represents and warrants that neither it nor any of its directors, officers, members, partners or employees, has any interest nor shall they acquire any interest, directly or indirectly, which creates a conflict of interest.

Certifications that are overly broad:

• Contractor agrees to adhere to the highest standards of ethical competence and integrity in the performance of this Contract.

• The Contractor certifies that there is no conflict of interest that would violate the Client’s Code of Ethics, including: i) the employment by Contractor of any of Client’s employees or family members; ii) permitting a Client employee or family member to own or have a material personal financial interest (directly or indirectly) in the Contractor; or iii) engaging in material personal business transaction with a Client employee or family member.
Sample Ethics & Compliance Clauses – Cont.

Clauses requiring disclosure:

• Contractor shall disclose any Conflict of Interest or potential Conflict of Interest that may exist. Conflicts of Interest (potential or actual) will be evaluated by the Director of Purchasing of Client to determine the proper course of action.

• No gratuities, in the form of entertainment, gifts, or otherwise, were offered or given by Contractor or any agent or representative of Contractor, to any officer, official, agent or employee of the State, in an effort to secure the Agreement or favorable treatment with respect to any determinations concerning the performance of the Agreement.

• Contractor is not in violation of, charged with, or, to the best of Contractor’s knowledge, under any investigation with respect to violation of, any law, ordinance, or regulation, or any other requirement or order of any governmental or regulatory body applicable to delivery of the Services.
Extreme Remedies for Breach

Instead of using the contractual process for breach clients will attempt to impose harsher remedies, such as:

• Cancellation of Agreement without liability and refund/withhold of all monies paid to Contractor
• Indemnification from any and all claims, investigations, liabilities, or damages resulting from or related to any and all alleged conflicts of interest
• Debarment or finding of Non-responsibility (ineligibility to participate in future business)
• For certifications made under penalty of perjury – possible criminal sanctions
Audit Clauses Included in Contracts

- Audit right is often not tailored to the particular contract
- Time and place of the audit is not specified
- Scope and purpose of audit is not defined
- Party to execute the audit is not agreed
- Audit process is not defined
- Audit may not be required by law
Impact on Agreeing to These Clauses, Certifications and Audits
Impact of ethics and compliance clauses and certifications on businesses

- Disclosure of sensitive business operations and procedures
- Disclosure of ongoing internal or government investigations
- Disclosure of confidential settlements
- Contract terms that expand legal definitions
- Contractual obligations that disproportionally impact one party
- Overly broad audits by business partners
- Excessive compliance costs – human capital and actual cost
- No method to execute such broad due diligence
- No mechanism to comply with ongoing obligations
Risks in Agreeing to Audit Clauses

- Audit right is often not tailored to the particular contract
- Time and place of the audit is not specified
- Scope and purpose of audit is not defined
- Party to execute the audit is not agreed
- Audit process is not defined
- Audit is not required by law
- May be inconsistent with international laws and regulations
- Ownership or disclosure of the findings are not clearly defined
- Ramifications of any “findings” are not clearly defined
Determining Whether to Accept the Requirements

- Is the certification or clause consistent with US laws and the laws of other nations
- Do the requirements have a disproportionate cost or impact on your organization
- Is the clause effective at managing the ethics and compliance risk?
- Do you have the means to conduct the due diligence necessary to make the certifications?
- Do the disclosures expose sensitive business operations and procedures; investigations or settlements?
- What will the cost of complying with the requirements impost on the business?
- How invasive and cumbersome will the audit be?
- Is the scope and purpose of the audit narrowly tailored?
Negotiating Ethics & Compliance Clauses

• Tailor clauses to conform with applicable laws
• Add definitions – eg “conflict of interest”
• Limit conflicts to situations where the Contractor is unable to render impartial assistance, advice, or services to the Client
• Limit application of clause to Contractor and to personnel on the contract
• Qualify clauses “to the actual knowledge” of the signatory
• Edit so that clauses are true and accurate for your company
• Limit/qualify to link to material adverse impact on performance of contractual obligations
Best Practices in Creating Your Own Clauses & Certifications
Assess Need for Clauses and Certifications Based on Risk -

- Do you need to even use a third party?
- Where is the entity located?
- What will they be doing for your business?
- What are the industry standards?
- How much due diligence has been executed on the entity?
- How closely will your organization interact with the third party?
- Are there legally required ethics and compliance flow downs?
- What are the applicable laws?
- What is the length of your relationship?
Should You Seek Audit Rights?

- What risk will audit rights mitigate?
- Who will conduct the audit?
- What is the scope of the audit?
- How often will you audit? Regularly or as needed?
- What can trigger an audit?
- What will you do with any audit findings?
- Is there a government right to audit that must be flowed down?
Should You Seek Disclosures and Certifications?

• Due diligence may provide more accurate and detailed information than contractual disclosures.
• What precisely are you seeking to be disclosed?
• Is there a legal requirement for the disclosure?
• What precisely will you ask them to certify to?
• Should you consider required ethics and compliance training rather than inserting a compliance clause?
• How regularly do you want a certification?
• How will you manage the compliance with the required disclosures and certifications?
QUESTIONS?