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Bribery: Lines less blurred

By Henny Sender



Passing the bucks: in the US and now the UK, even if third party agents are involved in bribery a multinational can be held responsible

Slush funds distributed via travel agencies to pay for sightseeing trips abroad. Shopping bags stuffed with bank notes handed over in parking lots. Those were just two of the ways that IBM of the US greased the palms of government officials in Asia during a number of years, according to the Securities and Exchange Commission.

In March, the computer multinational paid a \$10m fine to settle civil charges brought by America's markets watchdog of violating the Foreign Corrupt Practices Act in its efforts to secure state purchases of its hardware in China and South Korea.

IBM is hardly unique. Just six weeks earlier, the Department of Justice said Maxwell Technologies, a California maker of energy storage products, paid almost \$15m to settle both criminal and civil charges of giving bribes to win sales of its electric utility infrastructure to Chinese state-owned enterprises by inflating contract prices to cover the cost.

Among many other instances involving well-known companies, in 2009 Alcatel-Lucent of France settled with US regulators who found that factory visits and training trips laid on by the telecommunications group for another set of Beijing's bureaucrats mostly involved time spent at Disneyworld and Universal Studios or in Las Vegas.

US authorities are investigating possible violations of the FCPA with greater intensity than ever before, bringing more cases, announcing more settlements and receiving more in fines. The DoJ and SEC together brought 74 cases last year, up from 12 just five years earlier, according to Weil, Gotshal & Manges, a New York law firm. **That is partly because western companies are venturing more into countries where governments control swaths of the economy.** "It is all part of globalisation," says one regulator. "When you operate in emerging markets, it is difficult to navigate from a compliance perspective."

Another reason, however, is that investigations have proved lucrative for stretched federal coffers – as former regulators freely admit. The business pays well. In three years, the proceeds to the Treasury from settlements totalled \$3bn, according to research from White & Case. That is a big selling point when agencies seek congressional approval for bigger budgets. Moreover, in the wake of the global financial crisis and of frauds such as those conducted by Bernard Madoff, regulators are under pressure to show they have teeth. FCPA cases are powerful demonstration tools.

As a result, the issue is becoming increasingly troublesome for those doing business abroad, from the largest multinational to the smallest investment boutique. Even a seemingly innocuous outing for customers or suppliers can raise questions.

While US companies maintain that the strict rules unfairly handicap them, foreign groups complain of the extraterritorial reach of US regulators. Indeed, five of the six largest settlements under the act have been with companies headquartered outside the US, according to Baker & McKenzie. Siemens paid the largest combined penalty and disgorgement sums ever, a total of \$1.6bn in the US and Germany in connection with charges of making improper payments to officials in Argentina, Bangladesh, Iraq and elsewhere to win contracts.

Other governments are emulating the US. The UK's anti-bribery law took effect on July 1. The Organisation for Economic Co-operation and Development has several bribery initiatives, though in its 2011 survey, Transparency International noted that among OECD nations, only seven had active enforcement while 21 had little or no enforcement; the remaining nine made moderate efforts.

Not only in developing countries can activities give rise to concern. The scandal over the News of the World, the British Sunday title closed this month by Rupert Murdoch’s News Corp, has raised questions about potential violations of the FCPA, while “the London Olympics has set off quite a buzz in the FCPA community”, says Brian Whisler, a partner in Baker & McKenzie’s Washington office. “If a big US company flies a client to the Olympic Games, might it be deemed to be creating an unfair business advantage? Now, you have to ask these questions.”

Methods: Cake, wine and charity are all in the frame



Bribery no longer involves just bags of cash – or even \$100 bills baked alongside egg yolks into mooncakes, the pastry Chinese traditionally exchange at their mid-autumn festival.

Moreover, the stakes keep getting higher. One preferred method of bribery in China is to present an official with expensive art.

The official will then place that art with an auction house for sale, whereupon the donor pays for it once more while the official collects the proceeds, paid offshore.

The same dynamic is in evidence with cases of expensive wine. The offices of China branch managers of some foreign banks can look like a vintner, with stacks of expensive bottles to be brought to banquets or presented as part of the requisite relationship building.

Even apparently charitable donations can be considered disguised bribes. Some years back, a subsidiary of Schering-Plough donated \$76,000 to one Chudow Castle Foundation, which had as its mission the preservation of castles in the Silesian region of Poland. The founder of that foundation was also the director of the Silesian Health Fund, with responsibility for procuring drugs for hospitals in the area. The US Securities and Exchange Commission determined that the donations were meant to secure favourable treatment from the health fund. According to the SEC, the company settled its charges.

For most of the years since 1977, when the FCPA was introduced following disclosures of improper payments made to Japanese politicians by Lockheed, the US aircraft maker, the law was no big deal. Its significance started to show itself only lately, both in terms of cases brought and the chilling effect it has exercised. The DoJ established a dedicated unit in 2009, as did the SEC the following year. Each has dozens of staff operating in Washington and in offices outside the capital.

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Steve Tyrrell, who headed the DoJ’s fraud section and is now in private practice at Weil, Gotshal & Manges in Washington, says: “It was an area where the section could distinguish itself.” Regulatory activities have snowballed partly because “it is a shrewd business model”, says Charles Monteith of White & Case in London. “Companies come in with their head on a platter. Regulators have it down to a fine art.”

The economics of so-called industry sweeps are especially sweet. Those are when regulators send out letters to the general counsels of big companies in a sector, asking for detailed

information about how they operate. Some see that as outsourcing the investigation to the targets themselves.

These investigations often focus on sales practices. “It can be a kind of fishing expedition where one tip leads to others,” says one Washington-based lawyer. As groups often fear that convictions may put them out of business, they are usually eager to settle rather than dispute charges in a public trial where, all too often, the facts are not exactly attractive. Some even self-report in the hope of clemency.

Regulators estimate that \$1,000bn is paid in bribes each year, in what one describes as a “soup of illegality”. Settlement payments of \$3bn in the past three years are by that measure still only a drop in the bucket, and enforcement cases and settlements touch only a small fraction of the total activity. But that number is growing.

“If a business depends on bribery, then it doesn’t have a sustainable business model,” says one regulator. “It’s not good for shareholders.”

Critics say there is a huge grey area and, given the potential number of cases, inevitably a degree of arbitrary decision-making in selecting targets. Sceptics add that many practices have to be seen in a cultural context of gift-giving as part of building a relationship. But regulators have scant sympathy for such views. “We don’t pursue cases on the legal grey line,” says one regulator. “Hundreds of millions of dollars are involved in cases that are nowhere close to the line.”

Another reason companies are quick to settle is that lack of knowledge is not an adequate defence. If a drug producer hires third-party distributors who bribe hospital officials to put their medicines on the shelves, that company is still vulnerable to action, on the theory that it failed to maintain adequate internal controls. “That’s where the problems usually are,” says Mark Lehmkuhler, a partner at Davis Polk & Wardwell in Hong Kong. “Companies that decide to do this sort of thing often push out the dirty work to third parties, which increases the due diligence exponentially.”

The rules have two prongs: first, violations involving bribery itself; and second, records, books and internal control violations, which are far easier to prove. A false entry in financial reporting, say by over-invoicing to disguise an improper payment, makes a company and all its directors vulnerable if it files reports in the US, has senior people resident in the country or is listed on a US exchange.

As these investigations gather momentum, investment firms as well as industrial companies are becoming more careful. “Clients are walking away from deals specifically out of concerns with anti-corruption due diligence,” says Asheesh Goel, a lawyer with Ropes & Gray. “If things can’t be cleared, they just walk.”

For example, one US private equity firm dropped out of the auction for a Beijing voltage regulator company being sold by Affinity Partners of Hong Kong because it did not have the time to establish that all the payments to officials of state-owned companies were legitimate, a lawyer familiar with the matter says. The company was ultimately sold to a European investor for \$600m.

Many businesses have changed practices once considered routine. For example, Morgan Stanley now donates money to the favourite charity of winners of its golf outings for clients, rather than giving gifts.

Sometimes, the FCPA has become a means of settling scores. For example, when Blackstone and Warburg Pincus were invested in Kosmos, a Dallas-based oil explorer operating mainly in west Africa, one Ghanaian official contacted the DoJ to report violations of the law. The company produced sheaves of documents, spent a great deal on investigating the charges and then struggled to convince the regulators that they were being duped. Unusually, it received a letter establishing that no wrongdoing had been established. “The FCPA is being used and abused by both sides,” says one investor in Kosmos.

Such tips may become even more common. Provisions in America’s new Dodd-Frank legislation on financial reform encourage whistleblowers to go to regulators rather than through internal reporting lines. They can collect 10-30 per cent of funds disgorged as a result of their information.

The changed approach to bribery has been rapid. As recently as 15 years ago, business people in some European countries were able to deduct bribes from their tax bills. Ten years ago, World Bank officials would make arcane distinctions between concepts such as “adaptive corruption” and “dysfunctional corruption” that to their audience seemed to border on rationalisation.

Corruption today is seen as much less acceptable. However, whether in the long run measures such as the FCPA will make much difference in putting an end to its worst forms, rather than more minor transgressions, remains a question. In any event, the investigations

have meanwhile become big business not only for regulators but lawyers too. Large law firms have also been enthusiastically boosting the staff and other resources they dedicate to the act's strictures. **New legislation: UK act puts big names on notice**

The UK Bribery Act, which came into force on July 1, overhauls laws more than a century old and deemed no longer fit for purpose, writes Caroline Binham.

“We were using Victorian legislation to combat the scourge of 21st-century international corporate crime,” says Jonathan Fisher QC, a senior lawyer in the field. Most notably, the limits of the old law lay in the so-called “controlling mind” requirement to prove that a board member was controlling the bribery.

That is now no longer the case. “For a company to be liable it has to do nothing more than have one of its associated parties bribe on its behalf without there being adequate procedures in place to prevent bribery,” says Vivian Robinson, the Serious Fraud Office’s outgoing general counsel.

The catalyst for the act was a 2008 rebuke by the Organisation for Economic Co-operation and Development over the UK’s feeble record in prosecuting bribery cases. The Paris-based think-tank’s anti-bribery convention, signed in the late 1990s, led to legislation being toughened in many countries.

The UK Ministry of Justice and the SFO say the act benefits business as it helps treat everybody equally in international commerce. Richard Alderman, director of the SFO, says he will target unethical foreign companies that disadvantage UK companies through routine bribes. Companies that systematically flout the law can expect American-style surprise arrests at airports as soon as they touch down on British soil.

The wide-ranging jurisdiction given to UK prosecutors is akin to that enjoyed by their US counterparts under the Foreign Corrupt Practices Act. As the lead prosecuting agency, the SFO can investigate any company with links to the UK, even if it is not based in the country and even if the bribery takes place far from British shores. Suspect payments do not have to be passed to government officials in order for them to fall under the scope of the act. Unlike the FCPA, the Bribery Act also outlaws facilitation payments.

Individuals face up to 10 years in prison; companies face an unlimited fine. For companies, one of the biggest threats is exclusion from public works if they are convicted of corruption.

The OECD will review the act’s effectiveness in autumn. With just £2m (\$3.2m) of the SFO’s total budget of £34m ring-fenced to enforce the Bribery Act, some commentators have questioned just how tough the agency can be.

“Some cynics have said we’ll go after low-hanging fruit,” says Mr Robinson. “Nothing could be farther from the truth: we’ll go after the big names.”