Guilty by Association:
Transnational Joint Ventures and the FCPA

BY DENNIS HAIST

Boards of directors and audit committees of multinational companies are growing increasingly aware of the aggressive pursuit by the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) of violations of the US Foreign Corrupt Practices Act (FCPA). Attorneys and compliance professionals who closely monitor the enforcement activities of the DOJ and the SEC are also aware of record fines and penalties, the use of new detection and investigative techniques, and the government’s focus on the prosecution of individuals. Now, with the passage of the Dodd-Frank Act, there is the added incentive of substantial cash rewards to whistleblowers who report violations of the accounting provisions of the FCPA. As part of their compliance and ethics programs, multinationals subject to the FCPA are conducting greater due diligence on their foreign third party intermediaries, such as agents, distributors, resellers and other foreign business partners. Doing so provides reasonable assurance that companies know with whom they are doing business. It will also minimize the chances that such intermediaries will violate the FCPA when selling the company’s products or services, or obtaining permits, licenses and clearances required to conduct business in foreign countries. This due diligence is critical because most FCPA offenses involve intermediaries, and the DOJ will seek to hold the company responsible for any such violations. Transnational joint ventures represent an increased risk of FCPA exposure. Early involvement by in-house counsel in partner selection and joint venture formation, along with effective compliance controls, are more imperative than ever. This article assumes that in-house counsel are familiar with the prohibitions contained in the FCPA, are generally aware of the FCPA enforcement climate, and that their companies have implemented or are implementing compliance and ethics program provisions to address third-party FCPA risk. The specific guidance provided in this article can serve as a checklist when addressing foreign joint venture partner FCPA risk.
The stakes keep rising

In January 2010, the DOJ announced that 22 individuals had been indicted for engaging in schemes to bribe foreign government officials to obtain and retain business. The indictments were the result of the first large-scale use of undercover enforcement techniques to expose FCPA violations, and the largest DOJ action ever taken against individuals for FCPA violations. This “sting” operation reflects a fundamental expansion from uncovering FCPA violations, to actively targeting companies and individuals who might be tempted to violate the FCPA. The aggressive FCPA enforcement efforts also include the creation of new, specialized enforcement units and dedicated resources; coordinated global efforts in prosecuting FCPA cases; targeting industry sectors, such as medical devices and pharmaceuticals; soliciting tips on violators; increasing use of disgorgement by the SEC; and even anti-bribery charges by the SEC against a nonissuer. The Dodd-Frank Act authorizes cash rewards of between 10 and 30 percent of monetary penalties exceeding $1 million that the government recovers as a result of a whistleblower’s assistance leading to a successful prosecution of securities laws violations, including violations of the accounting provisions of the FCPA. In light of the large fines, penalties and disgorgement amounts recovered in recent FCPA enforcement actions and the new financial incentive, companies should anticipate an increase in whistleblower allegations rather than internal hotline calls from individuals with knowledge of violations. The Wall Street Journal recently indicated that there has been a surge in high quality tips to the SEC. Organizations doing business in or from the United Kingdom will undoubtedly face increased risks relating to corrupt payments beginning in April 2011, when the Bribery Act 2010 is scheduled to take effect. In several regards, the Bribery Act is more stringent than the FCPA, prohibiting corrupt payments not only to public officials, but to private parties as well. The Act contains a new strict criminal liability offence for failure to prevent bribery by a person associated with the organization. The only defense to this offense will be to prove the existence of “adequate procedures” to prevent such payments from occurring. In contrast to the relative lack of guidance by the DOJ, the UK Ministry of Justice has issued draft guidance on the meaning of “adequate procedures” with final guidance to be published early in 2011 before the law comes into force. Principal 3 of the draft guidance requires organizations to have due diligence policies and procedures that cover all parties to a business relationship, including all forms of joint venture and similar relationships.

Characteristics that elevate risk

Many FCPA cases involve transnational joint ventures, defined generally as the entry by one company, referred to here as a multinational, into a foreign market through a joint venture arrangement with a foreign firm. Transnational joint ventures have several characteristics that elevate the FCPA risk to the multinational, whether the multinational has a majority or minority equity interest in the joint venture. Even non-equity licensing or product-development joint ventures may involve an FCPA risk if there is joint venture interface with foreign officials.

Ten characteristics that increase FCPA risks

Identifying these risk factors requires close examination by in-house counsel of the nature and structure of the joint venture and its governing documents. Examples of characteristics that increase FCPA risks include the following:

1. Sharing of risk and reward by the joint venture participants. In its basic form, a transnational joint venture may involve the cooperative pooling of resources by the participants, and the sharing of the rewards of the joint venture. The multinational will therefore benefit from any business obtained or retained, or any permits, licenses, permissions or other advantages granted to the joint venture through improper payments to foreign officials.

2. A joint venture with a local company may be a foreign government requirement to participate in that government’s tendering process. It is not uncommon for a foreign public tender process to restrict bidders to local companies or joint ventures that include a local company. The local company will likely use this requirement to negotiate an equal or majority equity interest and management control over the joint venture, adversely impacting the multinational’s ability to control compliance.

3. The foreign joint venture partner is often selected based upon its local knowledge and connections. The multinational’s international business units will likely propose a strong local partner who is well connected within the country, with knowledge of how things are done to enhance the likelihood of business success. Quite often, in-house counsel will be brought into the discussions only after preliminary negotiations have taken place, and perhaps even after the development of a term sheet, letter of intent or heads of agreement.
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What About My Local Lawyer?

When taking a matter to local courts in a country known for bribery and corruption, some local counsel could suggest a payment to the court to get the desired result. If you have not conducted meaningful due diligence on your local counsel before engaging them, you could end up retaining an individual or firm that may act on its own to explore the possibility of buying a favorable result. Under those circumstances, the local counsel may seek to achieve favorable results by acting through intermediaries, thereby avoiding direct contact with the deciding judge. The proposal may be presented as a contingent payment; e.g., “I will not release the payment unless the court rules in our favor.”

Lawyers practicing in the United States can spend their entire careers interfacing with outside counsel, with never so much as a hint at such activity, but these ethical standards are not universally observed. Aside from making it clear to local counsel at the outset that such practices are out of the question, in-house counsel should strive to find local counsel who have the stature and reputation for integrity within the country, to obviate the need for such assistance. This usually means retaining a large, well-established firm, or a local affiliate of a large US firm.

with the prospective partner. Terms relating to compliance may not appear in any of these preliminary documents, complicating future negotiations.

4. A foreign official may have recommended the foreign joint venture partner. Unless the prospective partner was only one entity on a formal list of pre-qualified local partners, such a recommendation should raise a red flag, as discussed further below.

5. If a joint venture entity is to be formed, it is likely to be formed under the laws of the entered market. Such laws may dictate a certain percentage equity interest by the foreign partner and the appointment of local personnel to officer and management positions.

6. The foreign joint venture partner is often designated responsibility for day-to-day interface with local government officials. It will balk at the seconding of expensive US or Western European expatriates to the joint venture (and its payroll), and block such action if the foreign partner has an equal or controlling equity interest in the joint venture.

7. The foreign joint venture partner may receive a “sponsor” or “management” fee, which may be used for improper purposes. Such fees may simply be based upon a percentage of joint venture revenue or profit, and often are not required to correspond to defined tasks, or specific efforts or hours.

8. The books and records of the joint venture, or portions of them, may be kept in the local language, complicating auditing. The problem becomes more difficult if the foreign joint venture partner is receiving a corrupt payment or offer will be made. When entering into a joint venture with a foreign partner in a country known for corruption, in-house counsel must be concerned that the multinational does not take a “head in the sand” approach.

How Will a $365 Million Loss Impact Your Company?

On July 7, 2010, the SEC announced the settlement of FCPA charges against ENI, S.p.A., an Italian company, and its former indirect Dutch subsidiary, Snamprogetti Netherlands B.V. The DOJ also announced settlement of FCPA-related criminal charges against Snamprogetti. ENI and Snamprogetti will pay a total of $365 million in penalties and disgorgement, making this the fourth largest settlement in a FCPA case. The criminal penalty alone was $240 million. ENI and Snamprogetti were the latest entities to be charged in a Nigerian bribery scheme conducted by a joint venture that also included Technip and KBR, Inc. Technip, KBR and its former parent Halliburton paid a combined $917 million to settle FCPA charges. The $365 million paid by ENI and Snamprogetti brings the joint venture total to more than $1.28 billion.
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For all transnational joint ventures, regardless of whether the multinational has a controlling equity interest:

- Determine who recommended the prospective joint venture partner if the companies have not worked together previously. Question the circumstances and reasoning behind the recommendation, particularly if the entity or principals were recommended by a foreign government official or third party, such as a consultant or agent, who may have a relationship with foreign officials.
- Consider requiring a comprehensive due diligence questionnaire from the prospective foreign partner and its principals, which includes consent to an independent investigative due diligence process.
- Any refusal to describe its ownership, the details of its business, and to answer basic questions relating to the absence of bribery, corruption and relationships with foreign officials or political parties, should be considered a red flag.
- Recommend that the multinational conduct enhanced investigative due diligence on the prospective joint venture partner and principals (with the exception of the approach to its due diligence. To avoid criminal liability under the UK Bribery Act, companies will need to establish and maintain clear and effective anti-bribery “adequate procedures.”) Likewise, ensuring that the multinational has a majority or equal equity interest in the joint venture, and corresponding right to mandate certain joint venture agreement terms, management policies and procedures, and monitoring and auditing of joint venture activities, can mitigate bribery and corruption risks. That said, it may not be possible to fully control the activities of the foreign joint venture partner in its own country.

Key considerations for in-house counsel

In-house counsel should make senior management aware of the heightened FCPA risk associated with transnational joint ventures. To address and mitigate these risks, counsel should request early involvement in joint venture discussions, well before a commitment to a new foreign partner is extended. Follow this checklist of actions and agreement provisions to minimize your risk of violating the FCPA, and assist in detecting violations should they occur.

Baseline Due Diligence Questions

When beginning the due diligence process for third party intermediaries, most companies collect basic information as a starting point for further investigative due diligence. Due diligence questionnaires are normally designed to balance the third party’s burden against the need for enough information for reasonable due diligence, and can be completed by a knowledgeable person in 30 to 60 minutes. Due to the nature of a joint venture business relationship, prudent companies tend to err on the side of gathering more information notwithstanding the burden on the prospective joint venture partner.

In-house counsel should consider preparing a set of due diligence questions that capture the following basic information on prospective joint venture partners and principals:

1. Entity information
   - Entity name, DBA, previous names, physical address and contact information, website address
   - Legal structure, jurisdiction of organization, date organized and whether the entity is publicly traded
   - Entity registration number(s), and dates and places of registration; number of years in business
   - Entity tax licenses, business licenses, or certificates or commercial registrations
   - Description of business, customers, industry sectors

2. Ownership information
   - Name, address, nationality, percentage of ownership and date of acquisition for each parent company up to ultimate parent
   - Name, nationality, ID type/number, percent ownership and date of acquisition for all shareholders and owners (5 percent threshold more for publicly-listed entity)
   - Identity of any other persons having a direct or indirect interest in the entity’s equity, revenues or profits
   - Identity of any other person able to exercise control over the entity through any arrangement or relationship
   - Information on any direct or indirect ownership interest by any government, government employee or official, or political party, party official or candidate

3. Management information
   - Name, address, nationality, ID type/number and title for each member of the entity’s governing board
   - Name, address, nationality, ID type/number and title for each officer of the entity

- Names, addresses and jurisdictions of formation for a companies or other affiliated entities, and ownership interest in each
- Names and contact information for main point of contact
- Names and contact information for entity’s outside accountants/auditors and primary legal counsel
For joint ventures in which the multinational has a controlling or equal equity interest, or is otherwise able — because of financial or technical contributions — to negotiate favorable terms in the joint venture governing documents and joint venture agreement, it is advisable to:

- Include FCPA/anti-bribery and corruption representations, warranties and covenants. The representations, warranties and covenants not to violate the FCPA should also include reference to the national and local anti-corruption laws of the foreign country, including laws enacted to comply with the UN Convention Against Corruption, the OECD Anti-bribery Convention and the UK Bribery Act, if applicable.
- Include a right of immediate termination for breach of the warranties or covenants relating to FCPA/anti-bribery and corruption, and a requirement for annual certification of compliance with such provisions by joint venture partners and joint venture officers, managers and employees. Since termination of a joint venture may not be the most desirable result, consider including other remedies such as the right to

4. Government relationships

- Information on whether any principals, owners, partners, directors, officers or employees hold any official office or have any duties for any government agency or public international organization
- Information on whether any owners, directors, officers or employees have an immediate family member who is an employee, contractor or official of the foreign government, or a public international organization
- Information on whether any employee of, or contractor or consultant to, any government entity or public international organization will benefit from the joint venture
- Approximate percentage of entity’s overall annual sales revenue derived from government sales

5. Business conduct

- Information on whether the entity has ever been barred or suspended from doing business with a government entity
- Information on whether any principals, owners, partners, directors, officers or employees are identified on any government designated nationals, blocked persons, sanction, embargo or denied persons lists
- Information on whether the entity, its principals, owners, partners, directors, officers or employees have ever been charged with, convicted of, or alleged to have been engaged in fraud, bribery, misrepresentation and/or any other criminal act
- Information on whether the entity, its principals, owners, partners, directors, officers or employees have been investigated for violating the US Foreign Corrupt Practices Act or any anti-corruption law
- Information on whether the entity has a compliance program which includes the prevention of bribery and information on the training of employees

6. References

- Three or more unrelated business references, including a bank and existing client.

7. Certification/authorization/declaration

- Certification of accuracy
- Authorization to conduct due diligence, authorization for third parties to release data and consent to collection of data
- Anti-corruption compliance declaration
Is Your Company Ready for FCPA “Sting” Operations?

On Jan. 19, 2010, the Department of Justice, announced the indictment of 22 executives and employees of companies in the military and law enforcement products industry for engaging in schemes to bribe foreign officials. The indictments represent the largest single investigation and prosecution against individuals in the history of DOJ’s enforcement of the FCPA. What was unique and frightening about this enforcement action was the use of undercover “sting” techniques. The defendants allegedly agreed to pay a 20 percent “commission” to a sales agent who the defendants believed represented the minister of defense for a country in Africa in order to win a portion of a $15 million deal to outfit the country’s presidential guard. In reality, the “sales agent” was an undercover FBI agent. The defendants were told that half of that “commission” would be paid directly to the minister of defense. The defendants allegedly agreed to create two price quotations in connection with the deals, with one quote representing the true cost of the goods and the second quote representing the true cost, plus the 20 percent “commission.” The defendants also allegedly agreed to engage in a small “test” deal to show the minister of defense that he would personally receive the 10 percent bribe. Assistant Attorney General Lanny A. Breuer said: “The fight to erase foreign bribery from the corporate playbook will not be won overnight, but these actions are a turning point. From now on, would-be FCPA violators should stop and ponder whether the person they are trying to bribe might really be a federal agent.” Each of the indictments allege that the defendants conspired to violate the FCPA, conspired to engage in money laundering and engaged in substantive violations of the FCPA. The maximum prison sentence for the conspiracy count and for each FCPA count is five years. The maximum sentence for the money laundering conspiracy charge is 20 years in prison.

If the multinational has a minority equity interest in the joint venture, it may still be possible to implement basic ethics and compliance controls by negotiating for supermajority approval of certain actions, such as the appointment of joint venture officers and managers, the engagement of agents and consultants, and the engagement of the independent auditor. If the multinational is unable to achieve what it believes to be reasonable ethics and compliance controls over joint venture operations, or the results of due diligence produce unresolved red flags, in-house counsel should advise senior management of the compliance risks that the joint venture may represent to the multinational, and recommend passing on the opportunity.

Acting on the foregoing considerations, and having senior representatives of the multinational conduct in-country monitoring of joint venture compliance and ethics procedures, should provide reasonable assurance to the multinational’s board that measures exist to prevent and detect violations of the FCPA. These considerations may also enhance compliance with other laws and regulations that may apply to the multinational, such as those relating to export control. There is also

- Conduct an independent investigation, removal and replacement of offending joint venture employees, and financial penalties to the foreign partner.
- Require that the joint venture follow generally accepted accounting principles (GAAP), properly identify and characterize all financial transactions, keep books and records in the English language (or multinational’s home language), and conduct an annual audit by an agreed upon independent accounting firm.
- Include the right to conduct ongoing audits of the joint venture books. Consider negotiating the right to audit the foreign joint venture partner’s use of any management or sponsor fees paid by the joint venture. An ideal situation would be funding by the joint venture of a full-time senior financial position, filled by an expatriate with auditing experience, and chosen by the multinational. This individual could also be designated as the second signature on joint venture checks and fund transfers.
- Prohibit the creation of any funds without the approval of the joint venture’s governing body (supermajority approval in the case of minority interest by the multinational).
- Include the right of the designated representative of the multinational to attend any meetings with foreign officials, and provide for funding by the joint venture of an independent translator, retained by the multinational.
- If the foreign joint venture partner has day-to-day management responsibilities, require dual signatures for checks or electronic funds transfers drawn on joint venture bank accounts.
- Require that the joint venture conduct investigative due diligence on agents, consultants and other third parties retained by the joint venture. Require that contracts with such third parties be approved by the joint venture’s governing body or a committee of such body (supermajority approval in the case of minority interest by the multinational).
- Require the implementation of a code of business conduct by the joint venture, and implement an anonymous reporting mechanism for joint venture employees, so that a designated representative of each partner receives any hotline reports.
the possibility that investigative due diligence may uncover information that a prospective partner is not only a compliance risk, but also a serious financial risk. This was the case when Nokia and Motorola entered into the cellular phone business with the Uzan family companies in Turkey. 

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NOTES
3 Dodd-Frank Wall Street Reform and Consumer Protection act, HR 4173, 105th Cong §922 (2010).
4 http://online.wsj.com/article/sb100014240527487048551045754700899896588.html.