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RISK MANAGEMENT

BY JAMES LORD, REBECCA FELSENTHAL

Foreign agents and partners: Blessing or curse to international business?

Inadequate anti-corruption compliance measures can subject a company to both civil and criminal liability for third-party corruption, as well as seriously tarnish its brand

AS OUR LAST ARTICLE DISCUSSED, the greatest threat to brand owners may well be their own partners. Inadequate anti-corruption compliance measures can subject a company to both civil and criminal liability for third-party corruption, as well as seriously tarnish its brand. According to Ernst & Young's 12th Global Fraud Survey, 90 percent of Foreign Corrupt Practices Act (FCPA) cases involve third parties. For most multi-national companies, third parties are essential to their success, but simultaneously create risk in the anti-corruption area. Fortunately, there is a solution: implement an effective third-party due diligence program.

Regulatory Guidance

The FCPA's anti-bribery provisions prohibit corrupt payments to foreign officials with the intent to influence the award or retention of business. Regulators have made it clear that the FCPA forbids corrupt

payments by third parties or intermediaries. *See A Resource Guide to the US Foreign Corrupt Practices Act* (the Guide). Moreover, settlement agreements have repeatedly required companies to engage in "properly documented risk-based due

diligence" for their partners. *See Deferred Prosecution Agreement, Panalpina World Transport (Holding) Ltd.* Companies' failure to adhere to this regulatory guidance has resulted in the imposition of enormous penalties. For example, in January 2014, Alcoa's subsidiary paid \$223 million in penalties for FCPA violations resulting from the payment of millions of dollars in bribes through a London-based middleman. Similarly, Alstom S.A. recently paid more than \$772 million in penalties for using "consultants" to pay bribes disguised as payments for "consulting services."

As set forth in the Guide, "[b]usinesses may reduce the FCPA risks associated with third-party

agents by implementing an effective compliance program, which includes due diligence of any prospective foreign agents.” Since the Guide’s publication, the Department of Justice (DOJ) has declined to prosecute both Morgan Stanley and PetroTiger, despite clear FCPA violations by their managers. The DOJ cited to the strength of the companies’ compliance programs (including their third-party due diligence process) as a reason for the declinations.

Which Partners Create Risk?

When companies evaluate the type of third parties that create risk, they often think of agents like the “middleman” or “consultants” hired by Alcoa and Alstom S.A. However, other types of third-parties also create risk for companies, including freight forwarders, customs brokers, sales representatives, distributors, and joint venture partners:

- *Freight Forwarders:* Panalpina admitted that between 2002 and 2007, its foreign subsidiaries and agents had paid bribes to circumvent local import regulations in numerous foreign jurisdictions. As part of its settlement agreement, Panalpina was required to enhance

its compliance program and pay over \$81 million in penalties. Panalpina’s customers were also subject to investigation. For example, Shell Oil Co. and its subsidiaries entered into a deferred prosecution agreement (DPA) and were required to pay approximately \$48 million in penalties related to Panalpina’s payment of bribes on its behalf.

- *Customs Brokers:* In 2010, New Orleans-based shipping company Tidewater Inc. admitted to reimbursing its Nigerian customs broker \$1.6 million for bribes paid to Nigerian Customs officials to induce them to ignore regulatory requirements governing the importation of Tidewater’s vessels. Tidewater and its subsidiary paid over \$15 million in penalties for FCPA violations.
- *Sales Representatives:* In April 2015, United Technologies Corporation announced that it was under investigation by the Securities and Exchange Commission (SEC) for FCPA violations involving alleged bribes paid by a non-employee

sales representative relating to the sale of engines and aftermarket services in China.

- *Distributors:* In 2012, medical device company Smith & Nephew entered into a DPA with the DOJ for having violated the FCPA via improper payments made by its Greek distributor to public doctors.
- *Joint Venture Partners:* In 2010, the partners in a four-company joint venture agreed to pay criminal penalties for their role in a bribery scheme to obtain engineering, procurement and construction contracts from the Nigerian government. Although each joint venture partner owned only a 25 percent interest, they were required to pay penalties ranging from \$218 million to \$579 million.

What is the Solution?

There are steps companies can take to minimize the risk created by relationships with third parties, including the following:

- Ensuring the organization has a robust compliance program premised on a culture of ethics and

compliance that permeates the organization and extends to its third parties;

- Implementing an effective risk-based third-party due diligence process;
- Developing effective third-party anti-corruption policies;
- Requiring third parties to provide audit rights and certify compliance with anti-corruption laws; and
- Conducting anti-corruption training for third parties.

How Can You Implement an Effective Risk-Based Due Diligence Process?

Regulatory guidance is clear that a “properly documented risk-based due diligence” process for a company’s third parties minimizes risk and is a hallmark of an effective compliance program. One effective way to implement such a process is by using an automated third-party due diligence and data management platform that identifies applicable geographic and transactional risk factors, weights them, and classifies third parties as “very low risk” to “very high risk” based upon the weighted factors. The assigned

risk category then corresponds to the appropriate level of due diligence to be conducted with respect to a particular third party. Such an automated system allows companies to comply with regulatory expectations and manage third-party risk in a cost effective manner.

Conclusion

The Dodd-Frank Act whistleblower provisions provide enormous incentives to company insiders and third parties to report FCPA violations to regulators, since whistleblowers are eligible to receive up to 30 percent of any settlement -- and FCPA settlements typically range from the tens to hundreds of millions of dollars. The stakes are simply too high to ignore the risks posed by third parties. A company’s failure to implement an effective third-party due diligence process will likely result in FCPA exposure, and could result in the company and/or its managers and executives facing criminal and civil liability. Fortunately, cost-effective third-party due diligence data management platforms are available to assist companies with their third-party due diligence and

with properly documenting that process. Consequently, should regulators come knocking due to the rogue act of some third party, the company should be able to demonstrate through its data management platform that it did all the right things and hopefully avoid liability.

CONTRIBUTING AUTHORS

JAMES LORD is a shareholder with Inman Flynn. His practice focuses on internal investigations, compliance, business crimes, regulatory matters, and complex civil litigation (including class action litigation). Jim is a seasoned litigator and compliance practitioner who served as a U.S. Department of Justice prosecutor for over twenty years.

REBECCA FELSENTHAL is an associate at Sideman & Bancroft in San Francisco. Working with the firm’s Brand Integrity and Innovation Group, she represents business entities in connection with brand protection issues, trademark enforcement, and a range of civil litigation matters.