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How To Avoid The FCPA Hook For 3rd-Party Misconduct

By T. Markus Funk

Law360, New York (March 9, 2011) -- 2010 was nothing short of a breakout year for the reinvigorated criminal and regulatory enforcers of the Foreign Corrupt Practices Act. And the government's ever intensifying FCPA enforcement efforts aimed at "direct" company bribery or books and records misconduct understandably have been the topic du jour in many U.S. boardrooms.

What often appears to be missing from discussions, however, is a realization that in the majority of recent FCPA cases, liability attaches indirectly through the misconduct of foreign third parties, such as a company's agents, intermediaries, consultants, joint venture partners, suppliers, distributors, local counsel, private equity portfolio companies and franchisees. As we move into 2011, all signals are that such third-party liability will become an increasing target for the government — and a growing headache for U.S. businesses.

An Overview of the Legal Basis for Third-Party Liability

The FCPA, in part, expressly provides for direct company and individual liability for bribes paid (that is, "anything of value" given) by a third party to (1) foreign government officials, (2) foreign political parties or officials, or (3) candidates for foreign political office, provided the principal has "knowledge" of the third party's misconduct.[1]

The FCPA itself directs that, as a matter of law, "knowledge" exists when "a person is aware of a high probability of the existence of [the corrupt conduct]."

The FCPA's twin enforcers, namely, the U.S. Department of Justice and the U.S. Securities and Exchange Commission, in keeping with this broad definition, interpret a principal's "knowledge" to include circumstances where the company fails to exercise due diligence by, for example, following up on "red flags." The courts have, in turn, followed the government's lead. Under this now generally accepted expansive interpretation of "knowledge," constructive — rather than actual — knowledge is, therefore, all that is required to support an FCPA charge.

Without question, this is a low threshold for liability considering (1) the inherent difficulty in controlling foreign third parties, and (2) the potentially disastrous consequences to companies unable to demonstrate good faith efforts to conduct the appropriate due diligence in their hiring, contracting and subsequent monitoring.

The Bourke Case and "Conscious Disregard" as a Basis for FCPA Liability

Consider, for example, the recent case of successful entrepreneur Frederic Bourke. Bourke made an $8 million investment in the failed privatization of the Azerbaijani government-controlled petroleum industry. Although Bourke was not alleged to have himself bribed or directed any acts of bribery, the government charged that he invested in an entity which he knew, or should have known, engaged in a scheme to bribe the Azerbaijani officials.

The trial judge, accepting the government's deliberate ignorance argument, instructed the jury that conscious disregard of a "high probability [that corrupt payments had been offered or made]" constituted knowledge. On July 20, 2009, a New York jury convicted Bourke of conspiring to violate the FCPA, resulting in a year and a day imprisonment, as well as a $1 million fine.

Private Equity and the FCPA

The government's willingness to push the third-party envelope is again on display through recent reports that the SEC is investigating Allianz SE, Europe's largest insurer, for bribery by a German printing press. The investigatory finger points to Allianz simply because it was the majority stakeholder in the press. Allianz, in short, now has to worry about joining the ranks of BAE Systems ($400 million in fines and disgorgement in 2010), Snamprogetti ($365 million in 2010), and others who acquired companies, only to later have to pay the price for the acquiree's misdeeds.

What is a Company to Do? Proactive Steps to Avoid Third-Party Liability

The lesson from Bourke and the Allianz investigation is that companies that want to ward off claims of conscious disregard toward third-party misconduct should consider putting into place compliance programs and other internal controls narrowly tailored to the individual company's particular circumstances. Such proactive measures can include:

Require appropriate company officials to complete a company-internal FCPA Contracting Form

An internal FCPA Contracting Form can initiate the due diligence process. Such a form can be used to memorialize (1) background information concerning the prospective third party, and its competition, and (2) information relating to the reasons the company selected a particular third party over others.

Require the prospective foreign third party to complete a detailed FCPA Third-Party Questionnaire

A third-party questionnaire, tailored to the specific circumstances of the company and of the third-party relationship, can be used to elicit key background and "red flag" information. Depending on the answers

received, appropriate follow-up inquiries help demonstrate good faith due diligence and otherwise robust and effective internal controls.

During the negotiation phase require the third party to execute an FCPA Acknowledgment Letter

Letters that summarize, both in English and in the third party's native tongue, the FCPA's legal requirements can also help emphasize the company's ongoing commitment to FCPA compliance and its expectation that all of its business partners and third-party intermediaries share that same dedication.

Substantive Follow-Up

The company's obligations do not end with the pen stroke finalizing the post-inquiry deal. Third-party supervision and monitoring ought to continue throughout the term of engagement. If additional red flags emerge, the company should undertake appropriate steps to investigate them.

Create a thorough and complete FCPA Due Diligence File

In order to provide ready, one-stop access to the documents, responses and follow-up activities outlined above, companies should maintain comprehensive FCPA due diligence files. The files can include any potential red flags raised during the due diligence process, as well as any actions taken in response to them, specifying who within the company (or within outside counsel) undertook what specific due diligence activities.

No fortune teller is needed to predict that in 2011 and beyond the misconduct of foreign agents, intermediaries, consultants, joint venture partners, suppliers, distributors, local attorneys, private equity portfolio companies and franchisees will pose an ever-expanding threat of generating third-party FCPA liability to U.S. companies doing business with them.

And, when trouble hits, an effective, robust, in-place compliance program addressing principal-third party issues may well prove to be a game-changer when dealing with the government. There can be little doubt that the corporate stakes are high in this area of federal law enforcement. Companies must, therefore, seek out experienced counsel to tailor a compliance program that meets their particularized needs. As the old saying goes, an ounce of prevention is worth a pound of cure.

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[1] The FCPA, however, contains an explicit exception to the bribery prohibition for "facilitating payments" for "routine governmental action" (both of which unfortunately remain largely undefined) and provides certain specified affirmative defenses that can be used to defend against alleged violations of the FCPA.