

Foreign Agents, Partners & Intermediaries: You Can't Live With Them, But You Can't Live Without Them

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Agenda

- Overview of the FCPA & Associated Third Party Risks
- Third Party Due Diligence in Practice
- Data Analytics & Risk-Based Sampling

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Overview of the FCPA & Associated Third Party Risks

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The Foreign Corrupt Practices Act ("FCPA")

Anti-bribery provision: Makes it unlawful to offer or make a corrupt payment to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business.

Books & Records provision: Requires corporations to:

- Make and keep books and records that accurately reflect the transactions of the corporation; and
- Devise and maintain an adequate system of internal accounting controls.

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Anti-Bribery Provision – Third Party Relationships

The FCPA prohibits knowingly making corrupt payments through third parties, agents, and intermediaries, including subsidiaries and joint venture partners.

- “Knowing” includes conscious disregard, willful blindness, and deliberate ignorance.
- “Knowledge” exists where one is aware of a *high probability* a bribe would be offered or paid.

- Requires “*due diligence*” in dealing with third parties and knowledge of *red-flag* issues.

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DOJ Guidance & Corporate Enforcement Policy

In February 2017, DOJ published its *Evaluation of Corporate Compliance Programs* guidance outlining how it evaluates the effectiveness of a corporate compliance program, specifically outlining its expectations in such areas as -

- Ethical Leadership from Senior and Middle Management
- Autonomy and Resources of the Compliance Function
- Compliance Policies and Procedures
- Risk Assessment & Third-Party Management
- Training and Communications
- Compliance-related Incentives and Disciplinary Measures
- Continuous Improvement, Periodic Testing and Review

In November 2017, DOJ released its *FCPA Corporate Enforcement Policy*, formalizing its 2016 “FCPA Pilot Program” by announcing that when a company self-reports, fully cooperates, & timely remediates, DOJ will presume a declination is warranted, and has published recent declinations pursuant to this policy on its website:

- Insurance Corporation of Barbados Limited (August 23, 2018)
- Guralp Systems Limited (August 20, 2018)
- Dun & Bradstreet Corporation (April 23, 2018)

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Can't Live With Them, But... Can't Live Without Them?

- Companies face liability for third parties acting on their behalf
- 90%+ of reported FCPA cases involve third-party intermediaries
- 2018 FCPA Cases Involving Third Parties
 - ✓ *Stryker* (Sept 2018): Insufficient internal controls to detect and prevent third party schemes such as dealers that issued inflated invoices to ultimate private hospital customers and a distributor who « reimbursed » government employees expenses for attendance at Stryker events that Stryker had already paid for
 - ✓ *Société Générale* (June 2018): Paid commissions to Libyan broker to use as bribes to Libyan officials to secure investments from Libyan state institutions
 - ✓ *Panasonic Avionics* (April 2018): Retained as a consultant a state-owned airline employee while that employee was involved in negotiating a lucrative contract amendment on behalf of the airline, and paid funds to vendor to hide ultimate payments to sub-agents that did not pass the company's internal diligence requirements
- Use of third-party intermediaries is a business necessity

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Only Show in Town

SCENARIO:

- Your company is bidding on a public contract in a high-risk emerging market.
- The law on public procurement consists of a single statute established a complex public bidding process plus a variety of government decrees, circulars and official guidance letters.
- Due to the detailed and complex legal process, you determine the company needs assistance navigating the public procurement process.
- A local contact familiar with the process strongly recommends a specific consultant to help avoid problems commonly encountered by foreign companies.
- The local consultant seems established, has a reputation for "getting things done" and appears to have a good relationship with the procuring agency's procurement director.
- You have been unable to find any adverse information in public database or media searches.
- You cannot identify any other recommended consultants to use in that country.

Any concerns or red flags?

Recommendations to get comfortable?

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Who's On First?

SCENARIO:

- You have been offered a deal in an emerging market with a joint venture company consisting of JV Partner #1 (the operating partner) and JV Partner #2 (the operating partner's funder).
- JV Partner #2 is a venture capitalist that JV Partner #1 (the operating partner) has declined to give you further information on, claiming they are a passive investor who insists on anonymity.
- Amounts owed to you by the joint venture will be paid to your U.S.-based bank through a special fund created by JV Partner #2 in their own local bank.
- JV Partner #2 will also directly pay other companies involved in the deal any amounts owed to them by the joint venture.
- JV Partner #1 (the operating partner) explains that JV Partner #2's anonymity and this payment arrangement are conditions of the funder's investment in the joint venture.
- No adverse information has been discovered on the identified companies, although this emerging market has a high risk CPI rating per Transparency International.

Do you need to know the full identify of JV Partner #2 (the funder)?

What other controls or measures, if any, can you take if you do not know who the funder is?

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Corruption History v. Mere Politics

SCENARIO:

- You discover that the principal of your strategic partner in a certain emerging market was convicted of "corruption against the people" and tax fraud several years ago.
- Your partner has a long history of conducting business with political opponents of the country's ruling party and claims the charges and conviction were politically motivated.
- The country's ruling party has been known to trump up charges against political opponents, but this country also is also considered high-risk for corruption.
- Your business leaders insist that the partner is trustworthy and is simply the victim of political fighting.

What can you do to help assess whether the past convictions were politically motivated or evidence of actual corruption?

How can you manage situations where the local business leaders do not agree with your risk assessment? Who makes the final decision?

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Third Party Due Diligence in Practice

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Third-Party Relationships: Assessment of Risk

DOJ's FCPA Resource Guide provides:

- "Risk-based due diligence is particularly important with third parties and will also be considered by DOJ and SEC in assessing the effectiveness of a company's compliance program."
- "Performing identical due diligence on all third party agents, irrespective of risk factors, is often counterproductive, diverting attention and resources away from those third parties that pose the most significant risks."

The Bribery Act 2010 Guidance, directs organizations to take a "proportionate and risk based approach, in respect of persons who perform or will perform services for or on behalf of the organisation, in order to mitigate identified bribery risks."

What does this mean in practice for global organizations?

- Reasonable Risk Based Approach
- Higher the Risk = Higher Level of Due Diligence
- Consistent Application of Process, Periodic Review & Audit Trail

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Third-Party Relationships: "The Standard?"

World Economic Forum Good Practice Guidelines on Conducting Third-Party Due Diligence (2013)

- "I am confident that my agent, reseller, supplier etc. does not make corrupt payments, and that our business relationship is a normal, legitimate one. I can explain to, and convince others why my confidence is justified."
- "This means making appropriate inquiries to determine whether an organization's existing or prospective third parties are honest and can be reasonably expected to refrain from corruption. The higher the risk, the broader and deeper the third-party due diligence should be."

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Mitigating Measures

SCENARIO:

- Your screening of a potential new reseller discovers media reports of an ongoing government corruption investigation involving a 15% owner of the reseller company.
- This 15% minority owner had other business dealings with the local government through a separate company, and is alleged to have conspired with government officials to purchase prime public land at below-market values.
- In addition to being a minority shareholder, the 15% owner is also one of the corporate directors of the reseller company.
- You are not sure what role that 15% owner has in directing or overseeing the reseller's business.

What further due diligence would be prudent to do, and on whom?

Are there any mitigating measures that might get you comfortable with doing business with the reseller company?

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How Much Due Diligence Is Enough?

SCENARIO:

- You have a potential distribution deal with a local partner in a high-risk emerging market where local law requires foreign businesses to partner with a local company.
- You have no experience with the potential new partner, so decide to conduct due diligence.
- Public database and media screening reveals commercial disputes by the partner's shareholders in other countries involving claims of counterfeiting by one claimant and breach of contract by another claimant.
- Enhanced due diligence reveals a complex ownership structure, with no single person or company owning the majority of the potential partner company.
- You learn that the potential partner company was only formed in this emerging market a year ago and does not have a established business history in this market.
- You learn that the potential partner has a local office in the country, a legal requirement for this type of business venture.

Is further "boots on the ground" diligence appropriate?

If so, what type of "boots on the ground" diligence would you recommend?

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Data Analytics & Risk-Based Sampling

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Data Analytics & Risk-Based Sampling

Use data analytics to make risk-based judgmental samples over three years of disbursement data (~60K transactions).

- ❑ Manual review is time consuming, requires too many resources, and can be ineffective.



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Risk-Based Approach

1. Focus on the appropriate period to test whether controls are effective.
2. Select the right locations.
3. Look at trends on an analytical basis – make sure the trends match the books!
4. Understand customs & practices and assess reasonableness.
5. Judgmentally select a sample of transactions for high-risk contracts / payment recipients.
6. Sometimes the books may be correct, even when you find something.
7. Follow through with interviews.

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Risk-Based Approach (cont.)

1. Selection of 80 disbursements for testing, with a focus on high-risk areas such as payments to / for:
 - a. High-risk vendors
 - b. Vendors not on approved list
 - c. Employees
 - d. Travel & entertainment expenses / Consulting fees
 - e. Seminar / conference / training expenses

Focus on Employees



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You Need More Than Technology

SCENARIO:

- A global company, in the business of building power stations, sold a 25% stake in a South African subsidiary ("Sub") to a company called Front in 2014 for \$200K.
- In 2015, Sub was awarded \$6B in power station contracts in South Africa.
- In late 2016, Company repurchased 25% share of Sub from Front for \$4MM.
- In reviewing the books & records of the South African subsidiary, you noticed a consulting fee of \$1.5MM to Front in 2015, plus dividend payments of \$1MM to Front in 2016.

How would you proceed to determine the legitimacy of the consulting fee, dividend payments, and repurchase of shares?

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COMMENTS OR QUESTIONS?
