

Corruption crackdown*

How the FCPA is changing the way
the world does business



*connectedthinking

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The heart of the matter

Anticorruption compliance rises on the boardroom agenda.

An aggressive international push to fight corruption has moved well beyond well-intentioned rhetoric and toward hard results. Foreign Corrupt Practices Act (FCPA) investigations and enforcement actions have spiked in the last several years while investigation backlogs pile up and criminal prosecutions lead to executives serving prison sentences. Penalties, disgorgement of profits and monitoring costs have also grown appreciably. Additionally, forfeiture actions against foreign officials receiving bribes further indicate greater progress by anticorruption regulators. Two underpinning factors have driven this push: (1) a deeper desire among most developed nations to establish a level playing field for business competitors regardless of their countries of domicile and (2) the recognition by governments that corruption of any type is a destabilizing force within the international community.

Companies face intensified risks and competition as they expand globally via mergers and acquisitions (M&A), especially where geopolitical risk and corruption are pervasive. This new anticorruption era is forcing companies to change their behaviors to adapt to greater financial and reputational risks. At the same time, gray areas—including facilitation payments, travel and entertainment expenses and the retention of third-party agents—add to the ever-heavier burden of anticorruption compliance.

Business leaders and board members should take notice. How well companies prepare for geopolitical risk and anticorruption compliance could make or break the viability of doing business in a desired region. While the US and the Organisation for Economic Co-operation and Development (OECD) have led the world in promoting and harmonizing antibribery initiatives, some countries still lag and send mixed messages with inadequate records on antibribery legislation, policing and investigative rigor. The resulting patchy progress in combating corruption throughout the world leaves US companies to expect the worst and guard most vigilantly against exposure to FCPA violations. Some companies may believe that complying with anticorruption laws inevitably places them at a competitive disadvantage against companies that do not comply. While this may be true in some cases, the increasing vigor of anticorruption investigations should not necessarily discourage companies from doing business in countries where bribery, for example, is pervasive. Instead, companies that commit to competing internationally need to build in aggressive and thorough anticorruption compliance measures, especially in monitoring contracts, M&A due diligence and budgets—thus guarding against risks of unpredictable employee behavior in all corners of the world where companies do business.

The following trends are likely to intensify going forward:

- The number of FCPA cases and severity of penalties will likely continue to increase as the US Department of Justice (DOJ) and the US Securities and Exchange Commission (SEC) work through a backlog of up to an estimated combined 120 cases. The year 2008 saw its first billion-dollar settlement, with a global company agreeing to pay over \$1.6 billion in penalties to several governments.
- FCPA compliance will become a top corporate governance issue leading to more rigorous FCPA compliance and self-monitoring programs. The onus—and the expense—will continue to be placed upon companies to dedicate greater resources to anticorruption initiatives, including due diligence, during mergers and acquisitions.
- International harmonization of antifraud and anticorruption regulation will lead to more parallel investigations, with the likely consequence of increased penalties.
- FCPA investigations will likely continue to trigger other actions such as shareholder litigation, tax investigations and money-laundering probes.
- Individuals are likely to face increased scrutiny when regulators are investigating potential FCPA violations.

An in-depth discussion

Enforcement wave puts companies on notice.

Anticorruption trends

FCPA enforcement actions strong in 2008, large backlog into 2009

In 2008, regulators at the DOJ and the SEC were involved with investigations unusually large in scope. This could explain the slight decline in the number of cases in 2008 as compared with 2007. However, the backlog of FCPA cases has grown. Mark Mendelsohn, the Deputy Chief of the Fraud Section in DOJ's Criminal Division, confirmed at the end of last year, there were some 100 companies involved in open FCPA investigations.¹

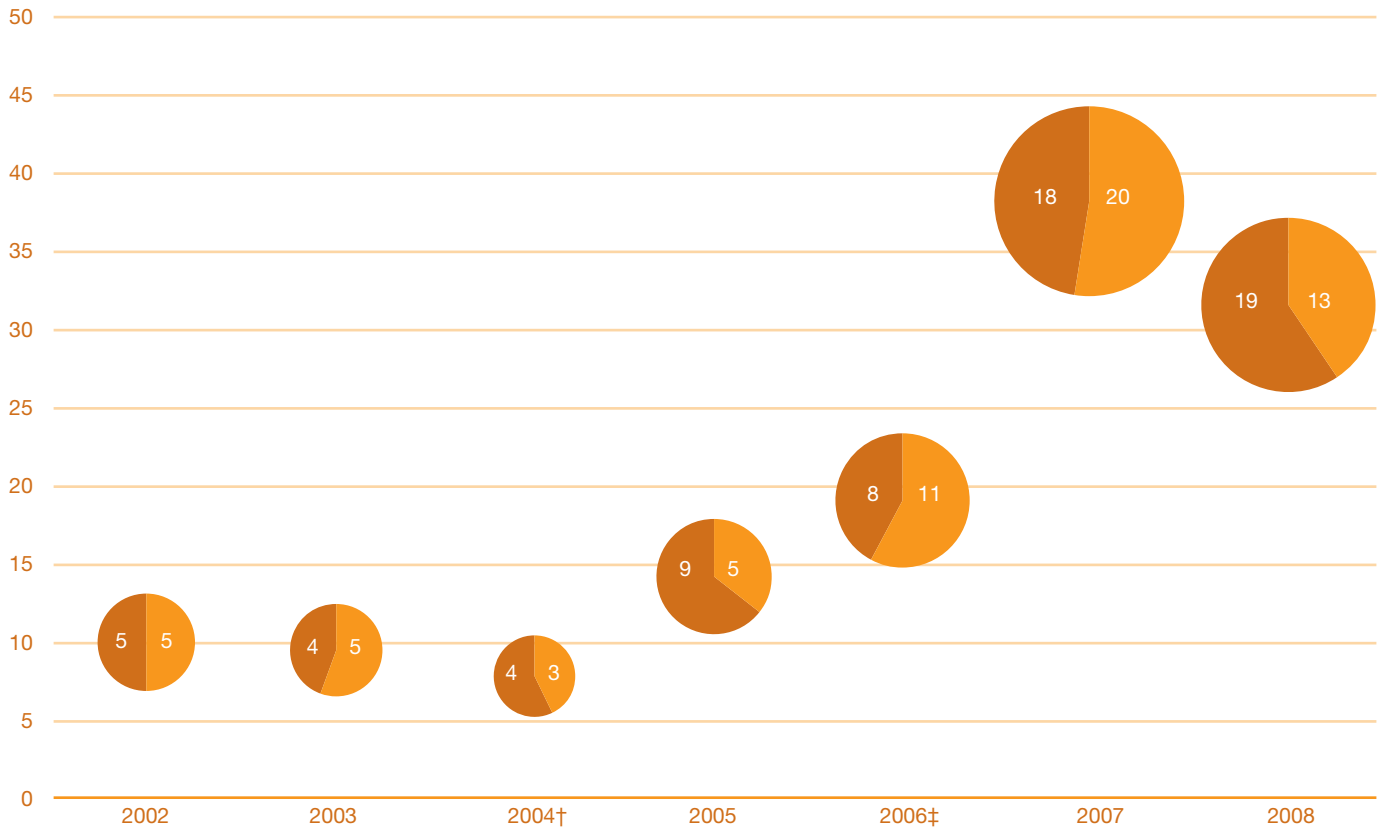
What is the FCPA?

In 1977, the US Congress enacted the Foreign Corrupt Practices Act to prohibit bribery and corruption of foreign officials and to promote fair business practices, integrity and accountability and the efficient and equitable distribution of economic resources. The FCPA created criminal and civil penalties for payments (or even the promise of anything of value) by US corporations or US nationals to foreign officials that could be interpreted as bribes for any improper advantage in obtaining or retaining business. Additionally, the FCPA applies to foreigners who take part in furthering such bribes while in the US. The FCPA's provisions apply to "issuers," which include companies that have issued securities registered in the US or that are required to file periodic reports with the SEC. The FCPA also covers foreign issuers of American Depositary Receipts traded on US stock exchanges. The FCPA focuses as follows:

- The **antibribery provisions** prohibit the promise, payment or giving of money or anything of value to any foreign official for the purpose of obtaining or retaining business or gaining an improper advantage.
- The **accounting and internal control principles** (also known as the books-and-records provisions) require companies to (1) maintain a system of internal controls that provide reasonable assurance that management's instructions are being carried out and that discrepancies in a company's books and records are detected and remediated and (2) make and keep books, records and accounts that, in reasonable detail, accurately reflect the transactions and dispositions of assets of the issuer.

¹ 2008 Year-end FCPA Update, Gibson, Dunn & Crutcher LLP, January 5, 2009.

Figure 1. Total FCPA proceedings brought against companies and individuals, 2002–2008



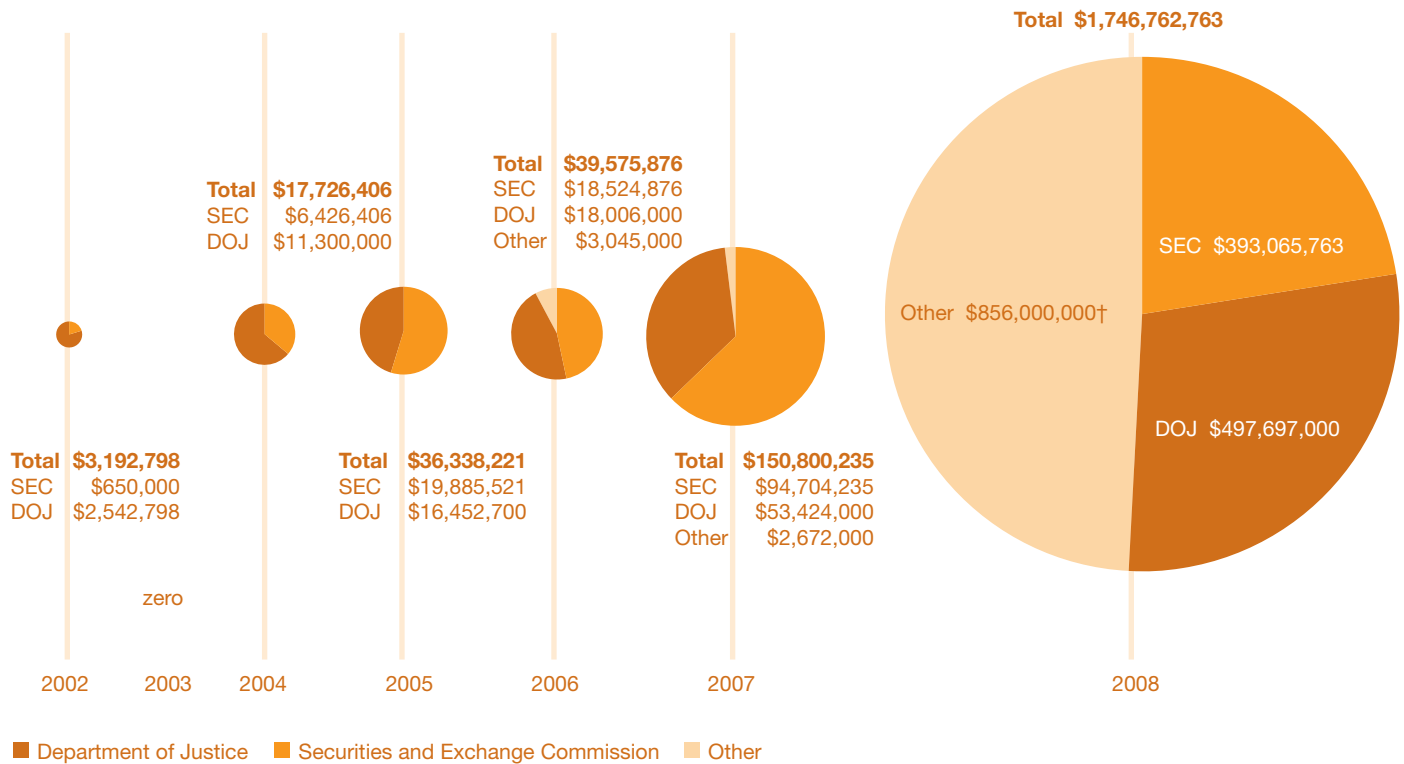
■ Department of Justice ■ Securities and Exchange Commission

† DOJ includes two individuals who pleaded not guilty.

‡ DOJ includes proceedings brought against one individual who pled guilty to money laundering, not FCPA charges.

Sources: DOJ, PwC analysis, SEC

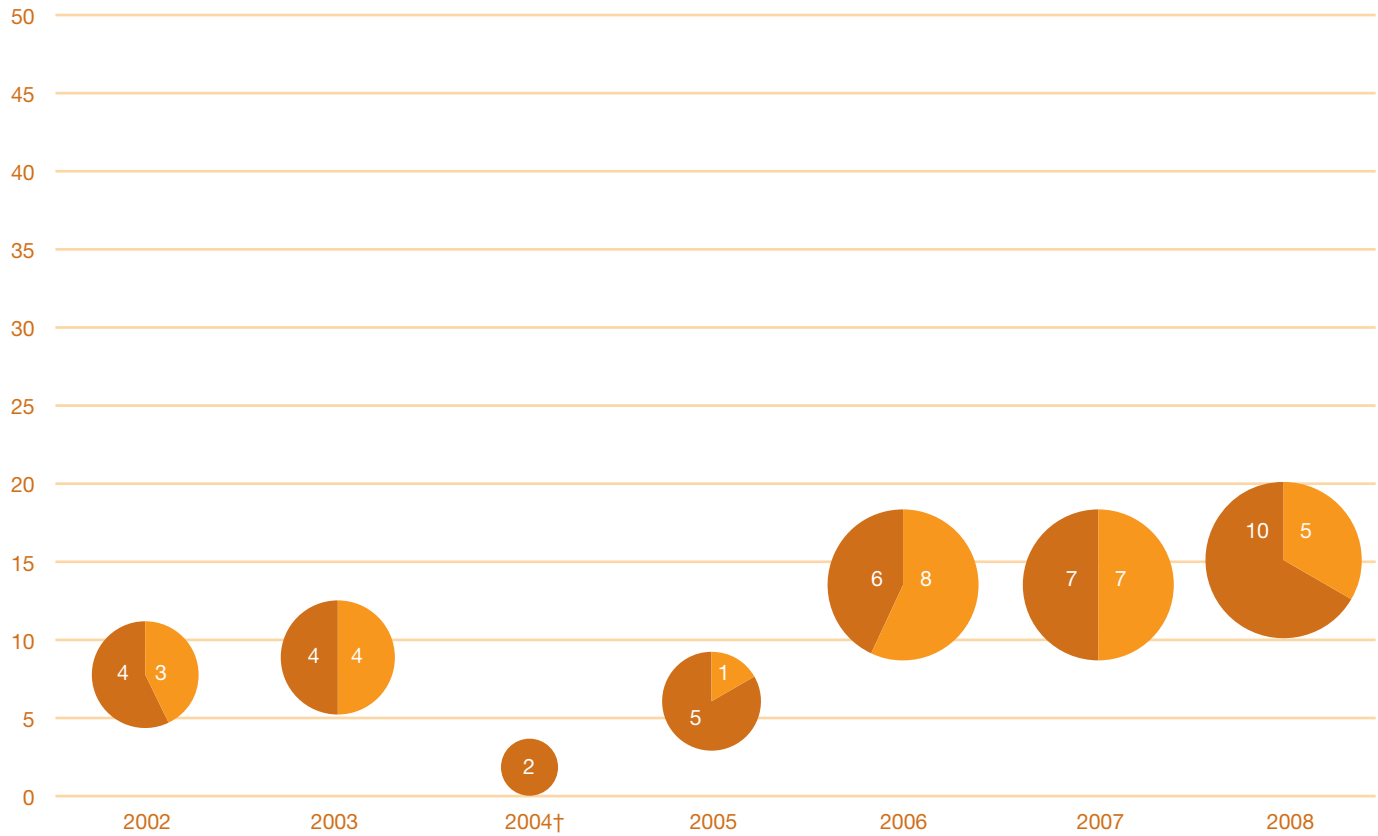
Figure 2. Total FCPA settlements and penalties assessed, by year, 2002–2008



† Other includes \$800 million in non-US settlements and penalties in Siemens AG enforcement collected by German law enforcement and a pending fine of \$550,000 for AzkoNobel (fine converted to USD as of settlement date).

Sources: DOJ, PwC analysis, SEC

Figure 3. Total FCPA proceedings brought against individuals, by year, 2002–2008



■ Department of Justice ■ Securities and Exchange Commission

† Includes two not-guilty pleas for DOJ.

Sources: DOJ, PwC analysis, SEC

Anticorruption trends

Proceedings against individuals, voluntary disclosures persist

The establishment of a more aggressive FCPA enforcement strategy has led to a greater number of prosecutions of individuals in recent years. Over the 2002–2005 period, FCPA proceedings brought against individuals averaged six per year, compared with 14 per year over the 2006–2008 period.

For example, an executive at a former unit of a global oil services company pleaded guilty in 2008 to facilitating \$180 million in bribes to Nigerian government officials in connection with a liquefied natural gas plant in Nigeria. The executive, who also pleaded guilty to taking \$10.8 million in kickbacks, could face a prison sentence of seven years and \$10.8 million in restitution payments.

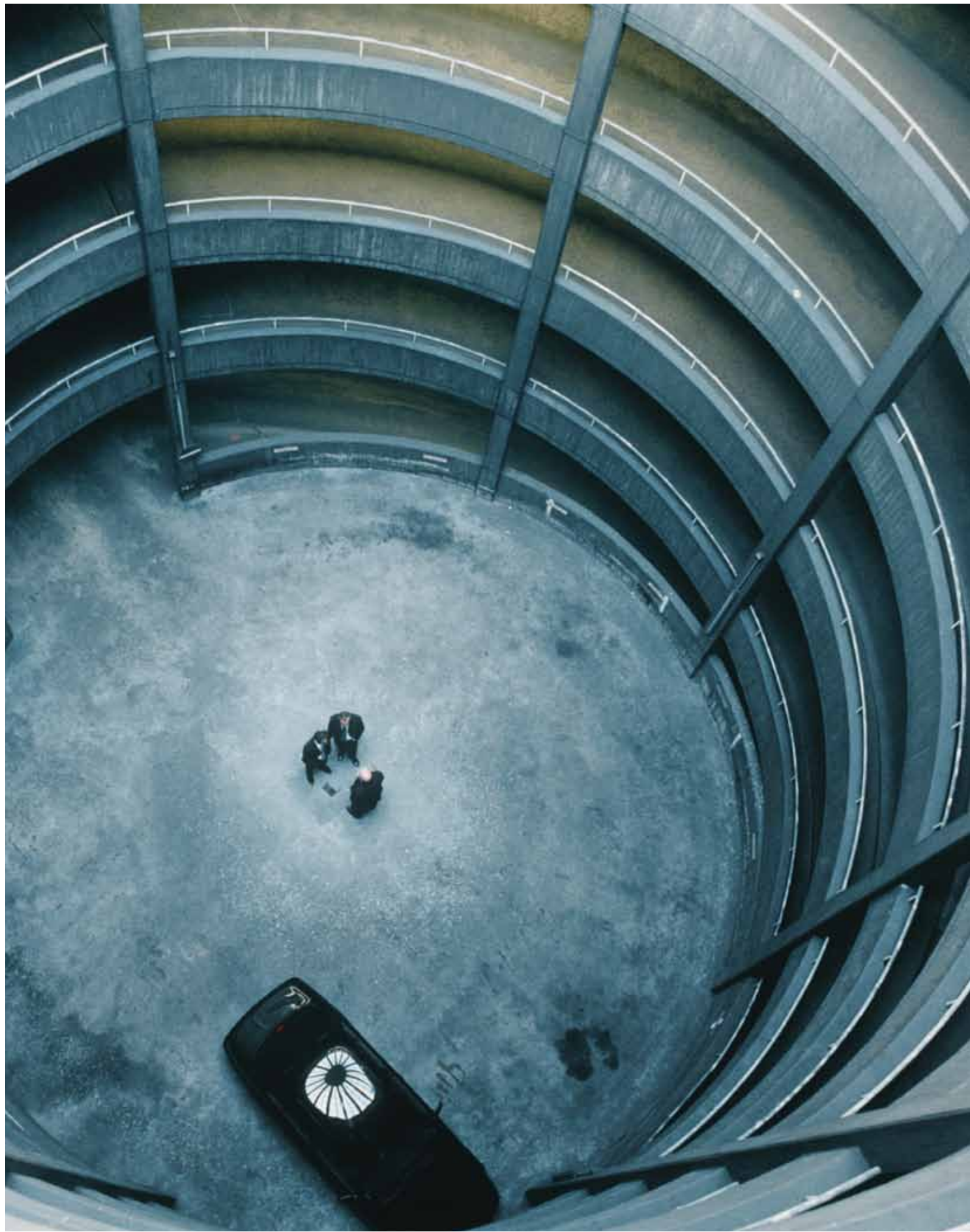
In October 2007, two former executives of a US food industry company were convicted for FCPA violations linked to payments made to Haitian officials to decrease customs and duties owed by the company. One executive was sentenced to 37 months in prison, and the other was sentenced to 63 months.

Such well-publicized prosecutions against individuals have done much to place FCPA compliance on the boardroom radar. Even steps that once might have been considered as routine rubber stamping—such as securing government permits, customs papers and sales licenses—now carry risk that can ultimately impact company executives.

“The number of individual prosecutions has risen—and that’s not an accident. That is quite intentional on the part of the department. It is our view that to have a credible deterrent effect, people have to go to jail. People have to be prosecuted where appropriate. This is a federal crime. This is not fun and games.”²

—Mark Mendelsohn, Deputy Chief, Fraud Section, Criminal Division, Department of Justice, in remarks made at an American Bar Association panel in September 2008

² “Mendelsohn says criminal bribery prosecutions doubled in 2007,” *Corporate Crime Reporter*, September 16, 2008.



Well-publicized prosecutions against individuals have done much to place FCPA compliance on the boardroom radar.

Rise in voluntary disclosures suggests greater cooperation with regulators

The number of FCPA-related prosecutions has risen in lockstep with an increase in voluntary disclosures, the latter made in an apparent effort to avoid prosecution or mitigate penalties. Companies are increasingly assuming the best-defense-is-a-good-offense approach, meeting head-on any inkling of an FCPA issue.

Over half of FCPA investigations from 2005 to 2008 and roughly half of the open cases in 2008 resulted from voluntary disclosures. One recent case resulting from a voluntary disclosure involved Pennsylvania-based transport company Westinghouse Air Brake Technologies Corp. (Wabtec) and its Indian subsidiary, Pioneer Friction Ltd. Following an internal investigation of alleged FCPA violations, Wabtec voluntarily disclosed its finding to the DOJ, which, in February 2008, decided not to prosecute—in return for Wabtec’s agreeing to adopt remedial compliance measures. The SEC, however, charged Wabtec with violating books-and-records and internal controls provisions, including disgorgement of profits, interest and civil penalties and fined them.³ The trend toward voluntary disclosure in the US—and the collaboration between companies and regulators—have not gone unnoticed in the rest of the world. In 2007, for example, the World Bank developed its own Voluntary Disclosure Program.

Companies should be alert to voluntary disclosures in their industries and to disclosures by companies engaged in similar activities in other countries. A single voluntary disclosure can flag corrupt practices that are prevalent in an industry, business process or region.

“The SEC and DOJ have clearly communicated expectations that companies make voluntary disclosure of violations,” said Walter Ricciardi, a partner at Paul, Weiss, Rifkind, Wharton & Garrison and former deputy director of the SEC’s Division of Enforcement. “As a result, one company in an industry can come forward with voluntary disclosure, and investigators will ask themselves, ‘If this company has this sort of problem, could it also be happening with its competitors in the same industry? If this company has a problem with an agent, for example, which other companies were using this agent?’ The companies that haven’t self-disclosed could therefore very well be caught flat-footed,” Ricciardi added.

³ SEC Litigation Release No. 20457, “SEC sanctions Westinghouse Air Brake Technologies Corporation for improper payments to Indian government employees,” February 14, 2008.

Anticorruption trends

Resolution trends: deferred prosecutions, disgorgement, forfeiture, remedial actions

In many cases, if regulators are satisfied that companies cooperated fully with the investigation and had rigorous FCPA compliance programs in place, then nonprosecution or deferred prosecution agreements may be offered. These agreements may include penalties, disgorgement of profits and the requirement that companies under investigation install a strengthened FCPA compliance program as well as an independent compliance monitor. In 2008, for instance, there were seven deferred prosecution agreements struck.

Flowserve Corp. and its subsidiary Flowserve Pompes SAS, for example, entered into a deferred prosecution agreement in February 2008 in connection with charges of FCPA violations surrounding a United Nations Oil-for-Food program investigation during 2000–2003. Ultimately, Flowserve agreed to pay an SEC penalty of \$3 million and \$3.5 million in disgorged profits in addition to a penalty of \$4 million to the DOJ. The deferred prosecution agreement was made available due to Flowserve’s “thorough review of the improper payments” and was contingent upon the company’s “implementation of enhanced compliance policies and procedures,” according to the DOJ, which added that the “criminal information” would be dropped after three years if the company followed these terms.⁴

Disgorgement of profits in FCPA settlements has risen dramatically, another example of heightening stringency carried out by regulators. In the 2004–2008 period, disgorgement of profits totaled roughly \$480 million, with \$376 million in 2008 alone.

“We are in an era of strong scrutiny . . . I have no reason to believe that the trend [of enforcement] will reverse anytime soon, in the number of cases, the broad reach and the number of countries enforcing against bribery.”

—Walter Ricciardi, partner at Paul, Weiss, Rifkind, Wharton & Garrison LLP and former deputy director of the SEC’s Division of Enforcement

⁴ US Department of Justice press release, “Flowserve Corp. to pay \$4 million penalty for kickback payments to the Iraqi government under the UN Oil for Food program,” February 21, 2008.

Anticorruption trends

Investigation domino effect

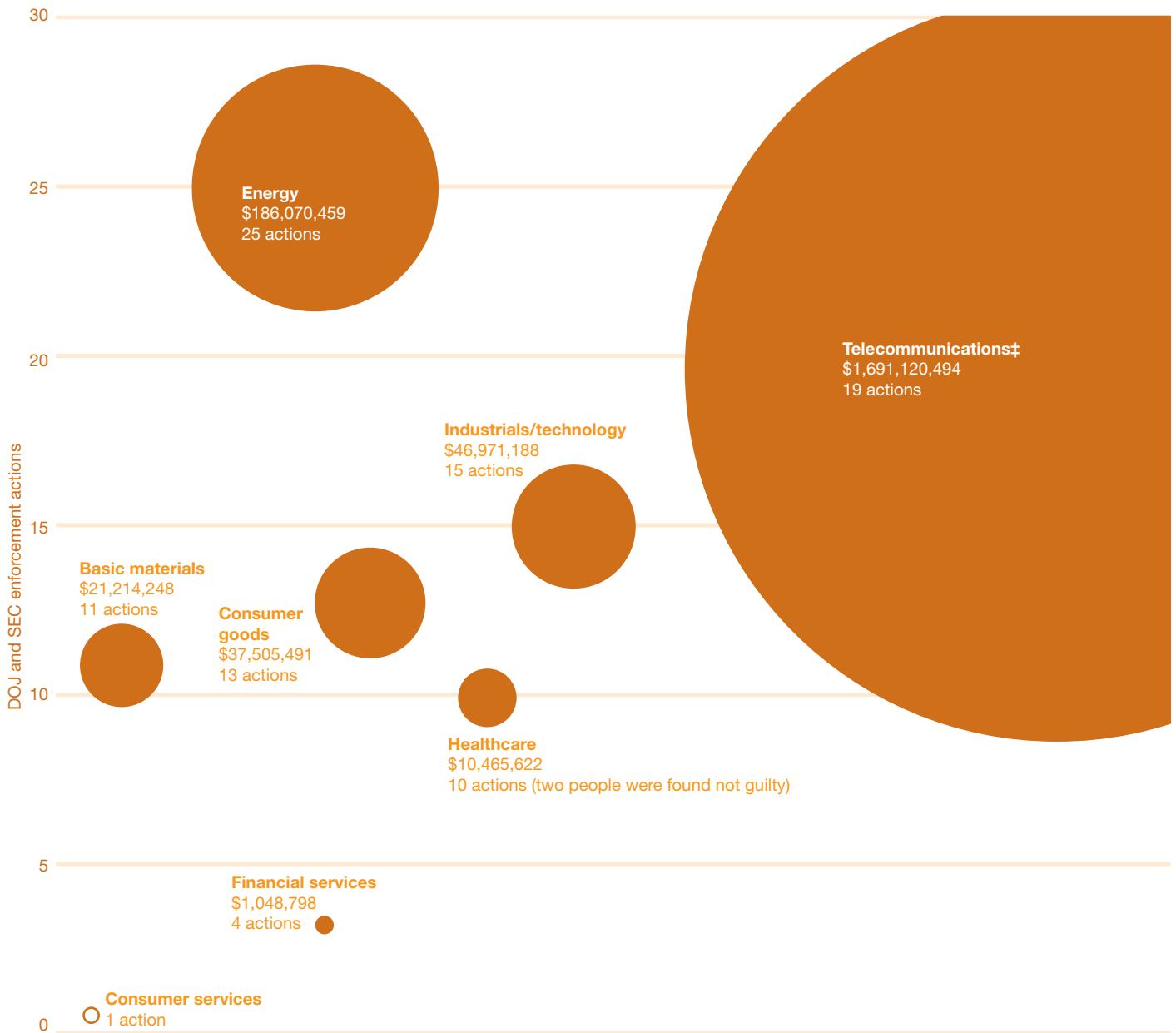
Investigations have clustered around industries, countries or common suppliers and activities. It is clear that some industries—such as energy and medical devices—have been involved in more cases than have others, largely as a result of having historically done business in countries where public officials expect—or even demand—bribes to carry out business.

This is true in industries as diverse as telecommunications, healthcare, industrials/technology and energy. These industries have a history of doing business in emerging economies where corruption and graft are rampant and encounter particularly high vulnerability to corruption when operating in such areas. In 2007 and 2008 alone, for example, eight companies and eight individuals from the energy sector were named in FCPA proceedings, resulting in a total of \$64.2 million in criminal penalties and \$81.2 million in total penalties, including disgorged profits. In the 2002–2008 period, 25 enforcement actions involving telecommunications companies totaled \$1.6 billion in FCPA-related settlements and penalties.

Charged with bribing a state-owned oil company in Kazakhstan to secure business, an oil field services company agreed, in 2007, to pay \$44 million in penalties consisting of an \$11 million DOJ criminal penalty, an SEC penalty of \$19.9 million in disgorged profits and \$3.1 million in interest, according to the SEC and DOJ. In January 2009, a former unit of another global oil services company agreed to pay \$579 million in settlement of FCPA-related corruption charges. The charges were connected to alleged bribes the unit had made to government officials in Nigeria over the previous two decades to win gas liquefaction contracts and other bids, according to DOJ and SEC FCPA enforcement action records.

Statoil, the Norwegian state energy company, paid \$18 million in DOJ and SEC penalties for bribery and books-and-records FCPA violations in connection with \$5.2 million paid to Iranian officials, through an intermediary, with the intent to secure participation interests in natural gas and oil fields. In addition to the US penalties, the company paid \$3 million in penalties to the Norwegian regulator, which was credited against the US penalties. The company, now named StatoilHydro, did not admit guilt in the case.

Figure 4. FCPA settlements and penalties assessed, by industry, 2002–2008†



† Does not include actions that have not yet been settled or are pending sentencing.
 ‡ Includes \$800 million in SEC and DOJ settlements and penalties in Siemens AG enforcement.

Sources: DOJ, PwC analysis, SEC

In May 2008, Panama City-based oil and gas infrastructure construction and engineering company, Willbros, agreed to pay \$32.3 million for FCPA bribery and books-and-records violations in Bolivia, Ecuador and Nigeria, comprising \$22 million in criminal penalties, \$8.9 million in disgorgement of profits and \$1.4 million in interest. Four former Willbros employees were charged with making \$6 million in bribes. Willbros also entered into a three-year deferred prosecution agreement with the DOJ.⁵

FCPA-derived litigation: The other shoe

FCPA enforcement actions have given rise to a proliferation of FCPA-based lawsuits with plaintiffs including shareholders, other governments and business partners. This follow-on litigation activity is becoming more common, making up for the absence of private rights of action under the FCPA. In February 2008, for example, technology company FARO settled a class-action securities fraud lawsuit brought by shareholders for \$6.9 million. In June 2008, FARO paid \$1.1 million in penalties to the DOJ and \$1.9 million in disgorgement penalties in connection with payments made by the company in its Chinese operations.⁶ Willbros settled a class-action lawsuit for \$10.5 million, and Immucor agreed to pay \$2.5 million in a follow-on lawsuit. Also, in June 2008, lawyers representing the Republic of Iraq filed a civil lawsuit in the Southern District of New York, listing 93 companies allegedly connected to kickbacks under the United Nations Oil-for-Food program.

In late April 2009, a bill—cited as the Foreign Business Bribery Prohibition Act of 2009—was introduced in the US Congress, which authorizes “certain private rights of action” under the FCPA for “violations by foreign concerns that damage domestic businesses.” If signed into law, the implications for companies doing business abroad could potentially be profound.⁷

5 US Department of Justice press release, “Willbros Group, Inc. enters deferred prosecution agreement and agrees to pay \$22 million penalty for FCPA violations,” May 14, 2008.

6 FARO press release, “FARO announces agreement to settle securities litigation,” February 26, 2008.

7 H.R. 2152, Foreign Business Bribery Prohibition Act of 2009. 111th Congress, 1st Session, April 28, 2009.

Pandora's box: The common agent

Here is one illuminating illustration of how an investigation of one company triggers investigations into competitors and noncompetitors alike operating in the same regions of the world—all of them linked by a common supplier. In February 2007, the DOJ announced, in connection with its bribery investigation of three subsidiaries of oil services company Vetco International, that Vetco's bribes were "paid through a major international freight forwarding and customs clearance company" to employees of the Nigerian Customs Service.⁸ Vetco, in a plea agreement with the DOJ, admitted to making at least 378 payments totaling \$2.1 million. Vetco eventually paid \$26 million in criminal penalties. In the wake of this investigation, the DOJ contacted at least 11 other oil services companies that had done business with a major global logistics company, requesting lists of countries in which it had performed services for them in the prior five years.⁹ The investigation also spread beyond oil services firms to oil producers. Royal Dutch Shell disclosed, in its 2008 annual report, that it was contacted by the DOJ regarding its use of the logistics company and "potential violations" of the FCPA "as a result of such use."¹⁰

Another industry-wide probe was spearheaded by the SEC in 2007, which reportedly contacted five orthopedic device makers connected to a preliminary investigation of possible FCPA-related violations. The alleged violations included payments made to public hospital healthcare professionals.¹¹

These cases offer a stark forewarning to companies about the risk of improper actions of their third-party intermediaries and suggest that companies need to be especially vigilant in monitoring these intermediaries—be they suppliers, logistics firms, distributors or consultants.

8 US Department of Justice press release, "Three Vetco International Ltd. subsidiaries plead guilty to foreign bribery and agree to pay \$26 million in criminal penalties," February 6, 2007.

9 Judith Burns, "US Justice Department probing oil operations in Nigeria," Dow Jones Newswires, July 4, 2007.

10 Royal Dutch Shell plc Annual Report and Form 20-F for the Year Ended December 31, 2008.

11 FCPA Digest, Shearman & Sterling, LLP, March 2009.

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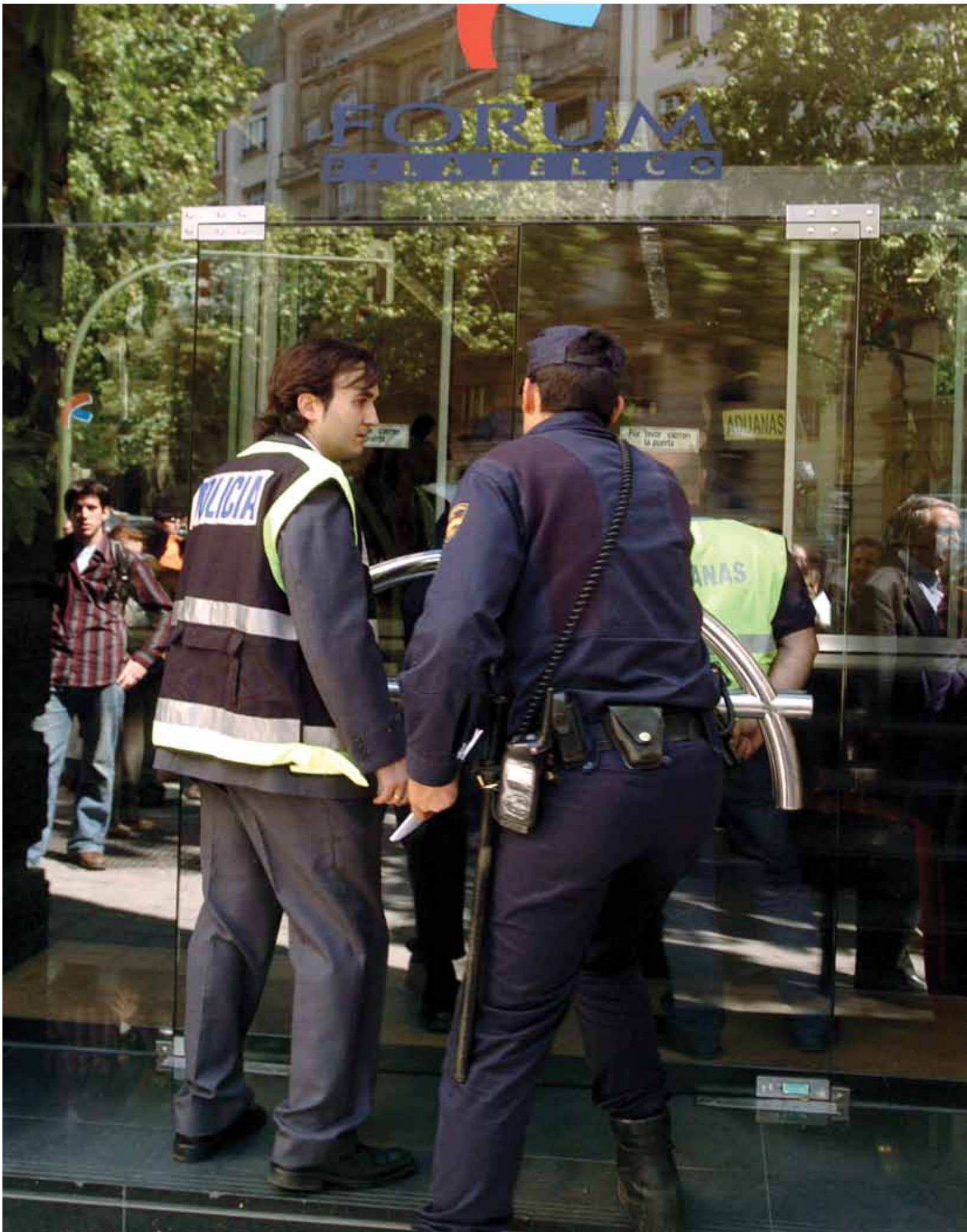
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ARMANAS

ARMANAS

POLICIA



Regulators are also getting better at ferreting out corruption and are seeing more cooperation with companies and more entrenched collaboration with international counterparts.

Anticorruption trends

US regulators in corruption battle for long term, with long reach

Regulators believe the resources devoted to—and the momentum surrounding—anticorruption will continue to intensify, driven by the current backlog of FCPA cases and the Obama administration’s strong focus on transparency and accountability.

These trends will likely affect both domestic and foreign companies. For example, FCPA regulators are targeting foreign-based companies that fall under the FCPA rules. One example of this was the Siemens AG investigation, which also happens to be the largest FCPA case to date. It is unprecedented in scope and raised the bar in FCPA enforcement by breaking through the billion-dollar level in penalties. According to US regulators, from 2000 to 2006, Siemens and three of its subsidiaries allegedly paid over 4,000 bribes totaling \$1.4 billion to foreign government officials across the globe, including in Bangladesh, China, Libya, Mexico, Nigeria, Russia and Venezuela. In total, Siemens has agreed to pay \$1.6 billion in penalties and disgorgement of profits—the highest in FCPA settlement history. Of the \$1.6 billion, approximately \$800 million was paid to the German authorities, and in December 2008, Siemens agreed to pay \$800 million in penalties and disgorgement of profits to the DOJ and the SEC.¹²

The DOJ also launched a probe in 2007 into whether the UK’s BAE Systems, a defense contractor, had paid bribes to foreign officials to win arms contracts, including alleged bribes to Saudi Arabia’s Prince Bandar bin Sultan, a former US ambassador, connected to a 20-year, \$86-billion contract for fighter planes and other equipment.¹³ Although BAE is a British company, the case was opened under the suspicion that bribes had been routed through US banks, thus placing it under the jurisdiction of the FCPA. The BAE Systems probe had been carried out by Britain’s Serious Fraud Office. In 2006, certain aspects of the investigation were halted by then prime minister Tony Blair. In May 2008, the DOJ issued subpoenas to BAE’s chief executive and a nonexecutive director as part of its investigation.¹⁴

But it can work the other way as well. In January 2009, a unit of US-based insurance broker Aon Corp. was fined \$7.9 million by the UK Financial Services Authority (FSA) for having weak controls on some cross-border payments that the FSA described as “suspicious payments” and that allegedly could have been used for bribes.

12 US Department of Justice press release, “Siemens AG and three subsidiaries plead guilty to Foreign Corrupt Practices Act violations and agree to pay \$450 million in combined criminal penalties,” December 15, 2008.

13 “British court endorses appeal in BAE corruption inquiry,” Associated Press, April 24, 2008.

14 Jim Wolf, “US said pressuring Britain’s BAE in bribery probe,” Reuters, May 21, 2008.

Breaking an old habit

Global drivers of the anticorruption era

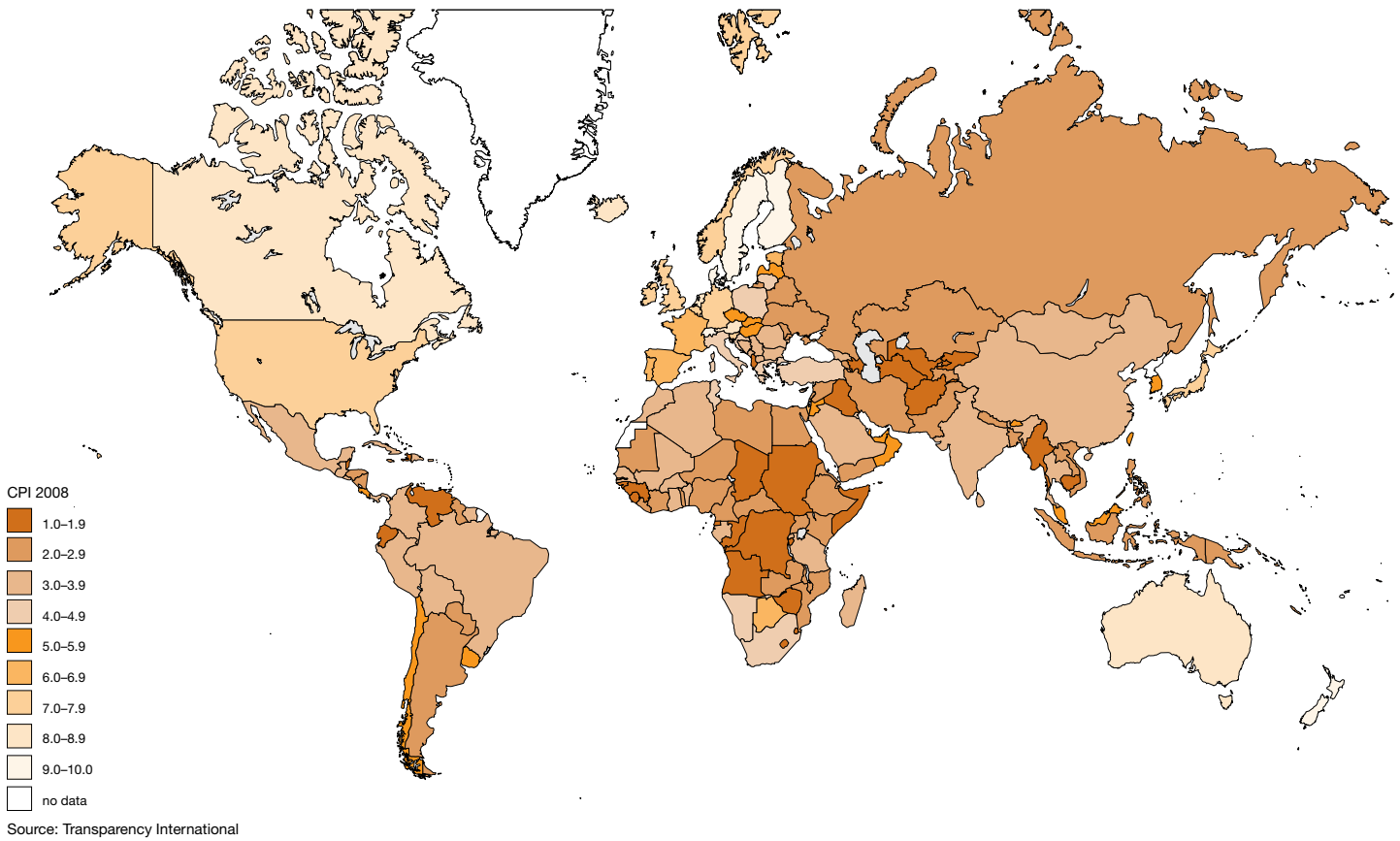
A confluence of factors has led to the rise in the number of US-led FCPA investigations as well as anticorruption enforcement initiatives globally, especially in countries where bribery has been both rampant and a standard business practice. The dual forces of (1) increased global penetration of US companies into such markets as China and India along with the USA PATRIOT Act of 2001 (drawing the link between bribing of foreign officials and money laundering to advance terrorist activity) and (2) the Sarbanes-Oxley Act of 2002 (raising the accountability standards of senior executives) ushered in an era of heightened penalties. In the wake of Sarbanes-Oxley, the Principles of Federal Prosecution of Business Organizations, or the so-called Thompson Memorandum, stated that “increased emphasis” be placed on the degree to which a company cooperates with regulators when regulators are considering prosecution. This memo was later replaced by subsequent memos (most recently the Filip Memorandum in September 2008), which stated that the DOJ would base a corporation’s “cooperation credit” not on the waiver of attorney-client privilege but on its disclosure of relevant facts.¹⁵ Additionally, new federal sentencing guidelines require companies to implement, update, communicate and monitor clear and concise compliance standards. In broad terms, the rising number of investigations and voluntary disclosures (described earlier) among US companies, in particular, mirrors the timing of these developments.

Closer international collaboration

Regulators are also getting better at ferreting out corruption and are seeing more cooperation with companies and more entrenched collaboration with international counterparts. Increased whistle-blowing, heightened media attention and greater local law enforcement around the world has aided this collaboration. In the past year, for example, the Federal Bureau of Investigation (FBI) has raised its number of agents dedicated to FCPA cases. The FBI has also flexed its muscles internationally, leveraging its international network of relationships with local regulators and police departments in dozens of countries—relationships built up substantially by FBI liaison officers in the 1990s under then FBI director Louis Freeh.

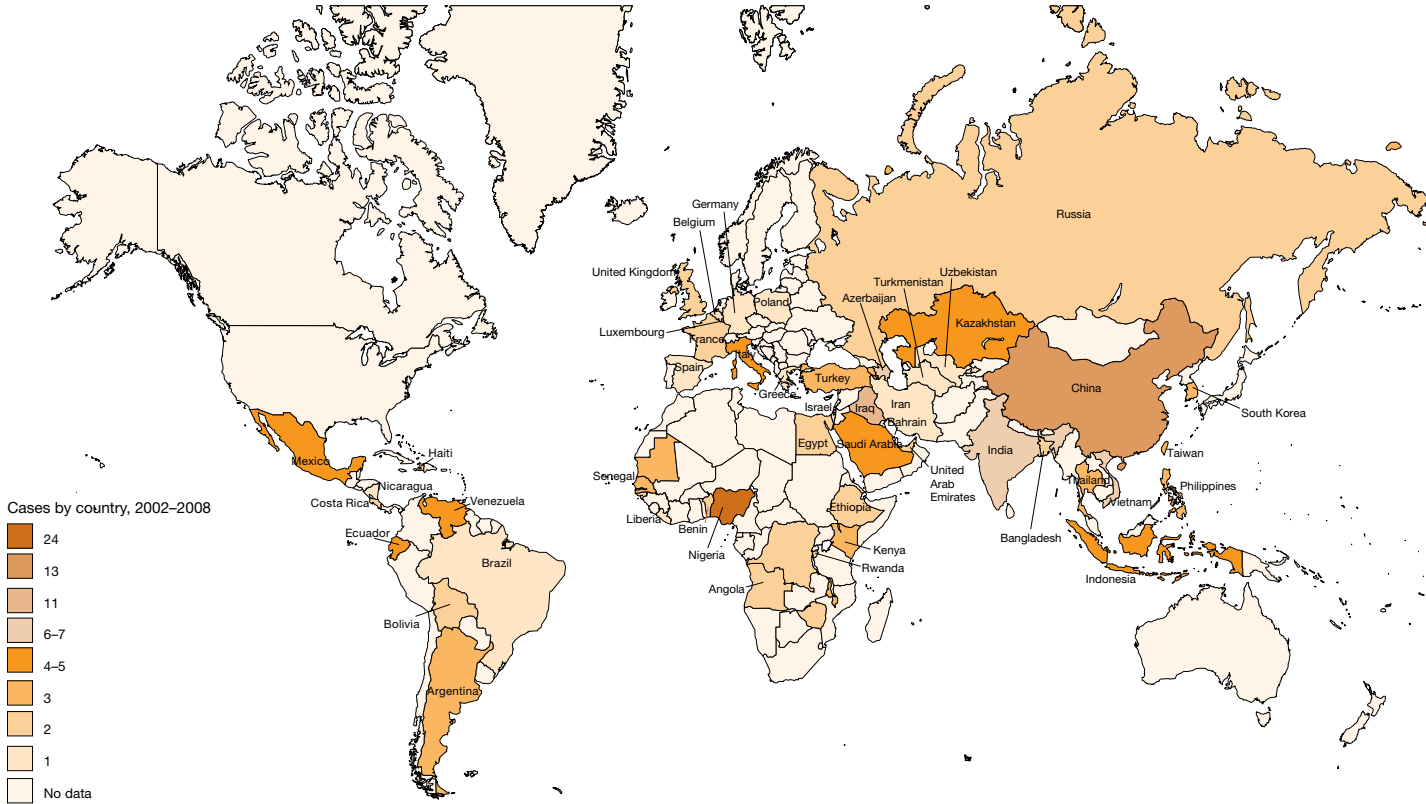
¹⁵ Mark J. Stein and Joshua A. Levine, “The Filip Memorandum: Does it go far enough?” *New York Law Journal*, September 11, 2008.

Figure 5. 2008 Corruption Perceptions Index



The Transparency International CPI measures the perceived levels of public-sector corruption in a given country and is a composite index, drawing on different expert and business surveys. The 2008 CPI scores 180 countries (the same number as the 2007 CPI) on a scale from zero (highly corrupt) to ten (highly clean).

Figure 6. Number of FCPA enforcement actions reported as of January 1, 2009



Sources: DOJ, SEC, PwC analysis

Building a global framework—slowly

A wave of anticorruption laws has been adopted in the past decade, triggered largely by the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which was passed in 1997. Prior to legislation stemming from the convention, bribes were, in principle, tax-deductible business expenses in numerous countries such as Australia, Austria, Belgium, France, Germany, Luxembourg, the Netherlands, New Zealand, Portugal and Switzerland, according to the OECD.¹⁶ Today, there are 37 OECD signatories to the convention.

Indeed, a framework has been established to reduce the \$1 trillion—equivalent to 5 percent of global gross domestic product—that corruption costs the global economy, as estimated by the World Bank Institute.¹⁷ “Today, there are few major exporting nations that have not adopted foreign bribery prohibitions, although enforcement in some countries has been disappointing” said Leslie Benton of Transparency International. “Even so, companies should understand that the chance that a violation of law will surface and be prosecuted is greater today than ever before,” Benton added. She also noted a recent increased collaboration between countries investigating corruption, including prosecutors working with counterparts on cross-border investigations with greater frequency and depth, and sharing best practices.

While signing on to such anticorruption pacts shows goodwill, doing so doesn’t necessarily translate into a country’s passing antibribery legislation or, when it does, enforcing it. Therefore, progress is uneven. The UK is a prime example. In 2008, the country prosecuted its first individual for bribing a foreign official and has not passed legislation clearly linking common law bribery with bribery of foreign officials committed outside the UK by UK nationals and enterprises; this is significant because antibribery laws have existed in Britain since the nineteenth century. In contrast, in the 11 years since the OECD convention was instituted, there have been 19 bribery prosecutions in France, 43 in Germany and 103 in the US. Hungary prosecuted 18 companies in 2007 alone. “There is a global convergence on anticorruption. Countries are getting on the same page. The integrity of the market requires a level playing field for businesses,” said Ricciardi, the former SEC deputy director. “There is a new willingness among countries to join the global community of effective regulators, not to be perceived as looking the other way.”

16 Martine Millet-Einbinder, “Writing off tax deductibility,” *OECD Observer*, April 2000.

17 Ashley Seager, “Bribery costs \$1 trillion a year—World Bank,” *The Guardian*, July 11, 2007.

Breaking an old habit

When zero enforcement actions raise red flags

Enforcement has a long way to go to catch up to the realities of corruption, and the unlevel playing field of international business still very much exists. The absence of antibribery cases in a country does not necessarily mean that bribery is not expected in business. In fact, a country with no enforcement actions could be a red flag for endemic corruption through judiciary, police and government layers of the society. It is illuminating to compare the FCPA enforcements as of January 1, 2009 (Figure 6) with Transparency International's 2008 *Corruption Perceptions Index* (CPI) (Figure 5). In the CPI, countries that fell in ranking of perceived public-sector corruption include Bulgaria, Burundi, Maldives, Norway and the United Kingdom. Countries that rose most significantly in ranking in 2008 compared with 2007 included Albania, Cyprus, Georgia, Mauritius, Nigeria, Oman, Qatar, South Korea, Tonga and Turkey, according to the CPI. The corruption watchdog group noted that corruption in low-income countries is driven chiefly by corrupt judiciaries and inadequate parliamentary oversight, while corruption in developed countries generally stems from poor private-sector regulation of foreign bribery and insufficient oversight of financial institutions and transactions.¹⁸

The World Bank is also pressing on with debarment actions. In January 2009, there were already eight debarments as a result of fraud and corruption: four Chinese firms, three Philippine firms and one Philippine national. This compares with three debarments in all of 2008 and one in 2007. Meanwhile, the US government recently expanded the Contractor Code of Business Ethics and Conduct to require disclosure of certain violations of the False Claims Act and made a knowing failure to disclose such valuations a cause for suspension or debarment.¹⁹ These actions by the US and the World Bank may be indicative of changing attitudes toward disclosure.

Multilateral development banks throw weight at corruption

The World Bank has also stepped up efforts to fight corruption, working with other development banks, including African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank and the International Monetary Fund.

¹⁸ Transparency International press release, "Persistently high corruption in low-income countries amounts to an 'ongoing humanitarian disaster,'" September 23, 2008.

¹⁹ National Archives and Records Administration, *Federal Register*/Vol. 73, No. 219/November 12, 2008/Rules and Regulations (48 CFR Chapter 1, Parts 2, 3, et al.).

According to the World Bank’s Department of Institutional Integrity (INT), this work has yielded some success. In 2007, the INT closed 301 cases, comprising 149 external cases involving fraud and corruption in bank-financed projects and 152 internal cases—up 60 in number from 2006. Open cases carried over in 2008 numbered 232. The INT noted that collaboration between local investigative bodies has increased. For example, its investigation into French subsidiaries of Textron, Inc., a Rhode Island-based business-jet maker, spread across Bangladesh, Egypt, India, Indonesia, Iraq and the United Arab Emirates; and a case involving Paradigm BV, a private software maker owned by Fox Paine, a US private equity firm, covered China, Indonesia, Kazakhstan, Mexico and Nigeria.²⁰

Mixed messages from OECD countries

According to Transparency International’s *Progress Report 2008*, anticorruption enforcement has increased “substantially” in France, Germany and the US. The annual report assesses countries’ anticorruption enforcement across a range of initiatives, including number of cases or investigations, statutory obstacles, organization of enforcement, complaint procedures and whistle-blower protection. The report also noted that there has been “little or no enforcement” in Canada, Japan and the UK. (See chart below.) In a separate report, the Transparency International *Global Corruption Barometer 2007* (the last year it was issued) found that 54 percent of respondents globally think corruption will increase in the next three years, compared with 20 percent who think it will decrease.

Bribery enforcement in the OECD: movers and laggards

| Little or no bribery enforcement: | Significant bribery enforcement: |
|---|--|
| Austria, Brazil, Bulgaria, Canada, Chile, Czech Republic, Estonia, Greece, Ireland, Japan, Mexico, New Zealand, Poland, Portugal, Slovakia, Slovenia, Turkey and the United Kingdom | Argentina, Australia, Belgium, Denmark, Finland, France, Germany, Hungary, Italy, Korea, the Netherlands, Norway, Spain, Sweden, Switzerland and the United States |

Source: Transparency International, *Progress Report 2008*

20 The World Bank Group, *Improving development outcomes: Annual integrity report, fiscal year 2007, 2008*.

The OECD has also exerted pressure on countries that have yet to strengthen antibribery laws to meet the convention's standards. Most recently, the OECD's Working Group on Bribery announced that it is "disappointed and seriously concerned" about the UK's bribery laws, which it calls deficient, as well as about safeguards on the independence of the Serious Fraud Office, charged with investigating and prosecuting bribery violations.²¹ In September 2008—10 years after signing the antibribery convention—the UK brought its first conviction of an individual for foreign bribery, carried out by Britain's newly minted Overseas Anticorruption Unit. As previously mentioned, in January 2009, a unit of US-based insurance broker Aon Corp. was fined \$7.9 million by the UK Financial Services Authority (FSA) for having weak controls on some cross-border payments that the FSA described as "suspicious payments" and that allegedly could have been used for bribes.

The increase in bribery investigations and enforcement actions in the wealthiest exporting countries, to date, has done little to increase prosecution activity related to bribery and graft in developing countries. "There is constant pressure placed by the OECD Working Group on countries, pushing for answers on why more cases are not brought by signatory countries," said William Jacobson, former assistant chief of Foreign Corrupt Practices Act enforcement in the Fraud Section of the US Department of Justice's Criminal Division. "The US government and US companies hope there will be a snowball effect in the number of cases being brought by other countries, in order to make for a more level playing field for businesses throughout the world. We're seeing the first signs of this now," Jacobson added.

"FCPA compliance has risen up near the top of the compliance totem pole. I've seen many companies avoid doing business and walk away from lucrative opportunities because of FCPA considerations. Overall, there are fewer governments that still adhere to the pay-to-play arrangements."

—Timothy Dickinson, partner at Paul, Hastings, Janofksy & Walker LLP

²¹ Organisation for Economic Co-operation and Development press release, "OECD Group demands rapid UK action to enact adequate anti-bribery laws," October 16, 2008.

According to PwC's *Global Economic Crime Survey* . . .

More than 40% of companies globally report fraud . . .

. . . with larger companies reporting a greater number of incidents of fraud.

Figure 7. Companies reporting fraud (2003–2007)

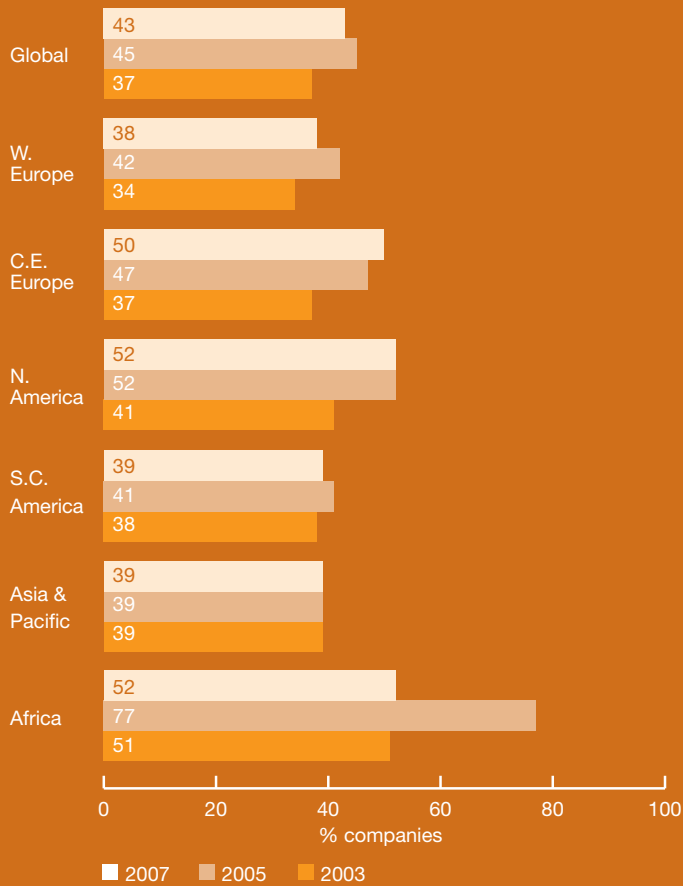
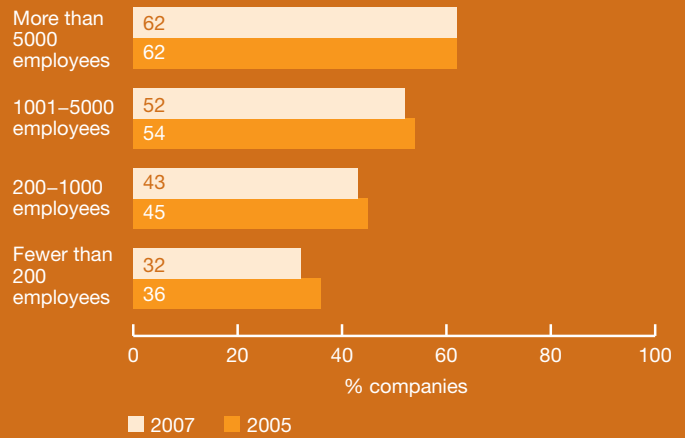


Figure 8. Companies reporting fraud, according to their number of employees



Source: PricewaterhouseCoopers, *Economic crime: People, culture and controls—the 4th biennial Global Economic Crime Survey, 2007*

Despite the corruption crackdown, bribery is still rampant in certain regions . . .

. . . leading to perceived lost business opportunities.

Figure 9. Percentage of companies asked to pay a bribe

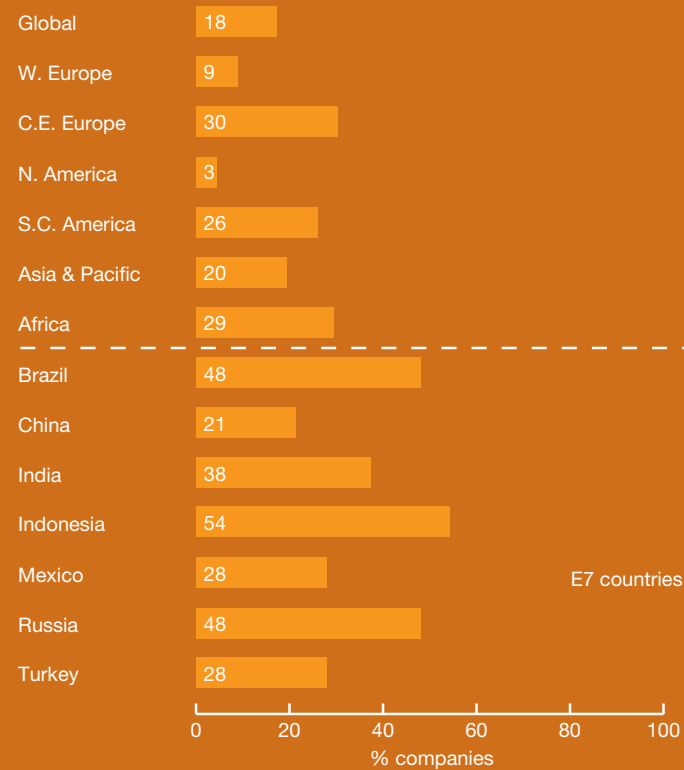
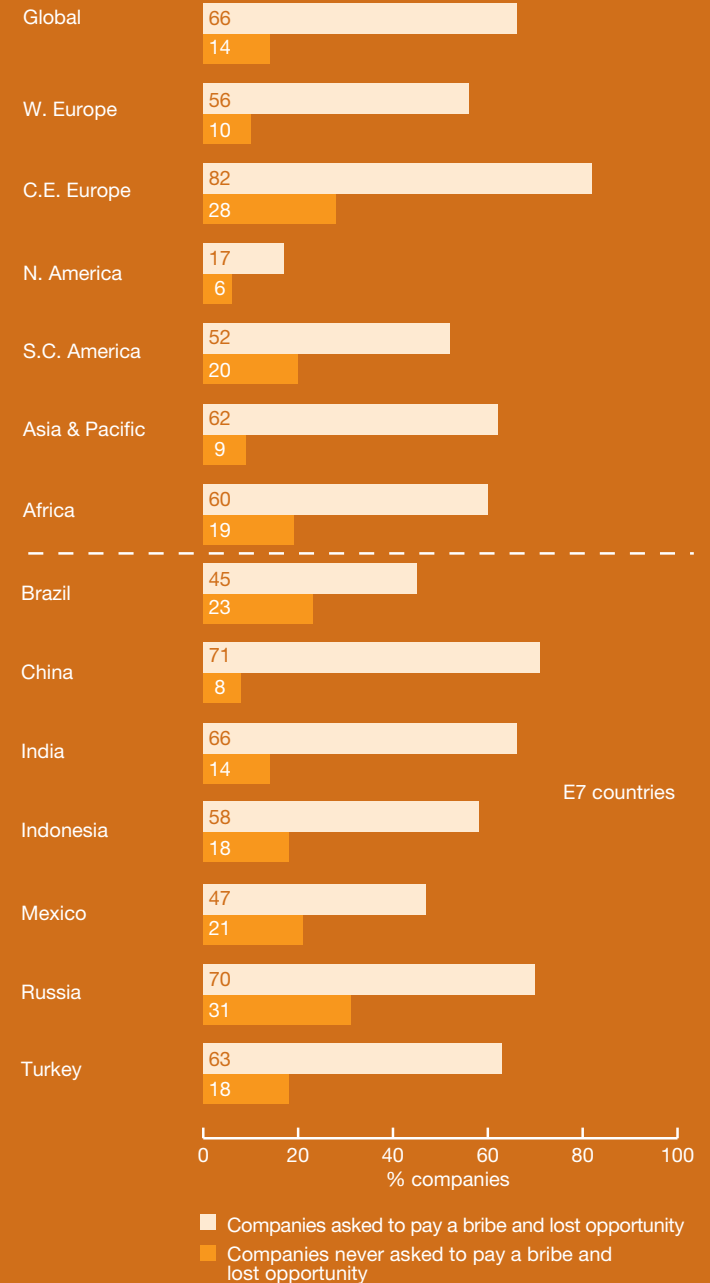


Figure 10. Companies asked to pay a bribe that lost an opportunity to a competitor



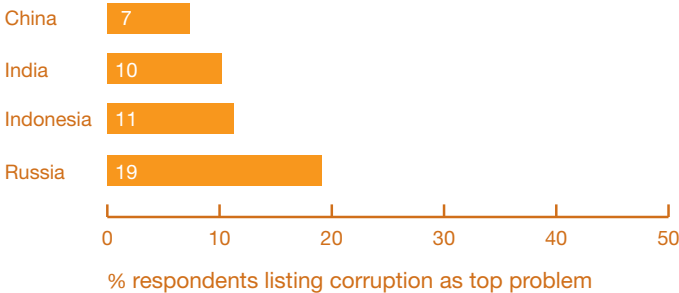
Breaking an old habit

Companies encountering graft

How do these global trends affect companies on a day-to-day level? According to PricewaterhouseCoopers' 2007 *Global Economic Crime Survey*, almost half of all survey respondents reported some sort of economic crime in 2005 and in 2007 (45 percent and 47 percent, respectively). All US survey participants responded that they were concerned about corruption and bribery in Brazil, China, India, Indonesia, Mexico, Russia and Turkey. "The biggest sleeper issue is that everyone wants to get into China. China is the big gorilla. You need initial licenses, permits to build, etc. Just getting a license to do business is a high risk," said Timothy Dickinson, a partner at Paul, Hastings, Janofsky & Walker LLP. The survey also found that 8 percent of companies with both compliance and ethics programs in place suffered corruption and bribery, compared with 15 percent of companies without these programs in place.

The World Economic Forum, too, has waged an anticorruption campaign. Its Partnering Against Corruption Initiative (PACI), a global anticorruption initiative comprising private companies, was instituted in 2004 and now has 140 signatory companies with total annual revenues of over \$800 billion. A 2008 PACI survey found that 100 percent of the signatories—which commit to adopting anticorruption programs modeled after PACI principles—had instituted anticorruption programs by the end of 2008 compared with 90 percent in 2007.

Figure 11. Corruption among the most problematic factors when doing business



Source: World Economic Forum, *Executive Opinion Survey*, 2008

The survey also found that 18 percent of the companies with anticorruption programs and ethical guidelines said they had lost business opportunities by not paying bribes. This compares with 25 percent of companies with no anticorruption programs or ethical guidelines in place reporting they had lost opportunities. This suggests a connection between the absence of anticorruption programs and a likelihood of losing opportunities.²²

Selective bribery

Interestingly, there also appears to be a double standard surrounding graft by companies headquartered in developed economies. Transparency International's Bribe Payers Index (BPI), which measures countries' propensities for corrupt business practices, revealed that the behaviors of foreign companies changed depending on where the companies are doing business. The BPI found that BPI scores for most companies were "considerably higher" when doing business in OECD countries compared with the scores of those companies doing business in low-income countries (LICs) and Africa. For example, companies from the United Arab Emirates scored 7.9 (on a scale of 0 to 10, with the prevalence of bribery lowest at 10) when doing business in OECD countries, but their scores fell to 5.3 in LICs. India, likewise, fell from 5.5 in OECD countries to 3.6 in LICs.²³

²² World Economic Forum Partnering Against Corruption Initiative (PACI), *2008 Highlighting Achievers Survey*, 2008.

²³ Transparency International, "Report on the Transparency International Global Corruption Barometer, 2007," December 6, 2007.

Breaking an old habit

Closing the gap between knowledge and action

Despite the gathering momentum of anticorruption campaigns, there still exists a gap between company executives' acknowledgment of the need for anticorruption programs and the strength of or their confidence in those programs. A 2008 PricewaterhouseCoopers survey of 390 senior executives globally found that while 80 percent said their companies had such a program in place, just 22 percent were confident of the program's efficacy. (See page 33.)

"Bribery wasn't really a board-level priority until fairly recently. It was just one of a basket of risks, and with rare exceptions—usually some crisis—it rarely took valuable board time and resources," said Michael Fine, director of private-sector initiatives at Transparency International-USA. "The magnitude of recent impacts in Europe and the US has changed this, making corruption a top-level issue. . . . Boards are paying much more attention to the details, on a proactive basis, and there is a small but growing number of multinational companies that simply won't do business in especially high-risk countries based on pervasive unethical business practices," Fine added.

"A company has the obligation to self-investigate and should feel a duty and a need to know what's wrong in its own house."

—William Jacobson, former assistant chief for Foreign Corrupt Practices Act enforcement in the Fraud Section of the US Department of Justice's Criminal Division

Findings from PwC's *Confronting corruption*²⁴ (August 2008)

A survey of 390 senior executives from 70 countries:

- Nearly 80% of executives have programs in place to prevent or detect corruption; however, only 22% are “very confident” that these programs actually mitigate fraud and corruption risks.
- 28% of executives believe that their assessment of corruption risks is rigorous.
- 55% of executives see reputational effect as the biggest risk that corruption poses.
- 28% of executives believe that their companies are not strong at communicating their anticorruption programs.
- 45% said their companies had not entered into a market or pursued an opportunity because of corruption risks.
- 39% said they had lost bids because of corrupt officials.
- 42% said their competitors paid bribes.

²⁴ PricewaterhouseCoopers, *Confronting corruption: The business case for an effective anti-corruption programme*, 2008.

Increased burden on financial officers

Overall, FCPA enforcement trends have widened the roles of chief financial officers and their departments. Financial officers are likely to bear heavier burdens of responsibility to ensure full accountability for financial transactions internationally. Clearly, for companies with multi-tiered, subsidiary corporate structures in multiple countries, maintaining complete transparency can be a significant challenge, even with a solid compliance program and today's sophisticated enterprise risk management tools. Also, in the case of integrating acquisitions, such challenges can be compounded if accounting systems are not interoperable.

Meeting these and other challenges likely requires greater financial capital and human resources. "While it's hard to generalize, there is undoubtedly more focus on FCPA compliance. We see more money being spent on it. The question is whether enough is being done," said Roger Witten, a partner with WilmerHale. And in the case of an investigation, costs can be unpredictably high. "An FCPA investigation is extremely invasive and costly, especially for sprawling companies, where it can start at about \$3 million and go up from there. You could go through an investigation, not get convicted, and still be out \$10 million and have to grapple with a tainted reputation. The Siemens case will raise everything to a higher plateau," Witten added.

While most Fortune 500 companies are likely well aware of FCPA risks and have some level of compliance program in place, the question is whether it is an effective program. Companies at particular risk are the smaller companies venturing abroad, said Witten. "The companies that are at most risk are the smaller companies that run risks they're not even aware of and that have no general counsel or compliance officer," he said. As indicated by PricewaterhouseCoopers' *Global Economic Crime Survey*, over half of the companies with 1,001 to 5,000 employees have reported encountering fraud.

FCPA playing larger role in M&A deals

Increasingly, FCPA compliance is becoming an integral element of predeal M&A due diligence. Searching for potential FCPA-related red flags is crucial to cross-border deals. Deciding when and how to approach regulators, as described in a precedent-setting DOJ opinion procedure release such as 08-02, and fully grasping the risks of successor liability have become increasingly embedded as central M&A due diligence tasks.

For example, General Electric Company's plans in 2004 to acquire explosives detection systems maker InVision were delayed when General Electric's predeal due diligence revealed potential FCPA violations related to payments to foreign officials in China, the Philippines and Thailand. Both General Electric and InVision disclosed this finding to the DOJ and the SEC. Ultimately, the merger was carried out, with InVision paying a penalty and disgorgement of profits.

US Department of Justice Opinion Procedure Releases have changed the landscape of M&A due diligence of foreign acquisition targets. In 2008, as oil services and technology provider Halliburton carried out preacquisition due diligence of its UK rival Expro International Group PLC, it sought an opinion on the deal from the US Department of Justice on the grounds that, due to UK legal restrictions, it would not have time to carry out complete due diligence until after the closing. In June 2008, the DOJ released its Opinion Procedure Release 08-02. This opinion is a watershed opinion that held that if Halliburton satisfactorily completed a rigorous, DOJ-mandated 180-day FCPA and anticorruption due diligence work plan after the closing, then the DOJ did not “presently intend” to take enforcement action [against Halliburton] for any disclosed unlawful preacquisition conduct by Expro within 180 days of the closing.²⁵ As it happened, Halliburton eventually was outbid on the deal, but the DOJ’s flexibility and Halliburton’s open dialogue with regulators may well augur increased involvement between companies and regulators during due diligence or even before predeal due diligence is carried out.

The Opinion Procedure Release of 08-01 focused on determining the definition of a foreign official. An unnamed Fortune 500 company (the Requestor) planned to acquire, at a premium bid, a foreign company in which a private citizen of the company’s host country held a controlling interest. The Requestor, which considered the individual a foreign official based on ties to the government, sought an opinion from the DOJ, following a thorough investigation into the citizen—upon the assumption that he was a foreign official, as defined by the FCPA. Based on the Requestor’s deep due diligence and transparency, the DOJ determined that the acquisition would not violate FCPA provisions.

In 2004, Opinion Procedure Release 04-02 stemmed from the case of an investor group acquiring companies and assets owned by ABB. The investor group (Requestors) and ABB had carried out a predeal FCPA compliance review. Ultimately, two ABB units included in the deal pleaded guilty to FCPA violations. The DOJ, based on the Requestors’ compliance review, took no enforcement action against the Requestors for the ABB units’ FCPA violations prior to the acquisition.

Successor liability: Cautionary tales

A landmark example of FCPA considerations as deal breakers is Lockheed Martin Corp.’s plan to acquire Titan Corp. for \$2.2 billion in 2004, which was aborted after uncovering FCPA issues during its predeal due diligence.²⁶ Titan ultimately paid \$28.4 million in penalties for bribery, including disgorgement of profits associated with bribes made to officials in Saudi Arabia and Benin for securing business. According to the Department of Justice, the stiff penalties were issued in part because Titan did not have an FCPA compliance structure in place. “In its 23 years of existence prior to 2004, Titan has never had an FCPA compliance program or procedures,” the Department of Justice agreement with Titan stated.

²⁵ US Department of Justice Fraud Section, Foreign Corrupt Practice Act Review, Opinion Procedure Release 08-02, June 13, 2008.

²⁶ Renae Merle, “Lockheed Martin scuttles Titan acquisition,” *The Washington Post*, June 27, 2004.



This new era of corruption crackdown will continue to reveal the stubbornly entrenched and endemic nature of corruption — that it does not discriminate based on company size and is blind to borders.

What this means for your business

Corporate accountability in the new anticorruption era.

As anticorruption enforcement intensifies in the US and the rest of the world, the onus of self-regulation and self-monitoring has been placed firmly on companies and their executives. Companies are paying higher costs for corruption, and a new layer of private litigation is emerging following government charges. And yet, while some executives acknowledge these risks, they may still lack confidence in the strength of their corruption compliance programs.

With cross-border business becoming more integral to the growth of US companies, there is much that companies can and should do to mitigate risks, particularly when carrying out due diligence before entering into business combinations and hiring third-party agents, consultants and suppliers. Also, companies need to prepare so that if corruption issues do arise, they are able to act swiftly and collaborate openly with regulators to minimize the potentially devastating effects that full-blown prosecutions can cause.

“If you set the right tone at the top of the company, you build a culture of integrity and you will more likely avoid problems.”

—Walter Ricciardi, partner at Paul, Weiss, Rifkind, Wharton & Garrison LLP and former deputy director of the SEC’s Division of Enforcement

Building a strong anticorruption program amidst new risks

Navigating the gray areas of FCPA

A compliance program is only as good as the rigor with which it is monitored and enforced. Major areas of focus should include companies doing the following:

Set the tone at the top

Companies will be under greater pressure to build anticorruption programs that instill an anticorruption culture throughout the company—from executives, through management, and to the outer reaches of the organization. This means sending the right message and putting in place an effective compliance strategy in the geographic locations in which the company does business and among its operations, units, customer base, sales force and third-party agents.

Monitor FCPA compliance program regulations

The compliance program should include implementation of proactive monitoring procedures and identification noncompliant transactions. Compliance programs are only as robust as the monitoring and ongoing assessment and improvement of their effectiveness.

Look deeper

The methods of graft are becoming more hidden and more sophisticated and therefore more difficult to detect even through a company's own investigation. Consistent and disciplined attention is required within the following areas:

- High-risk countries
- State-owned or -controlled entities
- Excessive commissions and/or compensations
- Use of third parties
- Cash payments required to entities or individuals
- Required gifts and donations
- Noncash and/or broader considerations

Even companies with FCPA programs in place struggle with the compliance challenges in the international markets. A few areas that companies should commonly grapple with are the following:

Know whom you're dealing with

Companies should be aware of the people and entities they're dealing with. For example, medical device companies doing business with employees of state-owned hospitals in China may be working with individuals considered public officials. Or financial services firms may be working with a sovereign wealth fund without a full understanding of its ownership structure and thus not be aware of whether they're doing business with a public official.

Have a system in place to identify questionable payments

Payments that may potentially be in violation of local laws as well as FCPA rules are often overlooked because, at first glance, they do not appear to be material. They could include travel and entertainment expenses that may be off the radar. Companies should commit greater resources and have in place certain systemic, company-wide procedures to identify even the smallest, nonmaterial payment that might uncover potential corruption issues and raise compliance concerns.

Going forward, companies should embrace stringent anticorruption compliance and build the compliance controls that encourage accurate and constant monitoring of corruption. The ever-rising risks associated with new global business opportunities require the attention of senior management to mitigate risk.

Companies should consider (1) that this new era of corruption crackdown will continue to reveal the stubbornly entrenched and endemic nature of corruption, (2) that it does not discriminate based on company size and (3) that it is blind to borders.

Know when—and how—to self-disclose

One of the most common quandaries companies face when a potential FCPA issue is identified is whether to handle it in-house or disclose it to regulators. Voluntary disclosures to the SEC and DOJ have risen sharply in the last several years. Companies will need to consider establishing a more proactive approach in ferreting out FCPA-related issues as they increasingly face the difficult decisions of how to reach out to authorities and whom to contact. More collaboration with regulators is a strategy that should be evaluated in order to mitigate the numerous impacts of full-blown investigation and prosecution.

Devote more resources to preacquisition due diligence

A groundswell of FCPA enforcement activity adds more risk for Western firms doing deals in regions where corruption is pervasive. Companies that buy companies with FCPA issues are also buying the liabilities that extend to those risks, not only for the acquirer but also for the acquirer's management team. Such risks have prompted many companies to install full-time FCPA experts within corporate development or on mergers and acquisitions teams.

Compliance effectiveness can be sustained only by the allocation of necessary time, resources and programs built into any predeal due diligence and investigations, as well as joint ventures. Just as important, anticorruption controls along with monitoring protocols should be installed and enforced postdeal.

Focus on major due diligence areas when considering an acquisition target:

- Reputation, professional history and qualifications of those in top management echelons, key decision makers, managers, sales personnel and customers, including any state-owned enterprises
- The target's activity and ethical conduct within the industry it operates in, the anticorruption programs the target has in place, and the target's adherence to and monitoring of high anticorruption standards
- Evaluation of any corruption issues in the past and whether they were properly resolved; includes possibly conferring with regulators

Install postdeal measures

Anticorruption compliance measures must be put in place aggressively throughout the newly acquired target. Key areas include:

- Regular anticorruption messages sent loudly through the organization from the top
- Rapid deployment of an anticorruption program with rigorous training, monitoring and enforcement procedures
- Establishment of a call-in compliance hotline, ensuring easy and rapid address of corruption-related issues and queries
- Compliance oversight and supervision of third-party intermediary activities



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