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FCPA Initiates Sweep of Firms Doing Business with Sovereign Wealth Funds

The U.S. Securities and Exchange Commission ("SEC") has issued information requests to at least ten banks and private equity firms to examine whether their dealings with sovereign wealth funds ("SWFs") implicate the U.S. Foreign Corrupt Practices Act ("FCPA"). This development has broad implications for (i) firms in which SWFs have invested capital, (ii) firms that conduct other business with or provide services to SWFs, and (iii) SWFs themselves. The requests also signal the U.S. Government's intent to scrutinize an entire new area under the FCPA.

The Department of Justice ("DOJ") foreshadowed the U.S. Government's focus on SWFs in October 2008, when the then-head of the Fraud Section stated that "the recent boom of sovereign wealth funds is an area of particular interest to the Justice Department."[1] The SEC's current investigation (known as a "sweep" because it targets an industry and is not focused on a single firm) is in its early stages, and appears to be focused on financial firms that received significant capital injections from SWFs beginning in 2008. According to public reports, the sweep letters instruct firms to retain documents relating to and respond to general questions about the firms' dealings with SWFs. The firms can expect their responses to lead to further questions and requests for documents and, in certain cases, to full-blown investigations. Moreover, firms that were not included in the first round can expect to receive similar letters in the future.

The SEC created a specialized FCPA Unit in 2009 to focus on new and proactive approaches to identify FCPA violations, and the DOJ has increased its own resources devoted to FCPA investigations. The current sweep follows the model that the SEC and the DOJ have used for other industry sectors, in particular the pharmaceutical, medical device manufacturing, and oil and gas services sectors. The oil services sweep led to multiple investigations into individual companies, one of which culminated in a settlement in November 2010 involving seven companies and a total of $236.5 million in criminal and civil penalties.[2] The head of the FCPA Unit has stated that the

Key Issues

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[1] Nicholas Rummell, *Cash crunch could result in more corruption cases*, Financial Week, Oct. 7, 2008.

[2] *Oil Services Companies and Freight Forwarding Company Agree to Resolve Foreign Bribery Investigations and to Pay More Than $156 Million in Criminal Penalties*, DOJ Press Release, Nov. 4, 2010 (available at http://www.justice.gov/opa/pr/2010/November/10-crm-1251.html); *SEC Charges Seven Oil Services and Freight Forwarding Companies for Widespread Bribery of Customs Officials*, SEC Press Release, Nov. 4, 2010 (available at http://www.sec.gov/news/press/2010/2010-214.htm).

Unit will "conduct more targeted sweeps and sector-wide investigations, alone and with other regulatory counterparts both here and abroad."[3]

The Statute

The FCPA consists of two principal components: the anti-bribery provisions and the accounting provisions.

Anti-Bribery Provisions

The anti-bribery provisions prohibit using the "instrumentalities of U.S. commerce" — such as the mails, phone lines, or internet — or taking any act within the United States in furtherance of a corrupt payment or offer to pay anything of value to a "foreign official," directly or indirectly, to obtain or retain business. For U.S. companies and individuals, the anti-bribery provisions prohibit such payments anywhere in the world, without regard to the use of U.S. instrumentalities. The FCPA also prohibits knowingly engaging in this conduct through a third party, such as a consultant, contractor, or joint venture partner. Under prevailing FCPA enforcement theories, lavish entertainment and transfers of "value" other than cash can attract prosecution with the same intensity as outright bribery.

A foreign official is defined as "any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization."[4]

Accounting Provisions

The accounting provisions require U.S. issuers,[5] which include non-U.S. companies that issue stock or American Depository Receipts on a U.S. exchange, to maintain accurate financial records and adopt internal controls that ensure such records. These provisions apply to the foreign subsidiaries of U.S. issuers to the extent that the subsidiaries' books are consolidated with their parents'. Among other things, the accounting provisions require U.S. issuers to ensure: (1) that books, records and accounts are kept in reasonable detail to accurately and fairly reflect transactions and dispositions of assets, and (2) that a system of internal accounting controls is devised to: (a) provide reasonable assurances that transactions are executed in accordance with management's authorization; (b) ensure that assets are recorded as necessary to permit preparation of financial statements and to maintain accountability for assets; (c) limit access to assets to management's authorization; and (d) make certain that recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

FCPA actions against issuers typically include alleged violations of one or more of the accounting provisions on the ground that the issues misreported or failed to record illicit transactions in the company's books. Common examples include failures to record transactions, "off-the-book" transactions, and falsified or mischaracterized expenses (such as improper payments booked as "training" or "consulting" expenses).

Potential Conduct at Issue

SWFs are state-owned investment funds engaged in a diverse array of equity and debt investments, including participation in private equity funds and share ownership of financial services firms. Some of the largest SWFs are operated in the United Arab Emirates, China, Singapore, and Kuwait, and combined manage trillions of dollars in assets. These funds were particularly active in the United States and elsewhere following the credit crisis.

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[3] *Speech by SEC Staff: Remarks at News Conference Announcing New SEC Leaders in Enforcement Division*, Jan. 13, 2010 (available at http://www.sec.gov/news/speech/2010/spch011310newsconf.htm).

[4] 15 U.S.C. §§ 78dd-1(f)(1)(A), 78dd-2(h)(2)(A), 78dd-3(f)(2)(A).

[5] A U.S. issuer includes any company that either has a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") or that is required to file reports with the SEC pursuant to Section 15(d) of the Exchange Act.

"Foreign Officials"

Because SWFs are owned and operated by foreign governments, the DOJ has stated that their officers, directors and employees may be considered "foreign officials" for purposes of the FCPA.[6] Although controversial, the SEC and DOJ historically have interpreted "foreign officials" broadly to include employees of state-owned enterprises. For example, foreign officials identified in previously settled cases have included (i) doctors employed by Chinese state-owned hospitals; (ii) officers and employees of a joint venture consortium 49%-owned by a Nigerian oil and gas agency; and (iii) officers, directors, and employees of a 43% state-owned and controlled telecommunications provider in Malaysia.

"Obtaining or Retaining Business"

The SEC's focus on firms that received capital infusions from SWFs suggests that the SEC is investigating whether the firms provided improper benefits to individuals within the SWFs or agents of SWFs as inducement to make those investments.

At first blush, this suspected conduct is an uncomfortable fit with the conduct that the anti-bribery provisions of the FCPA appear to prohibit — improper payments made for the purpose of "obtaining or maintaining business." Nonetheless, the SEC and DOJ have not limited these provisions to the mere payment of bribes to secure a contract or business opportunity. Rather, they have applied them to the obtaining of any business advantage. For example, in 2001 the U.S. Government initiated an enforcement action against a company that paid Haitian tax and customs officials to reduce its tax burden, on the ground that the reduction in expenses gave the company a competitive pricing advantage that enabled it to secure contracts. After initially being rebuffed by a trial judge who interpreted the provision more narrowly, the Government obtained the endorsement of this interpretation from the court of appeals.[7] In the context of SWFs, the Government likely would take the position that securing a capital infusion that provides resources to a firm (or enables it to avoid insolvency) constitutes "obtaining or retaining business."

Accordingly, firms that receive funds from SWFs could face exposure if they improperly provided anything of value (e.g., gifts, charitable donations, entertainment, travel, or other inducements) to or for representatives of SWFs in connection with their efforts to obtain capital. More conventionally, firms that improperly provide anything of value in connection with efforts to secure business opportunities such as the provision of investment advisory services, custodial services, or back-office services to SWFs could face liability.

What About Materiality?

Many of the relationship-building efforts that accompany the negotiation of a transaction — for example, meals, entertainment, and site visits — would hardly influence a potential investor to enter into a deal that he or she otherwise would not. But they may be necessary to provide a potential investor exposure to and comfort with its counterparty. Would these common outreach efforts be exempted from the FCPA because they are immaterial to an investment decision? Unfortunately not, as the FCPA has been interpreted not to incorporate concepts of materiality.

"Reasonable and Bona Fide Expenditure" Defense

The FCPA does recognize an affirmative defense for "reasonable and bona fide expenditures, such as travel and lodging expenses, incurred by or on behalf of a foreign official . . . directly related to" either "the promotion, demonstration, or explanation of products or services" or "the execution or performance of a contract with a foreign government or agency thereof."[8] This exception may apply to the provision of travel and meals to employees of SWFs in the course of negotiating a deal. But U.S. authorities have taken a narrow view as to whether expense reimbursements or outlays are "reasonable and bona fide" and "directly related" to the "promotional" activities. For example, in one case the Government alleged that

[6] *Firms Cautioned Over Sovereign Fund Dealings*, Compliance Reporter, Oct. 13, 2008 (available at http://www.compliancereporter.com/pdf/CR101308.pdf).

[7] *See United States v. Kay*, 359 F.3d 738, 755 (5th Cir. 2004).

[8] 15 U.S.C. § 78dd-1(c)(2).

payment for first-class travel and associated expenses of a foreign official, his wife, and two children for trips to the United States were intended to influence the official rather than for legitimate promotional purposes.[9]

Impact on SWFs

The FCPA does not subject to prosecution the foreign officials who receive improper payments or other things of value, and representatives of SWFs are therefore unlikely to incur FCPA liability. However, SWFs should consider the potential application of other U.S. laws in the event the sweep leads to further investigation. For example, the DOJ has brought money laundering charges against former Haitian officials employed by Haiti's state-owned telecommunications company for their receipt of bribes in connection with an FCPA matter. Similarly, money laundering charges were recently filed against a former Thai official and her daughter in connection with the bribes at issue in an FCPA case involving Hollywood film executives.

Even in the absence of an information request directly to the SWF, SWFs that are linked to a particular case should be aware of their potential liability under U.S. law. Moreover, significant reputational harm can result from allegations of involvement in bribery. Accordingly, SWFs should assess the impact of this industry sweep with respect to recent transactions.

Recommendations

Although the sweep is in its early stages, we expect that the SEC will issue additional information requests and document retention orders to other financial institutions, hedge funds, and private equity firms, including non-U.S. firms. Accordingly, we recommend that firms prepare to receive such an inquiry, including by ensuring that the relevant persons within the firm are aware of how to respond if an inquiry arrives. In this regard, any firm that receives an inquiry from the SEC or a DOJ subpoena should carefully consider how the information requested will impact its position. First steps to consider include:

- Assessing the reach of the subpoena or information request and the impact of local law on the production of documents, and ensuring that the firm has instituted an appropriate document retention and production procedure for its response to the subpoena or information request;
- Ensuring that the firm understands the legal implications of the information contained in the documents that are requested, including whether the documents subject the firm to enforcement risk under applicable anti-corruption and other laws; and
- Identifying any collateral effects that may result from disclosing the information to the U.S. authorities or from resisting the information request.

In view of these developments, firms also should proactively take steps to confirm that they are properly managing their anti-corruption risk. In particular, firms should carefully review their compliance policies to ensure that they address FCPA issues raised by interactions with SWFs, implement strong accounting controls and audits for FCPA issues, and conduct FCPA training for employees.

[9] *U.S. v. Metcalf & Eddy*, C.V. No. 99-12566-NG (D. Mass. Dec. 14, 1999).