

Foreign Corrupt Practices Act Compliance in Joint Ventures and Consortia: Minimizing FCPA Risk

TUESDAY, JANUARY 7, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Edward J. Fishman, Partner, **Hogan Lovells**, Washington, D.C.

James G. Tillen, Member, **Miller & Chevalier**, Washington, D.C.

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 1.**

Tips for Optimal Quality

FOR LIVE EVENT ONLY

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-877-447-0294** and enter your **Conference ID and PIN** when prompted. Otherwise, please **send us a chat** or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the 'Full Screen' symbol located on the bottom right of the slides. To exit full screen, press the Esc button.

Continuing Education Credits

FOR LIVE EVENT ONLY

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 2.

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the link to the PDF of the slides for today's program, which is located to the right of the slides, just above the Q&A box.
- The PDF will open a separate tab/window. Print the slides by clicking on the printer icon.

AGENDA

- Brief Overview of the FCPA and FCPA Enforcement Trends
- FCPA Compliance Risks in Joint Ventures
 - What is a Joint Venture?
 - FCPA Compliance Risks in Joint Ventures
 - Accounting Risks in Joint Ventures
- FCPA Enforcement Actions Involving Joint Ventures
- Unique FCPA Risks with JV Partners
- Compliance Best Practices for JVs
 - Due Diligence of JV Partner
 - Implementing Internal Controls at JV
 - Compliance Terms
 - Post-Formation Monitoring
 - Auditing
- Special Issues When a Joint Venture is Under Investigation

The logo for Hogan Lovells, consisting of the words "Hogan" and "Lovells" stacked vertically in a black serif font, set against a solid lime green square background.

Hogan
Lovells

FCPA Compliance Risks in Joint Ventures

Prepared for:
Strafford CLE Program
January 7, 2020

Presented by Ed Fishman
Hogan Lovells US LLP
Washington, DC

OVERVIEW OF FCPA ANTI-BRIBERY LAW

- U.S. Foreign Corrupt Practices Act (FCPA)
 - FCPA has two basic sets of provisions:
 - Anti-bribery provisions that make it illegal to bribe non-U.S. government officials
 - Accounting provisions that impose record-keeping and internal control requirements on U.S. publicly-traded companies (i.e., “corporate issuers”)
 - Prohibits corruptly giving “**anything of value**” to a “**foreign official**” in order to obtain or retain business or **any improper advantage**
 - Third parties acting on behalf of a company (including joint venture partners) can create FCPA liability if the company ignores “**red flags**” about their improper conduct
 - There is a very narrow exception for “**facilitating payments**” under US law which is not recognized by the laws of most other countries
 - There are affirmative defenses for “**reasonable and bona fide**” promotional expenses, payments required under a contract with a foreign government agency, and payments allowed under the written laws of a foreign country

OVERVIEW OF ANTI-BRIBERY PROVISION

- Prohibits the offer or payment of “anything of value” to any “foreign official” for purposes of influencing any act or decision of such foreign official in order to obtain or retain business or direct business to any person
- Prohibits the offer or payment of “anything of value” to a third party while “knowing” that all or a portion of that payment will be offered or given to a “foreign official” for unauthorized purposes
- The FCPA anti-bribery provision applies to the following:
 - Any corporate issuer
 - Any domestic concern (i.e., US citizen/national/resident or any company with its principal place of business in the US or organized under US law)
 - Any non-issuer or non-domestic concern acting within the territory of the U.S.
 - Any officer, director, employee or **agent** of any of the foregoing
- A criminal conviction under the anti-bribery provision requires the government to prove that the offer or payment was made with “corrupt intent”

OVERVIEW OF ANTI-BRIBERY PROVISION

- Third-party liability risk arises from “willful blindness” or “conscious avoidance” of red flags or awareness that a violation is “highly probable”
- Both DOJ and SEC may invoke “willful blindness” or “conscious avoidance” to satisfy the knowledge standard required for an FCPA offense by a principal when an anti-bribery violation is carried out by a third party
- This makes FCPA compliance especially challenging with joint ventures, since the failure to conduct adequate due diligence on a joint venture partner or red flags associated with its activities could be sufficient to satisfy the knowledge standard as interpreted by the DOJ and SEC

OVERVIEW OF ANTI-BRIBERY PROVISION

- The FCPA prohibits both direct and indirect payments of “**anything of value**” to “**foreign officials**” for any improper purpose (i.e., with corrupt intent)
- The FCPA defines the term “**foreign official**” very broadly to include:
 - Any officer or employee of a non-U.S. government or department, agency, or **instrumentality** of that government at the local, regional or national level
 - Any employee or representative of a **state-owned or state-controlled enterprise** (such as doctors and administrators at hospitals in China)
 - Any officer or employee of a public international organization such as the U.N. or the World Health Organization
 - Any person acting in an official capacity for or on behalf of a non-U.S. government
 - Any non-U.S. political party or elected party official or any candidate for non-U.S. political office

OVERVIEW OF ACCOUNTING PROVISIONS

- The FCPA requires a “**corporate issuer**” to keep its books, records and accounts accurately, and in reasonable detail, so that they reflect all of a company’s transactions and the disposition of its assets.
- The FCPA also requires that a corporate issuer maintain a system of internal financial controls designed to prevent and detect fraud. These internal controls must be sufficient to provide reasonable assurance that:
 - Transactions are executed as authorized
 - Transactions are recorded to permit preparation of financial statements in accordance with GAAP and to maintain accountability for assets
 - Access to assets is restricted
 - Assets are examined periodically

Overall FCPA Enforcement Trends

- Vigorous corporate enforcement activity continues (\$2.9 billion in corporate enforcement settlements in 2019)
- Individual enforcement activity is at record levels and has become standard part of corporate resolutions
- DOJ has issued additional guidance on benefits of cooperation
- Global convergence of anti-corruption enforcement continues to increase
- Most FCPA corporate enforcement actions involve some level of involvement by third-parties (including agents, distributors or joint venture partners)
- Most active FCPA and anti-corruption enforcement investigations involve activity by multinational companies in the following countries:
 - China
 - Brazil
 - Russia
 - Venezuela
 - Argentina

FCPA Compliance Risks in Joint Ventures

- What is a Joint Venture?
 - Generally speaking, it is a collaboration between two separate business entities to carry out a joint business venture for profit. It usually involves a joint undertaking by two existing businesses in which they share risk (losses and liabilities), profits, control and/or management while remaining independent.
 - A joint venture often results in the establishment of a separate legal entity. However, a joint venture also can be formed by contract or through a strategic alliance that does not result in the formation of a separate legal entity.
 - A joint venture is an attractive model for entering into a new business or new market because it often involves each party contributing capital, technology or resources that the other party does not have at its disposal (e.g., multinational company enters new market through joint venture with local partner).
 - A joint venture interest can include the following:
 - A majority-owned subsidiary
 - A minority-owned subsidiary subject to operational or management control
 - A 50/50 joint venture controlled by neither party
 - A minority interest in a joint venture that is not subject to control and not consolidated into the financial results of the minority investor (cf. equity method of accounting)

FCPA Compliance Risks in Joint Ventures

- A company can be directly liable for FCPA anti-bribery violations committed through its participation in a joint venture (e.g. TSKJ enforcement action)
- A company can be vicariously liable for FCPA violations committed by a joint venture, joint venture partner or an agent acting on behalf of a joint venture where the company authorized, directed or controlled acts that violate the anti-bribery provisions
- The agency theory of liability is particularly expansive (although DOJ recently stated that “the Criminal Division will not suddenly be taking the position that every subsidiary, joint venture, or affiliate is an “agent” of the parent company by virtue of ownership status. Conversely, we will also not be taking the position that every parent company should automatically be held liable for the acts of its subsidiaries, joint ventures or affiliates based on an agency theory. Simply put, the law requires more. Each case and application of agency liability will need to be evaluated on its own and be based on provable facts that align with agency principles.” Remarks of Assistant Attorney General Brian Benczkowski on December 4, 2019)

FCPA Accounting Risks in Joint Ventures

- Where issuer holds 50% or less of the voting power of a domestic or foreign firm, the issuer is required to “proceed in good faith to use its influence, to the extent reasonable under the issuer’s circumstances, to cause such domestic or foreign firm to devise and maintain a system of internal accounting controls”
- The relevant “circumstances” referred to above include “the relative degree of the issuer’s ownership” and the “laws and practices governing the business operations of the country in which such firm is located”

FCPA Enforcement Actions Involving Joint Ventures

- **Bonny Island LNG Project (2009-2011)**
 - Almost \$2 billion in penalties assessed against KBR/Halliburton, ENI, Technip and JGC for anti-bribery violations
 - Alleged improper payments made through agents working on behalf of various joint ventures established to bid on LNG project with Nigerian National Petroleum Company (NNPC)
 - Individual enforcement and extradition proceedings
 - Global investigation of complex relationships involving consortium members and agents
 - Prosecutions in U.S. and abroad

FCPA Enforcement Actions Involving Joint Ventures

■ RAE Systems, Inc. (2011)

- California radiation detection system manufacturer settled criminal and civil FCPA charges arising from approx. \$400,000 in alleged payments to Chinese government officials by two majority-owned JV's
- JV's provided third-party agents with cash advances generated through false or misleading invoices
- Portions of the cash advances allegedly were passed on to the Chinese government officials
- Settled with DOJ for \$1.7 million criminal fine and non-prosecution agreement due to voluntary cooperation; settled with SEC for civil injunction and disgorgement of \$1.3 million
- Liability premised on failure to investigate red flags of continuing bribery by joint venture partners in China and failure to conduct adequate pre-acquisition due diligence of one joint venture partner

FCPA Enforcement Actions Involving Joint Ventures

■ Bellsouth (2002)

- Bellsouth paid a \$150,000 civil penalty and settled SEC administrative charges that it violated the accounting provisions of the FCPA as a result of its “operational control” of a Nicaraguan joint venture in which it had a 49% ownership interest (but operational control through agreement with its local partners and control of 4 of 6 Board seats)
- The SEC alleged that the joint venture created false books and records by improperly recording a payment to the wife of a Nicaraguan legislator as a “consulting fee”
- The SEC alleged that Bellsouth “failed to devise and maintain a system of internal accounting controls sufficient to detect and prevent” FCPA violations by the joint venture

FCPA Enforcement Actions Involving Joint Ventures

■ Bristol Myers Squibb (2015)

- BMS held a 60% equity interest in a China JV
- The SEC determined that BMS had “operational control” over the China JV through its right to appoint the President of the JV and a majority of the JV’s Board of Directors
- BMS agreed to pay \$14 million to settle SEC administrative charges that its China JV made cash payments and provided other benefits to healthcare providers at state-owned and state-controlled hospitals in exchange for prescription sales
- The SEC alleged that BMS failed to “respond effectively to red flags” at the China JV that indicated a “widespread practice” of improper payments to HCPs in exchange for prescription sales, failed to investigate allegations of improper activity raised by former employees, and identified control deficiencies at the joint venture that were not remediated in a timely manner
- The SEC alleged that BMS falsely recorded the relevant transactions as legitimate business expenses (since the JV’s books and records were consolidated with BMS’s own books and records) and failed to devise an adequate system of internal controls

2019 Enforcement Actions Involving Joint Ventures

- **Ericsson** (2019) – nothing particularly unique to joint ventures, but entities involved a majority-owned joint venture in China and various majority-owned foreign subsidiaries in Egypt and Indonesia
- **Westport Fuel Systems** (2019) – China joint venture allegedly bribed Chinese government officials
- **Technip** (2019) – the alleged bribery scheme involved a Singapore-incorporated, Brazil-based joint venture owned 25% by Technip and 75% by Keppel Offshore Marine that was deemed to be an “agent of a domestic concern”
- **Walmart** (2019) - the alleged improper conduct involved a joint venture in India and a Mexican entity that was publicly traded in which Walmart owned a majority of shares
- **MTS** (2019) – the alleged bribery involved shell companies and joint ventures in which foreign officials had ownership interests (i.e., conduit risk)

Unique FCPA Risks with JV Partners

- **Lack of Adequate Diligence on Business Partner**
 - Sometimes viewed differently from third-party agents
 - More interdependent business relationships
- **Governance Challenges**
 - Less direct control over actions of JV partner
 - Different accounting systems and controls
 - Conflicting corporate cultures and operational approaches
 - Varying levels of investment and responsibility
 - Local partner may have more control over day-to-day activities

Unique FCPA Risks with JV Partners

- **Different Compliance Expectations**

- Divergent legal regimes applicable to conduct
- Variance in cultural and historical practices
- Different expectations and objectives

- **State-owned enterprise as JV partner**

- Common in China, Africa and the Middle East
- Creates complexities on various levels:
 - SOE partner may exercise control over interactions with “government officials” because of relationships
 - Foreign partner may contribute technical expertise or IP

- **Project-specific JVs and Consortia**

- High-risk industries – e.g., infrastructure consortium
- Complicated, multi-party arrangements through SPV

QUESTIONS?

**ED FISHMAN
HOGAN LOVELLS US LLP
WASHINGTON, DC
202-637-3692
ED.FISHMAN@HOGANLOVELLS.COM**

Miller & Chevalier

FCPA Compliance in Joint Ventures

James G. Tillen
Miller & Chevalier Chartered
jtillen@milchev.com
202-626-6068

Best Practices Overview

- Compliance Best Practices for JVs
 - 1) Conduct due diligence of JV partner
 - 2) Implement internal controls, including anti-corruption compliance program, in JV
 - 3) Obtain representations in JV agreement from JV and JV partner re: compliance with anti-corruption laws
 - 4) Conduct post-formation monitoring of JV and JV partner

Best Practices: Due Diligence of JV Partner

- Similar to due diligence on any third-party agents
 - Verify ownership
 - Assess reputation (reference checks; screening of media, criminal records, and denied parties lists)
 - Identify connections to Government and Officials
 - Establish qualifications

Best Practices: Due Diligence of JV Partner (cont'd)

- If JV partner to contribute preexisting contracts and assets to venture, ensure that those contracts and assets were lawfully procured
- If JV partner to contribute any agents to the venture, conduct due diligence on those agents
- If JV partner a government official/entity, determine whether official/entity could secure improper advantage for the JV or your company and whether compensation of official/entity is reasonable

Best Practices: Ensuring JV Implements Internal Controls

- Particularly if your company is an issuer:
 - Require that JV adopt robust internal controls (which include an anti-corruption compliance program)
 - Require that JV maintain accurate books and records in accordance with GAAP principles
- Where the JV involves a government official, JV agreement should include additional controls, such as restrictions on the official's activities relating to the JV

Best Practices – Ensuring JV Implements Internal Controls

- Issue of acquiring a minority interest in an established venture
- When your company is an issuer and a minority shareholder, still need to satisfy “good faith” efforts of FCPA accounting provisions.

Possible good faith efforts:

- Seek to amend JV contract to add Compliance terms
- Propose board/shareholder resolution re: adoption of compliance program/internal controls
- Propose adoption in letter
- Pose questions regarding compliance at board/shareholder meetings
- Include anti-corruption compliance as recurring agenda item at board or shareholder meetings

Best Practices – Ensuring JV Implements Internal Controls (cont'd)

- Possible good faith efforts:
 - Seek certifications from JV and JV partners
 - Train employees seconded to JV or serving on board
 - Offer training to JV
 - Object to transactions presenting FCPA risk
 - Exercise audit rights if available

Best Practices: Representations of Compliance with Anti-Bribery Provisions

- Representations of FCPA Compliance in JV Agreement:
 - JV will not make improper payments
 - JV partner has not and will not make improper payments
 - JV partner is not contributing illicitly procured contracts to JV
 - JV partner is not affiliated with a foreign government (or if affiliated, provisions mitigating that risk such as recusals, compliance with conflict of interest laws, etc.)
 - Include mechanisms to permit investigation of compliance issues and the ability to exit venture or remove partner in event of suspected improper payment by partner or JV

Best Practices: Post-Formation Monitoring

- Provisions in JV Agreement to Monitor FCPA Compliance:
 - Audit rights – of both the JV's books, and the books of the JV partner for their work related to the venture
 - Compliance review (and potentially pre-approval) for agents or consultants retained by the JV or JV partner for the venture
 - Periodic compliance certification by JV and partner

Best Practices: Auditing

- Focus both on JV and your company's interactions with JV
- Financial auditing:
 - Payment irregularities
 - Recording
 - Controls for accounting
- Compliance auditing
 - Effectiveness of anti-corruption compliance program and related controls
 - Focus on corruption risk areas (third parties, hospitality, SOEs, etc.)
 - Employee understanding of compliance program

Special Issues When a Joint Venture is Under Investigation

Unique Challenges Posed by Investigation Of Activities Within Joint Ventures

- Varying levels of cooperation from JV and/or JV partner
- JV agreements/JV partners can complicate many aspects of investigation and disclosure decisions
- Challenges in accessing information
- Difficulties in maintaining privilege while investigating within another legal entity
- Whether to have a Joint Defense Agreement (JDA) with JV and/or JV partner

Level of Joint Venture Cooperation Can Vary Widely

- When liability turns on conduct within the JV, its management may not have an interest in full cooperation
- When liability for the JV or one of its partners turns on conduct of another partner, that partner may not have an interest in assisting the investigation
- Indeed, JV management or a JV partner may have an interest in pushing responsibility/liability for the matters onto the other JV partner

Importance of the Joint Venture Agreement

- JV agreements often provide limitations on disclosure of information regarding JV activities and data
- JV agreements often compel notification and/or permission prior to disclosure of JV activities
- JV agreements sometimes limit JV partners' access to information within the JV
- So, know your agreement

Legal Status of Joint Venture

- Where is JV domiciled?
- Is it a U.S. entity?
- What is its legal status in the country or countries in which it operates?
- Legal status can affect U.S. enforcement profile, access to data, local law exposure, level of cooperation from JV employees, and a host of other issues

Impact on Whether to Voluntarily Report

- A voluntary report regarding a JV likely relates, at least in part, to conduct of individuals outside direct company control, and can create collateral risk:
 - Cross accusations
 - Litigation risk from JV partners
 - Investigation challenges
- After disclosure, the government's expectations as to the investigation may exceed the ability to investigate within the JV

Data Privacy Issues

- Data privacy issues can be made even more complex when data is in an overseas JV, as opposed to a fully controlled subsidiary
- The data likely will not “belong” to the partners, but to the JV itself
- Ability to gain necessary releases and consent is more complicated, particularly in GDPR countries.
- Nonetheless, government expectations may be no less than in a “standard” case

Impact on Privilege Issues

- There is often a need to interview JV employees
- In the normal course, interviews of JV employees by counsel for one of the JV partners would not be privileged:
 - Different legal entities
 - Unless counsel purports to represent both entities, the corporate privilege of the JV partner will not extend to the JV
- Creating privilege through a JDA can have collateral consequences of its own

Whether to have a Joint Defense Agreement

- **Pros**

- A JDA may allow greater flexibility and access in the investigation
- Allows for privileged interviews of JV employees
- Enhances full knowledge of JV activities and ability to present them, as necessary, in disclosure

- **Cons**

- But, undermines separation from any suspect actions and ties the two entities together
- Creates potential conflicts for counsel
- May not be welcomed by government

Critical Conclusions

- Gaining cooperation of JV partner(s)
- Knowing the JV agreement and JV legal status
- Getting data and interviews without compromising privilege
- Managing government expectations

Thank You

Contact Info:

James G. Tillen
Miller & Chevalier Chartered
900 16th St. NW
Washington, DC 20006
202-626-6068
jtillen@milchev.com