Foreign Corrupt Practices

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The pace of formal developments to deter corrupt practices in the conduct of international business slowed in 1999. But out of the public eye there continued to be significant movement towards a coalescing of more global efforts to deter corrupt practices.

I. International Developments

Since the Organization for Economic Co-operation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention) entered into force on February 15, 1999,[1] a total of twenty signatories have now deposited their instruments of ratification.[2] Of these, at least twelve signatories have implemented the OECD Convention. Most of the remaining signatories either are in the process of implementing or are expected shortly to implement the OECD Convention.

As part of the process of implementation, the OECD Convention established a mechanism to ensure compliance with its provisions.[3] Phase I of the monitoring process began in 1999 with the legal texts of implementing legislation being evaluated to determine whether they met the standards set by the OECD Convention.[4] Phase II will follow and focus on the performance of countries that implement the OECD Convention.

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1. Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Dec. 18, 1997, 37 I.L.M. 1.

2. These now include Iceland, Japan, Germany, Hungary, the United States, Finland, the United Kingdom, Canada, Norway, Bulgaria, Korea, Greece, Austria, Mexico, Sweden, Belgium, the Slovak Republic, Australia, Spain, and the Czech Republic. For the latest developments, further information can be obtained from the OECD web site. *See* Organization for Economic Co-operation and Development (visited Apr. 13, 2000) <http://www.oecd.org/daf/nocorruption/annex2.htm> [hereinafter OECD].

3. Revised Recommendation of the Council on Combating Bribery in International Business Transactions (Revised Recommendation), May 23, 1997, 36 I.L.M. 1016.

4. The first legislation evaluated was that of Germany, Norway, and the United States. The legislation of Bulgaria, Canada, Finland, Greece, and Korea was examined in July 1999; that of Belgium, Hungary, Iceland, Japan, and Sweden followed in October 1999; and that of Austria, Australia, and the United Kingdom in December 1999. The legislation of Mexico, the Slovak Republic, and Switzerland was scheduled to be evaluated in February 2000. *See* OECD, *supra* note 2.

A. Other International Measures

Though these were less dramatic, there continued to be developments with the ratification and implementation of the Organization of American States' Inter-American Convention Against Corruption (Inter-American Convention).[5] The Inter-American Convention entered into force on March 6, 1997. Of the twenty-seven signatories to the Inter-American Convention, there are now eighteen countries that have ratified the Convention and deposited their instruments of ratification.[6] Except for Macedonia, no other signatories to the Council of Europe's Criminal Law Convention on Corruption (Criminal Law Convention) have ratified it.[7] The United States has yet to make a determination as to whether it will become a signatory to the Criminal Law Convention.[8]

II. Domestic Developments

Until December, there was little in the way of U.S. enforcement activity that became public in 1999, nor were any opinions issued through the Department of Justice's opinion review process during this period. However, a number of developments suggest an expanded application of the Foreign Corrupt Practices Act (FCPA)[9] by the Department of Justice and a further expansion of obligations by the Securities and Exchange Commission (SEC), particularly on issuers and auditors, to deter, detect, and report illegal conduct.

A. *United States v. Metcalf & Eddy, Inc.*

In December 1999, Metcalf & Eddy, Inc. entered into a civil settlement with the Department of Justice for violating sections 104(a) and (i) of the FCPA.[10] The government's complaint asserted that Metcalf & Eddy, Inc. provided travel, lodging, and entertainment expenses to the Chairman of the Alexandria General Organization for Sanitary Drainage (AGOSD), a local Egyptian official, to influence the U.S. Agency for International Development (USAID) in awarding contracts or contract extensions to its predecessor, M&E International, Inc.[11] While Metcalf & Eddy did not admit to the allegations in the com-

5. Inter-American Convention Against Corruption, Mar. 29, 1999, 35 I.L.M. 724.

6. These include Argentina, Bolivia, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, and Venezuela. The Bahamas (Commonwealth), Brazil, Canada, Guatemala, Guyana, Haiti, Jamaica, Suriname, and the United States have yet to ratify the Inter-American Convention. The latest developments relative to the implementation of the Inter-American Convention can be found on the web site. *See* Organization of American States, *Inter-American Convention Against Corruption* (visited Apr. 14, 2000) <http://www.oas.org/En/prog/juridico/english/Sigs/b-58.html>.

7. The latest developments as to the status of the Criminal Law Convention on Corruption can be found on the Council of Europe's web site. *See* Council of Europe, *Criminal Law Convention on Corruption* (last modified Jan. 1, 1999) <http://www.coe.fr/eng/legaltxt/173e.htm>.

8. *See id.* art. 33 at ¶ 1. The Criminal Law Convention is open to accession by states that are not members of the Council of Europe. The U.S. position is still being reviewed as of this writing as part of the inter-agency process of the U.S. government.

9. Foreign Corrupt Practices Act, 15 U.S.C. §§ 78m, 78dd-1–78dd-3, 78ff (1999).

10. *Id.* at §§ 78dd-2(a) and (i).

11. Consent and Undertaking, United States v. Metcalf & Eddy, Inc., No. 99CV12566NG (D. Mass., Dec. 14, 1999) [hereinafter Consent].

plaint, it did agree to the entry of a permanent injunction, the payment of a civil fine of $400,000, and an additional $50,000 as reimbursement for the cost of the investigation.[12]

Based in Massachusetts, M&E International was a non-public company that was merged into Metcalf & Eddy in 1997. As an environmental engineering firm, Metcalf & Eddy sought contracts and contract extensions on the AGOSD Phase I and II projects funded by USAID. Bids by prospective contractors were subject to review by technical review boards of USAID. AGOSD held a voting position on the technical review boards for the Phase I and II projects. Officials of M&E International were alleged to have known that the Chairman was capable of influencing his subordinates on these technical review boards.[13]

During the period of time that the contracts for the Phase I and II projects were awarded, the Chairman traveled twice to the United States with his wife and two children. Despite already receiving funds for his per diem expenses, M&E International paid for most of the travel and entertainment expenses incurred by the Chairman and his family on both trips. M&E International also paid for upgrading their airline tickets to first class. The airline upgrades, the payment of per diem advances, and the payment of the additional lodging and entertainment expenses of his family by M&E International, were alleged to have been used to induce the Chairman to have AGOSD use its influence with USAID officials to encourage the awarding of contracts or contract extensions to M&E International.[14]

Metcalf & Eddy is significant in a number of respects. It signals continued vigilance on the part of the Department of Justice as well as ongoing efforts to apply the FCPA in an expansive manner. The contracts in question in *Metcalf & Eddy* were with a U.S. governmental agency, not a foreign government or a foreign entity. The ultimate decision was made by a U.S. governmental agency, not a foreign government or foreign official. Also, there was no suggestion that U.S. government officials were influenced, actually engaged in any improprieties, or susceptible to being influenced. In essence, all that the foreign official in the person of the Chairman was asked to do was, in effect, put in a "good word" with U.S. officials.

By itself, asking a foreign official to put in a good word for someone is not a violation of the FCPA. But *Metcalf & Eddy* suggests that when airline upgrades, per diem expenses, or entertainment expenses are used for the benefit of a foreign official and, in particular, his or her family, questions can arise as to whether a quid pro quo existed or, at the very least, whether the upgrades, additional lodging, and entertainment expenses were used to induce his or her support. In addition, though the amounts involved may not seem significant by U.S. standards, the value of the upgrades and entertainment expenses can be significant from the standpoint of a government official in a country where the living standards may be considerably less than those in the United States or Western Europe.[15]

A logical extension of *Metcalf & Eddy* would be situations where anything of value is offered or paid to a foreign official to put in a good word relative to an undertaking solely

12. *Id.* ¶¶ 1 and 12.

13. *See* Complaint, *Metcalf & Eddy, Inc.*, ¶ 14 [hereinafter Complaint].

14. *Id.* ¶ 8.

15. *See id.* ¶¶ 18–23. (It should be noted that the travel of the Chairman was an essential part of M&E International's contract with USAID. His travel was specifically approved by USAID as being reimbursable. As a result, there is no question as to the Chairman's travel being bona fide in nature. Rather, it was the extras in the form of his airline upgrades, his per diem advances, and the payment of airline upgrades and entertainment and lodging expenses for his family that were alleged to have been improper).

within the United States. Retaining or obtaining business does not necessarily have to take place outside of the United States, nor does an international transaction have to be involved. In short, any offer or payment of anything of value to a foreign official to obtain an improper advantage could serve as a basis for a violation of the anti-bribery provisions of the FCPA. Moreover, no improper motive needs to be involved for there to be a civil violation of the FCPA. Corrupt intent is only required to prove a criminal violation of the FCPA.[16]

The other significant aspect of *Metcalf & Eddy* relates to the compliance and ethics program that Metcalf & Eddy agreed to implement as part of the settlement. M&E International did not have an FCPA compliance program in place when the travel and entertainment in question occurred.[17] By insisting upon and setting forth minimum components of a compliance and ethics program, the Department of Justice provided guidance as to what constitutes an adequate FCPA compliance program. The components include:

a. a clear corporate ethics policy prohibiting violations of the FCPA, and the establishment of compliance standards and procedures that are reasonably capable of reducing the prospect of violations;
b. assignment of responsibility for the FCPA compliance program to senior managers;
c. establishment of a committee to review and conduct due diligence on agents retained in foreign jurisdictions as well as foreign joint venture partners;
d. corporate procedures to ensure that companies do not delegate substantial discretionary authority to individuals with a propensity to engage in illegal activities;
e. corporate procedures, including a recorded due diligence inquiry, to ensure that the company forms business relationships with reputable agents, consultants, and representatives;
f. regular training of officers, employees, agents, and consultants concerning the requirements of the FCPA;
g. implementation of appropriate disciplinary mechanisms for violations or failure to detect violations;
h. establishment of a system by which officers, employees, agents, and consultants can report suspected violations without fear of retribution or going through the chain of command, including immediate managers;
i. inclusion in all contracts with agents, consultants, joint venture partners, and other representatives warranties that no payments of money or anything of value will be offered, promised, or paid, directly or indirectly, to any foreign official, foreign political party, party official, or candidate for foreign public or political office to induce such officials to use their influence with a foreign government or instrumentality to obtain an improper business advantage for the company;
j. inclusion in all contracts with agents, consultants, and other representatives a warranty that the agent, consultant, or representative shall not retain any subagent or representative without the prior written consent of a senior official of the company; and
k. inclusion in all contracts of a provision for termination for breach of any of the aforementioned undertakings, representations, and agreements.[18]

16. 15 U.S.C. §§ 78ff(a) and (c) (1999).
17. *See* Complaint, *Metcalf & Eddy, Inc.* ¶ 25.
18. *See* Consent, *Metcalf & Eddy, Inc.* ¶ 4. The Consent and Undertaking also provided for a number of other obligations in addition to the establishment of an FCPA compliance program.

B. *United States v. UNC/Lear Services, Inc.*

Also in December 1999, the accounting and record-keeping provisions of the FCPA came into play in *United States v. UNC/Lear Services, Inc.*[19] UNC/Lear Services was a Maryland corporation that supplied military parts and services to the Kingdom of Saudi Arabia as the prime contractor on a foreign military sales contract awarded by the U.S. Air Force. A privately-held Kentucky company served as one of the subcontractors for UNC/Lear Services, and a private Saudi consulting company acted as the agent in Saudi Arabia for both UNC/Lear Services and the Kentucky subcontractor.

In securing the contract with the Air Force, the contract proposal included a "handling fee" to cover UNC/Lear Services' direct and indirect costs associated with the performance of the contract, including costs for repackaging the equipment and other miscellaneous costs for readying the equipment for shipment. During the contract negotiations, UNC/Lear Services represented to U.S. government officials that it passed a portion of the handling fee on to a third party. However, UNC/Lear Services later represented that it did not have any agents working on the contract.

Contrary to these representations, the Kentucky subcontractor sent fictitious invoices to UNC/Lear Services for "in country engineering services" to secure $140,000 in payments for its Saudi consultant. In addition, through UNC/Lear Services' purchases, the Kentucky subcontractor became, in effect, a sole-source supplier.[20] The president of the subcontractor enlisted the aid of UNC/Lear Services' contract manager to create the appearance of a competition to meet Department of Defense procurement regulations, thereby enabling the Kentucky subcontractor to inflate the cost of the parts.

UNC/Lear Services pled guilty to a three-count information for engaging in mail fraud,[21] submitting a false statement to the U.S. government,[22] and violating the record-keeping provisions of the FCPA.[23] It also agreed to pay $843,000 in fines and restitution as part of the plea, and $132,000 in a civil settlement with the United States.[24] The FCPA violation was premised on the false recording by UNC/Lear Services of payments totaling $140,000 to its Kentucky subcontractor for its Saudi consultant as a fee for engineering services conducted in Saudi Arabia.[25] In sum, *UNC/Lear Services* demonstrates how the record-keeping provisions of the FCPA can play a critical role in buttressing charges of violations of statutes other than the FCPA.

C. Qualitative Materiality

In 1999, through the issuance of Staff Accounting Bulletin (SAB) No. 99, the SEC reiterated the care that needs to be taken in considering qualitative as well as quantitative materiality.[26] It emphasized that the "[e]valuation of materiality requires a registrant and its

19. Information, United States v. UNC/Lear Servs., Inc., 2–3 (W.D. Ky., Dec. 8, 1999).
20. *See id.*
21. *See* 18 U.S.C. § 1341 (1999).
22. *See id.* at § 1001.
23. *See id.* at § 78m(b)(2).
24. *See* Plea Agreement, *UNC/Lear Services* ¶ 4 (1999).
25. *See* 15 U.S.C. § 78m(b)(2).
26. SEC Staff Accounting Bulletin: No. 99-Materiality, 17 C.F.R. pt. 211 (1999), *available at* <http://www.sec.gov/rules/acctreps/sab99.htm>.

auditor to consider *all* the relevant circumstances."[27] It also reported that "there are numerous circumstances in which misstatements below 5% could well be material."[28] Among the considerations that the SEC staff believes may render a quantitatively small amount as being material are where the misstatement affects the registrant's compliance with regulatory requirements or where the misstatement involves concealment of an unlawful transaction.[29] A violation of either the anti-bribery or accounting and recordkeeping provisions of the FCPA could, therefore, fall within these categories under SAB No. 99.

Though SAB No. 99 does not represent new law, it does reflect a renewed emphasis by the SEC on the obligations of issuers and their auditors under what is commonly referred to as "section 10A." As part of the Private Securities Litigation Reform Act of 1995, issuers were required to institute procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts.[30] Unless clearly inconsequential, section 10A(b)(1) requires the auditor to inform the appropriate level of management of an illegal act and assure that the registrant's audit committee is "adequately informed" with respect to the illegal act.[31]

When an auditor concludes that an illegal act may have a material effect on the financial statements and that senior management has not taken remedial action, the auditor must report to the board of directors that the failure to take remedial action is reasonably expected to warrant departure from a standard report of the auditor or warrant resignation from the audit engagement.[32] The board of directors must inform the SEC by notice not later than one business day after receipt of such a report.[33] It should be noted in this regard that in December the SEC's chief accountant disclosed in a letter to the American Institute of Certified Public Accountants' (AICPA) Director of Audit and Attest Standards that a relatively small number of reports have been submitted to the SEC pursuant to section

27. *Id.*

28. *Id.* The Financial Accounting Standards Board has also stated that "magnitude by itself, without regard to the nature of the item and circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment." *Id.*

29. *Id.* at 4. The demonstrated volatility of the price of a registrant's securities in response to certain types of disclosures may provide guidance as to whether investors regard quantitatively small misstatements as material. "When, however, management or the independent auditor expects (based, for example, on a pattern of market performance) that a known misstatement may result in a significant positive or negative market reaction, that expected reaction should be taken into account when considering whether a misstatement is material." *Id.* Small intentional misstatements relative to managing earnings can be material. Misstatements should be considered separately and in the aggregate. *See id.* at 5. Moreover, in assessing whether a misstatement results in a violation of a registrant's obligation to keep books and records that are accurate "in reasonable detail," registrants and their auditors should consider the significance of the misstatement, how the misstatement arose, the cost of correcting the misstatement, and the clarity of authoritative accounting guidance with respect to the misstatement. *Id.*

30. Private Securities Litigation Reform Act of 1999, 15 U.S.C. § 78j-l(a)(1) (1999).

31. If an auditor becomes aware of information indicating that an illegal act has or may have occurred, the auditor must determine whether an illegal act has occurred. It does not matter whether the illegal act is perceived to have a material effect on the financial statements of the issuer. *Id.* at § 78j-1(b)(1). If an illegal act did occur, an auditor must determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects such as fines, penalties, and damages. The American Institute of Certified Public Accountants (AICPA) in adopting Statement of Auditing Standards (SAS) No. 82 has largely followed this same approach in clarifying an auditor's role in detecting fraud. However, unlike section 10A, the obligations under SAS No. 82 also extend to audits of privately-held entities.

32. *See* 15 U.S.C. § 78j-l(b)(2).

33. *See id.* § 78j-l(b)(3).

10A.[34] For this reason, the SEC is likely to be looking for situations in which to make an example of a company or its auditors, or both.

These obligations under section 10A become particularly complex when the obligations under Rule 13b2–2 under the Exchange Act are taken into account. Rule 13b2–2 prohibits any officer or director from making materially false or misleading statements or omitting to state any material facts in the preparation of filings required by the Exchange Act.[35] Though it applies only to officers and directors, it is broad in terms of its coverage. It extends to internal auditors as well as to outside auditors. It also extends to making or causing to be made a materially false or misleading statement.[36] Not only are misrepresentations covered, but a failure to clarify a statement can also constitute a violation of Rule 13b2–2.

The combination of management's obligations under Rule 13b2–2 and an auditor's obligations under section 10A therefore may effectively eviscerate the protections of the attorney-client privilege as well as any inclination to withhold unfavorable information. If auditors are carrying out their responsibilities under section 10A, audits must be designed to detect illegal conduct. As a result, questions should be asked as to whether management has knowledge of illegal acts or where illegal conduct is most likely to occur. Even though management may have become aware of or suspect questionable conduct through its attorneys, management controls the privilege and, therefore, is presented with the dilemma of disclosure, along with the possible consequences, or face a potential criminal charge for violating Rule 13b2–2 for failure to disclose.

III. Conclusion

As a practical matter, the consequence of the increasing obligations to detect illegal conduct, combined with the increasing obligations to disclose illegal conduct, is that questionable conduct can no longer be ignored or remain concealed. A company and, in particular, a publicly-held company, therefore, puts itself at great risk by not taking steps to insure that it has an effective system of internal controls that includes an FCPA compliance program. This is particularly so with the anticipated increase in enforcement activity that is expected to accompany the implementation of the various international initiatives that address corrupt practices in the conduct of international business.

34. Letter from Lynn E. Turner, Chief Accountant, Securities and Exchange Commission, to Thomas Ray, Director, American Institute of Certified Public Accountants, (Dec. 22, 1999), *available at* American Institute of Certified Public Accountants (visited Apr. 14, 2000) <http://www.aicpa.org/members/div/auditstd/secchief.htm>.

35. 17 C.F.R. § 240.13b2–2 (1999).

36. *Id.*