

with the OECD Convention, with the goal of placing U.S. companies on a level playing field with foreign competitors.

The FCPA does not have implementing regulations. However, the Securities and Exchange Commission (the "SEC") promulgated Rule 13b-2 to enhance enforcement of the accounting provisions of the FCPA. Rule 13b2-1 provides that "[n]o person shall directly or indirectly falsify or cause to be falsified, any book, record or account subject to Section 13(b)(2)(A) of the Securities Exchange Act." Section 13(b)(2)(A) of the Exchange Act, in turn, requires every reporting company to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Rule 13b2-2 prohibits directors and officers of reporting companies from making false or misleading statements to an accountant, or omitting material information from statements made to an accountant, in connection with the audit of financial statements included in periodic reports or the preparation of reports.

Anti-bribery Provisions

A violation of the anti-bribery provisions by a reporting company, its officers, directors, employees, stockholders agents, involves eight separate elements:

1. The company, its officers, directors, employees or agents, commits an act. . .
2. in furtherance of . . .
3. an offer, payment, promise to pay, authorization of payment, gift, promise to give, or authorization of the giving. . .
4. of money or anything of value. . .
5. to (a) any foreign official, (b) any foreign political party or party official, (c) any candidate for foreign political office, or (d) any other person while knowing that the payment or promise to pay will be passed on to one of the above. . .
6. corruptly. . .
7. for the purpose of (a) influencing an official act or decision of that person, (b) inducing that person to do or omit to do any in violation of his or her lawful duty, (c) inducing that person to use his influence with a foreign government to affect or influence any government act or decision, or (d) securing any improper advantage. . .
8. in order to obtain or retain business, or direct business to any person.

The FCPA imposes liability not only for making improper payments, but also for making an offer or promise to pay, even if the payment is never made. The FCPA does not require that a corrupt act succeed. Moreover, a company may be liable for payments by a local agent if the company authorizes or knows of the payment. The FCPA applies to a shareholder acting on behalf of the company or to a joint venture partner acting as an intermediary. A company is

deemed to know of a payment if it is aware of a high probability that such a payment or offer will be made and does not actually believe that the payment will not be made. Therefore, conscious disregard or deliberate ignorance of a prohibited payment will not protect a company from liability.

The business to be obtained or retained through the prohibited payment or offer does not need to be with a foreign government.

The FCPA applies to payments to any public official, regardless of rank or position. However, it provides an exception for "facilitating" payments, also referred to as "grease payments," made to employees or officials to expedite or secure the performance of "routine governmental action."

In addition, amendments to the FCPA in 1988 added two affirmative defenses. First, the FCPA provides an affirmative defense where the payment at issue was permitted by the written laws and regulations of the foreign official's country. The second defense is for reasonable and bona fide business expenses, such as travel or lodging expenses, for foreign officials to visit product demonstrations or tour company facilities, or to enable performance of a contract with a foreign government or its agency.

Penalties

The FCPA is a criminal statute, although civil penalties may also be imposed. Criminal penalties for individuals include fines up to \$250,000 or imprisonment up to five years, or both. Business entities may be fined up to \$2,000,000. In addition, where the offense(s) results in pecuniary gain or loss, a corporation may be fined up to an amount that is the greater of twice the gross gain or twice the gross loss, in accordance with the alternative fine provisions of 18 U.S.C. § 3571(d).

The FCPA allows the imposition of civil fines up to \$10,000 against any firm that violates the anti-bribery provisions of the FCPA, and against any officer, director, employee, or agent of a firm who willfully violates the anti-bribery provisions of the act. The Justice Department and the SEC may also obtain injunctions to prevent violations of the FCPA. A person or company found to be in violation of the FCPA may be barred from doing business with the federal government and from receiving export licenses. Mere indictment without conviction can lead to suspensions.

Since 1998, a foreign company or foreign national is subject to the FCPA if it causes, directly or through agents, an act within U.S. territory that is in furtherance of a corrupt payment. U.S. parent corporations may be held liable for the acts of their foreign subsidiaries if they authorize, direct or control the corrupt activity. Likewise, U.S. citizens or residents, who are employed by or acting on behalf of a foreign incorporated subsidiary, can be held liable.

Punishments for violations of the FCPA are determined in accordance with the Federal Sentencing Guidelines (the "Guidelines"). The Guidelines mandate specific sentencing ranges based on exacerbating factors (such as the amount of the bribe, prior convictions, the number of counts charged, and whether high-level corporate officers were involved in the violation), and on mitigating factors (such as acceptance of responsibility, cooperation with the government's

investigation, voluntary disclosure of any violation, and existence of a corporate compliance program). The Guidelines limit the discretion of prosecutors and judges to recommend or impose lenient sentences. As a result, under the Guidelines, an individual convicted under the FCPA for a prohibited payment of a significant amount is likely to face imprisonment.

Under recent revisions to the Guidelines, fines imposed on a corporation will be enhanced if the corporation lacks an effective compliance and ethics program designed to detect and prevent criminal conduct. *2004 Amendments to the Sentencing Guidelines, Policy Statements, and Official Commentary*, 8B2.1(b)(4) (2004).

In 2004, the U.S. Supreme Court, in *Blakely v. Washington*, 124 S. Ct. 2531 (2004), held that the sentencing guidelines of the state of Washington were unconstitutional. This was followed by a recent decision of the U.S. Supreme Court in January 2005 in *United States v. Booker*, 125 S. Ct. 738 (2005), which held that the mandatory aspect of the Guidelines was unconstitutional. The *Booker* decision did not, however, invalidate the Guidelines. It only invalidated the two provisions of the Sentencing Reform Act of 1984 that had the effect of making the Guidelines mandatory. As an advisory matter, the Guidelines remain in effect and an effective compliance and ethics program remains a mitigating factor considered by courts in establishing sentences. Accordingly, corporations are still well advised to implement and enforce an effective compliance and ethics program to reduce the risk that individual misconduct will lead to severe sanctions against the corporation.

The U.S. Department of Justice has primary responsibility for criminal enforcement of the FCPA.

Accounting Provisions

The central provision of the accounting and record-keeping provisions is the requirement in Section 13(b)(2)(B) of the Exchange Act that an issuer must "keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." An issuer must record transactions in conformity with generally accepted accounting principles and should design its record keeping to prevent off-the-books transactions such as kickbacks and bribes.

Unlike other disclosures required under the Exchange Act, the accounting and record-keeping provisions of the FCPA are not limited by the concept of materiality. A payment that is insignificant in terms of an issuer's overall financial condition may, if not accurately reported, result in a violation of the FCPA. The statute was designed to make any concealment of illicit payments a violation of law.

While liability will not likely result from inadvertent errors and inaccuracies about which management could not reasonably have known, Section 13(b)(2)(B) of the Exchange Act requires an issuer to have a system of internal accounting sufficient to provide reasonable assurances of the following:

1. Transactions are executed in accordance with management's general or specific authorization;

2. Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (2) to maintain accountability for assets;
3. Access to assets is permitted only in accordance with management's general or specific authorization; and
4. The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

When combined with the prohibition on circumventing internal controls and procedures or falsifying books and records under Section 13(b)(5), and the prohibition on the making of misleading statements or omissions in communicating with accountants under Rule 13b-2, Section 13(b)(2) of the Exchange Act prohibits any subterfuge in the reporting of financial information that could conceal illicit payments.

The accounting provisions of the FCPA require all expenditures to be properly accounted for and disclosed. Even "facilitating payments" permitted under the FCPA should be separately reported and identified.

The rules and standards of public accountants require an investigation into possible bribes or improper payments and the reporting of such activities. Issuers must accurately respond to such investigations and provide sufficient information to call a reviewer's attention to any potential impropriety.

While income tax implications of illegal payments are beyond the scope of this memorandum, bribes are also subject to sanctions under Section 162(c)(1) of the Internal Revenue Code of 1986, which prohibits a company from deducting such payments as an expense.

For foreign affiliates of which an issuer owns less than 50%, Section 13(b)(2)(6) of the Exchange Act imposes a more flexible standard of oversight. The U.S. issuer is to exercise its good faith efforts to exert its influence over the less than 50% owned foreign entity, to cause the entity to implement internal controls consistent with the FCPA.

The SEC is charged with enforcing the accounting provisions. It can enforce those provisions by seeking civil penalties or injunctions, or referring a case to the Department of Justice for criminal proceedings.

Comparison with Requirements of Sarbanes-Oxley Act

Section 404 of the Sarbanes-Oxley Act of 2002 has required public companies to closely examine their internal accounting controls. In particular Section 404(a) of the Sarbanes-Oxley Act and Rule 13a-15(c) under the Exchange Act, which implements Section 404(a), require management of each public company to assess the company's "internal controls over financial reporting." Section 404(b) of the Sarbanes-Oxley Act and Rules 210.1-02 and 210.2-02 of SEC

Regulation S-X require the company's independent auditor to attest to management's review of internal controls over financial reporting, in accordance with the Auditing Standard No. 2 of the Public Company Accounting Oversight Board ("PCAOB").

The regulation of internal controls over financial reporting under the Sarbanes-Oxley Act overlaps with the accounting requirements of the FCPA. The SEC intended that the regulations implementing the Sarbanes-Oxley Act would not interfere with the requirements of the FCPA. *See*, SEC Release No. 34-47986, *Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*, II.A.3 (2003). In particular, the SEC noted that its definition of "internal controls over financial reporting" under the Sarbanes-Oxley Act is consistent with the description of a "system of internal accounting control" under the FCPA. *Id.* While the language of the two provisions is similar, Rule 13a-15(c) applying the Sarbanes-Oxley Act requires only "prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that *could have a material effect* on the financial statements," while the FCPA has no threshold of materiality in verifying authorized use of assets. (Under both acts the issuer must achieve "reasonable assurance" of the proper use of assets.)

Accounting systems that satisfy Section 404 of the Sarbanes-Oxley Act may also satisfy the requirements of the FCPA. It is important, however, to keep in mind that the two regimes serve entirely different purposes. The Sarbanes-Oxley Act and Rule 13a-15(c) are designed to ensure the integrity of financial *reporting*, which must be accurate in all *material* respects. The FCPA does not address financial reporting, but requires adequate control to *prevent* corrupt payments, including those that would be *immaterial* to the company's financial position as a whole. As a result, public companies with foreign activities cannot assume that compliance with the Sarbanes-Oxley Act has superseded FCPA compliance programs. Companies must take steps to ensure that internal controls over financial accounting satisfy *both* the Sarbanes-Oxley Act and the FCPA.

Recommendations

As part of a comprehensive set of internal controls and procedures as mandated by Section 13(b)(2)(B) of the Exchange Act, we recommend that every issuer with international operations, sales or other activities have the following:

- a specific code of ethics for directors and for employees, consultants and agents engaged in international activities designed to ensure compliance with the FCPA (a form is attached as Exhibit B);
- a requirement that each director and each employee certify compliance with the international code of ethics at least once each year (a form is attached as Exhibit C); and
- a requirement that all foreign agents and consultants certify their compliance with the FCPA (a form is attached as Exhibit D).

In addition, all contracts with foreign individuals and entities, or contracts whose performance involves cross-border activity, should include a provision requiring compliance with the FCPA.

While commercial bribery is not directly addressed by the FCPA, many companies adopt an international code of ethics that targets any illicit payments, whether to government officials or to vendors and suppliers. (The model form of international code of ethics attached as Exhibit B includes provisions addressing commercial bribery as well.)

The existence – and enforcement – of an FCPA compliance policy is one of the mitigating factors recognized under the Guidelines applying to violations of the FCPA. Moreover, an effective compliance policy can make it less likely that the actions of renegade individuals who are determined to circumvent anti-corruption laws will be ascribed to the company, its officers and directors. As with any internal policy, an FCPA compliance policy should be designed to be practical and carefully observed after adoption. An overly idealistic policy that is ignored can make violations appear even worse.

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If you wish to discuss the matters in this memorandum further, please contact Peter Menard at 213-617-5483 or Su Lian Lu at 213-617-5546.