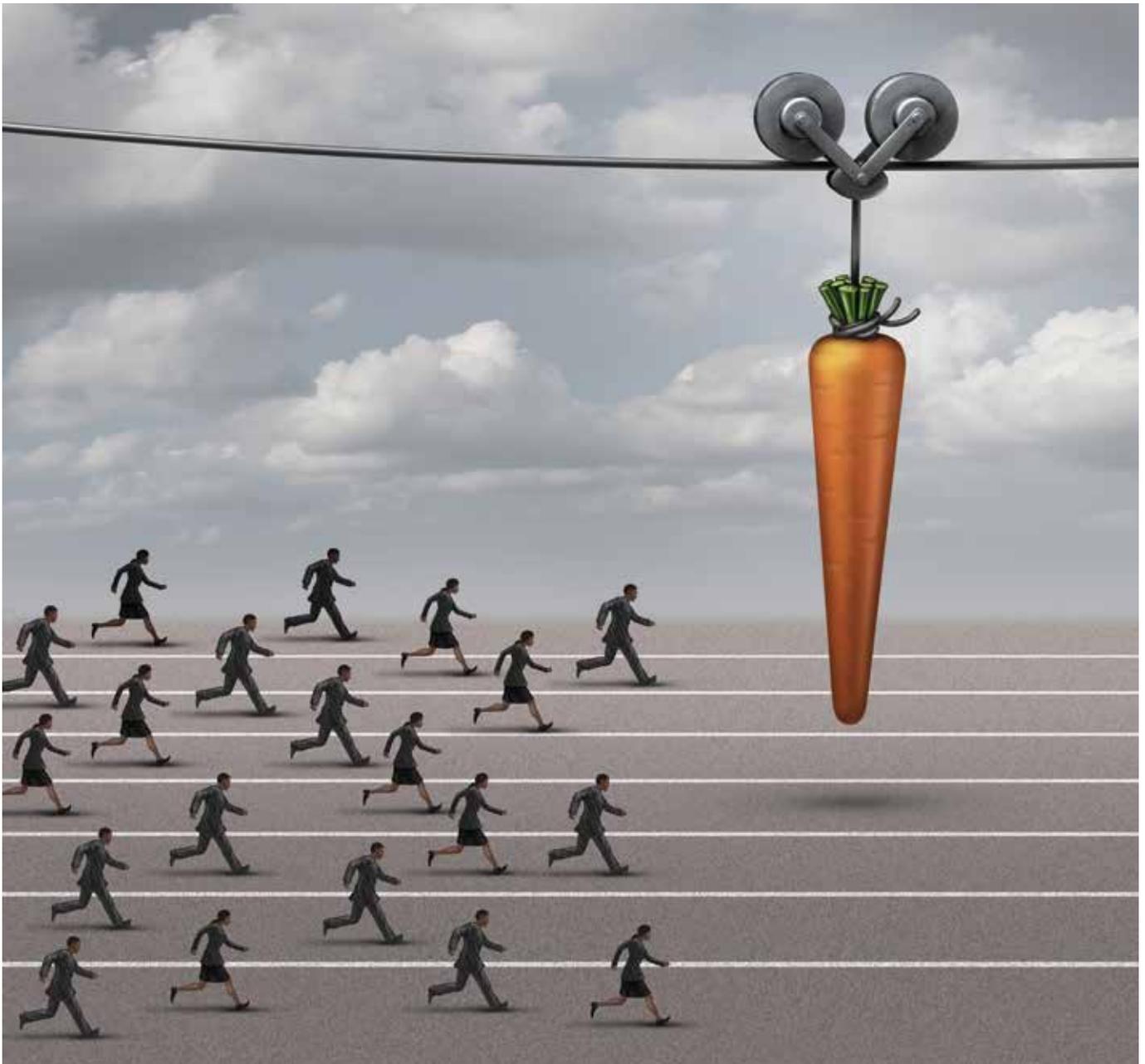


OF CARROTS AND STICKS

AS US AUTHORITIES HUNT DOWN CORRUPT PRACTICES, THE RISK POSED BY THIRD PARTIES TAKES CENTRE STAGE. **VASU MUTHYALA** AND **NAN WANG** ANALYSE WHAT HAS CHANGED AND HOW TO BUILD A DEFENCE



The world's third-largest economy, India has maintained actual and projected annual growth of 7.5% for 2015 and 2016. Its coming goods and services tax – the biggest makeover of its tax system – will further contribute to these strong growth figures. The country's investment climate, as Prime Minister Narendra Modi proclaims, has become more welcoming for foreign investors and multinational corporations (MNCs) that are looking for greener pastures as the rest of the global landscape turns brown.

Despite this, India remains a challenging market for MNCs. Government officials who expect payments to perform and middlemen who serve as fixers and facilitators raise concerns for even the most seasoned compliance officers in India.

For MNCs operating in India, the risk of corruption takes on great importance given the ever-increasing enforcement of the US Foreign Corrupt Practices Act (FCPA). The FCPA is a criminal statute that extends to US individuals, entities and issuers of US securities and prohibits them from paying bribes to foreign government officials and political figures for the purpose of obtaining or retaining business.

AN EVER-PRESENT SHADOW

Vigorous enforcement of the FCPA by the US Department of Justice (DOJ) and the US Securities and Exchange Commission (SEC) has resulted in severe penalties. In 2016, the SEC and the DOJ resolved around 40 FCPA enforcement actions including four of the largest settlements to date, in which MNCs agreed to pay fines ranging from close to US\$400 million to over US\$500 million.

On 28 September 2016 the SEC announced that Anheuser-Busch InBev, a beer company based in Belgium, had agreed to pay US\$6 million to settle FCPA charges related to conduct in India. An SEC investigation had found that the company used third-party sales promoters to make improper payments to Indian government officials to increase sales and production.

Then on 24 October the SEC, the DOJ and Brazilian authorities reached a global settlement that required the Brazilian aircraft manufacturer Embraer to pay more than US\$205 million to resolve alleged FCPA violations in various countries, including "an alleged accounting scheme in India". The total liability amount included a criminal penalty of US\$107 million, which according to the DOJ is 20% below the bottom of the applicable range under the US Sentencing Guidelines and is "a discount that reflects Embraer's full cooperation but incomplete remediation".

These actions are a result of a concerted effort by US regulators to increase enforcement of the FCPA. They have gone about this in a systematic way by offering rewards and threatening enforcement – a carrot and stick approach to regulation. US regulators have undertaken a series of initiatives and programmes designed to both increase cooperation from MNCs and, if they can't extract cooperation, stand ready to bring the types of cases that impact a company's bottom line and grab unwanted headlines.

TWO KEY FIRSTS

As part of its strategy to motivate companies to voluntarily disclose FCPA violations they discover, in April 2016 the DOJ launched a one-year pilot programme. Under the programme, if a company voluntarily self-discloses FCPA-related misconduct, cooperates fully in the ensuing investigation, and appropriately remediates the misconduct, it may receive up to a 50% reduction on potential penalties. In certain circumstances, the DOJ has said it is willing to consider declining prosecution altogether. This programme is the DOJ's carrot to entice cooperation.

Shortly after announcing the pilot programme, and in a clear attempt to show MNCs that there are tangible benefits to cooperating, in June the DOJ issued its first public declinations of criminal enforcement action. The two companies involved – a cloud computing and content delivery network company, Akamai Technologies, and a residential and commercial building products manufacturer, Nortek – had cooperated with the DOJ after disclosing FCPA violations by their Chinese subsidiaries. The SEC entered into separate non-prosecution agreements with both companies, which it had done only once before.

At the same time, to show companies how seriously the DOJ is taking compliance and to be able to more easily understand and communicate with MNCs, the DOJ added a compliance counsel to its ranks. The first person to hold this job is Hui Chen, who, among other positions, served as Microsoft's director of legal compliance for the greater China area. Chen's role at the DOJ includes providing guidance to prosecutors on the existence and effectiveness of a company's compliance programme and post-resolution guidance on evaluating the effectiveness of compliance and remediation efforts.

BENEFITS FOR WHISTLEBLOWERS

If the pilot programme or Chen's assistance doesn't net the cooperation from MNCs that the DOJ is hoping for, it stands ready with enhanced enforcement tools: more prosecutors and agents, large penalties, and whistleblower incentives.

IGNORANCE IS NOT BLISS

WITH REGULATORS IN THE US CONTINUING TO FOCUS ON INDIA, COMPANIES NEED TO BUILD A ROBUST DEFENCE

In India, as in other emerging markets, third parties that deal with government officials on behalf of companies are the most significant source of corruption risk. The recent cases where Foreign Corrupt Practices Act (FCPA) violations were linked to India originated from payments to third parties. In India, in particular, the US authorities have taken aggressive stances on what qualifies as an FCPA violation.

In a 2012 FCPA-related settlement with Oracle, the US Securities and Exchange Commission (SEC) alleged that the company failed to prevent its Oracle India subsidiary from secretly setting aside money from the company's books that could be used to make unauthorized payments to phony vendors in India. In that matter, the SEC did not allege that any payments were actually made to government officials, but rather asserted that the third-party payments created the risk that the funds could be used for illicit purposes.

PROTECTIVE MEASURES

When dealing with third-party intermediaries, ignorance is not bliss. Failure to know whom third parties are engaging is no defence to liability. As a result, MNCs in India should undertake sufficient due diligence to understand the full extent of their third-party relationship and, from the perspective of arming counsel to appropriately defend an MNC, should have a robust

system to track and document all their efforts. As anyone working in an emerging market knows, it can feel impossible to stop all bad actors. But implementing the right protective compliance measures is clearly achievable and necessary in light of US regulators continued interest in India.

KNOW YOUR THIRD PARTIES

First, an MNC must set the right tone at the top: the company's leadership needs to support compliance and make it an integrated part of the business. The compliance officer in India or the region should be empowered by and have the full support of global management. Visibility of this support is important.

Second, the MNC should conduct regular risk assessments. As most of the recent FCPA cases coming out of India relate to third parties, a risk-based compliance programme should scrutinize new third-party business partners and review existing third-party relationships. Keen attention should be paid to third-party red flags, such as requests for payments in advance of the rendering of services, payment to a different third party, vague description of services, or payments disproportionate to the services provided.

Where appropriate, public record and open source searches should be conducted to determine a third party's history including experience in the field, economic standing in the business community, civil or criminal suits, connections to govern-

ment officials and agencies, and business ethics and practices. Questionnaires that seek to elicit such information should also be used during the vetting process. Moreover, MNCs should obtain third-party certifications that all services will be performed in compliance with local laws and provisions of the FCPA.

Third, the manner in which all third parties are vetted and cleared should be systematic, consistent and clearly documented. In addition, records of due diligence efforts should be methodically maintained. Having a diligence procedure for third parties that is consistently followed and can easily be reviewed can prevent inappropriate payments to government officials, but an often overlooked benefit is that it will also allow a company to better defend itself against aggressive US regulators.

Fourth, an MNC must invest in training. Training must be tailored for the applicable industry, provided to the right people in the company, done regularly, and must take into account cultural nuances. Live training is warranted in a high-risk market like India.

Finally, no compliance programme will be effective or defensible unless it is enforced. Violations of the compliance programme must be addressed swiftly and consistently. Lack of enforcement undermines the programme's effectiveness and makes it difficult to defend against a regulator's accusation that the company turned a blind eye to corruption.



In April 2016 the DOJ announced it would increase by 50% the number of lawyers who investigate and prosecute FCPA cases. At the same time, the FBI established three new squads of special agents devoted to international issues including FCPA violations.

To help all these new prosecutors and agents uncover cases, the US government is taking advantage of a unique provision of the Dodd-Frank Act, passed in 2011 to ensure corporate accountability and compliance. While the UK and the EU have laws that protect whistleblowers from retaliation, they do not affirmatively reward them for reporting corporate-related fraud. The whistleblower provision under the Dodd-Frank Act offers awards to, among others, employees of MNCs who provide US regulators original information that leads to successful SEC enforcement resulting in monetary sanctions of more than US\$1 million.

A whistleblower is eligible for 10% to 30% of the monetary sanction and the highest award to date has been US\$30 million. Such eye-popping awards are attracting tips from around the world – 61 countries to be specific. India ranks among the top four countries for international tips. This enforcement tool clearly threatens MNCs in India.

IN THE CROSSHAIRS

Currently, more than 75 companies have reported that they are the subject of an ongoing FCPA-related investigation by the SEC and the DOJ. Many of those relate to India, including Cognizant Technology, Rolls-Royce, Wal-Mart and Beam.

The US\$6 million settlement paid by Anheuser-Busch InBev was for having inadequate internal accounting controls and for failing to detect and prevent improper payments made through promoters to Indian government officials in Tamil Nadu and what was then

Andhra Pradesh, and failure to ensure that these transactions were recorded properly in its books and records. Similarly, the settlement reached by Embraer was partly for hiding payments of US\$5.7 million to a third party when selling aircraft to the Indian Air Force. The Embraer settlement also related to FCPA violations in other parts of the world including South America, the Middle East and Africa.

In July 2015, Louis Berger International, a New Jersey-based construction management company, agreed to pay a US\$17.1 million criminal penalty to resolve charges that it bribed foreign officials in India, Indonesia, Vietnam and Kuwait to secure government construction management contracts. This included payments made through third-party vendors to government officials to win contracts in Goa.

As the US government takes all the steps it can – rewards and punishment – to increase enforcement of the FCPA, MNCs globally and especially in India are not without recourse. Implementing carefully crafted diligence programmes and documenting diligence efforts can go a long way in fending off violative conduct but also, when necessary, can help a company defend itself against an enforcement action and use some of the government's new tools to its benefit. ▲

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INDIA-RELATED FCPA ENFORCEMENT SINCE 2010

COMPANY	INDUSTRY	YEAR	AMOUNT PAID (US\$)
Embraer	Aircraft manufacturing	2016	205 million
Anheuser-Busch InBev	Beer brewing & sales	2016	6 million
Louis Berger International	Construction management consulting	2015	17.1 million
Tyco International	Industrial component sales	2012	26.8 million
Oracle	IT services	2012	2 million
Diageo	Liquor sales	2011	16.3 million
Pride International	Oil & gas services	2010	56.1 million