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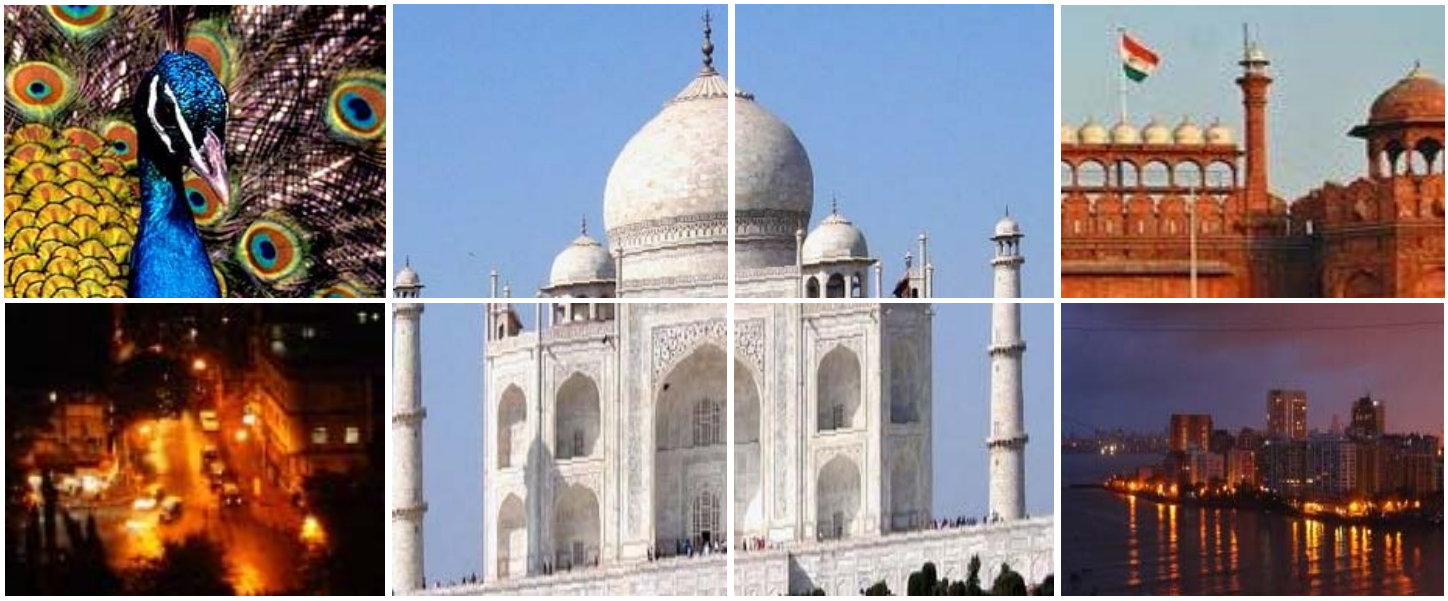

THE U.S. FOREIGN CORRUPT PRACTICES ACT AND DOING BUSINESS IN INDIA

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Why are American companies in India? The biggest reason is the high potential of the Indian market and economy. Although the gross domestic product of the U.S. is expected to grow 2.9% for 2011, the economy of India is expected to grow at 8.4%, according to the International Monetary Fund. While the Indian economy offers immense promise for American companies, there are also particular risk factors associated with doing business in India, and extra caution must be taken to not fall afoul of the U.S. Foreign Corrupt Practices Act ("FCPA"), which prohibits bribery of non-U.S. officials.

There is a history of corruption in all levels of government in India, and excessive bureaucracy and regulation, left from the days of the so-called License Raj, has left procedures that are complicated and lack transparency. It is often necessary to obtain approvals from several government officials to obtain one required permit or license. Underpaid civil servants yield broad discretionary power, and some deliberately stall administrative procedures to induce improper payment. It is also customary in India to give gifts to business contacts and government officials during Diwali and other religious festivals and Indian government officials often solicit donations from businesses for charitable organizations. These need to be scrutinized carefully in light of FCPA guidelines. In this article, we describe the elements of the FCPA, with a particular focus on doing business in India.

I. OVERVIEW OF FCPA ENFORCEMENT ACTIVITY IN INDIA

Passed in 1977, the FCPA made the United States the first country to prohibit transnational bribery. At the time, most countries criminalized bribery of their own domestic officials, but until the FCPA was passed, no country barred bribery of another country's officials. Since 1977, dozens of other countries have joined the effort to limit public corruption by passing transnational anti-bribery statutes and by increasing enforcement of domestic anti-bribery laws.

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In recent years, the number of FCPA enforcement actions pursued by U.S. authorities has increased dramatically, along with a corresponding rise in monetary penalties and the number of individuals going to prison for FCPA violations. In 2010, the average corporate fine associated with an FCPA enforcement action exceeded $100 million. In 2009, four individuals were tried and convicted on FCPA-related charges, and dozens more currently await trial. These trends reflect the increasing focus of U.S. enforcement agencies on corrupt business practices by companies operating outside the U.S.

Many of these FCPA enforcement actions have involved government officials in India. For example, the former director of sales for a U.S. industrial valve manufacturing company pleaded guilty to a criminal charge in the U.S. for, among other conduct, paying bribes to an employee of the Maharashtra State Electricity Board in 2008. Additional enforcement actions include:

- In 2010, a U.S. offshore drilling company settled an enforcement action with both the Department of Justice and the Securities and Exchange Commission, according to a Complaint filed by the SEC, relating in part to payments made through a third party to customs officials in India.
- In 2008, a U.S. rail brake manufacturing company settled an enforcement action with both the Justice Department and the SEC, according to a Complaint filed by the SEC, relating to payments made by its Indian subsidiary to officials of the Indian Railway Board.
- In 2007, a U.S. supplier of heating and cooling equipment settled an enforcement action, according to the SEC Complaint, relating to improper payments to officials of the Indian Navy to obtain orders for service on equipment the company sold to the Indian Navy.
- In 2007, a U.S. information technology firm settled an enforcement action, according to an SEC Cease and Desist Order, relating to improper payments made by its management consulting subsidiary to officials at two unidentified state-owned enterprises.
- In 2007, a U.S. chemical manufacturer settled an enforcement action, according to the SEC Complaint, relating to payments made by an Indian subsidiary to officials in the registration function of the Indian government.
- In 2007, a U.S. manufacturing conglomerate settled enforcement actions with both the Justice Department and the SEC, according to a Complaint filed by the SEC, relating to payments made to an un-named Indian government customer for the sale of gears and parts.
- In 2001, a U.S. oilfield services company settled an enforcement action related, according to the SEC Complaint, relating in part to payments made to the Indian Director General of Shipping.

Beyond these settled enforcement actions, a number of companies have publicly announced investigations involving improper payments in India obtained during an acquisition. For instance, in February 2011, Kraft Foods disclosed that it is investigating potential FCPA violations relating to a facility in India. Given these trends, multinational companies cannot afford to ignore the FCPA in their India operations.

II. ANTI-BRIBERY PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT

The FCPA contains two components – the anti-bribery provisions and the accounting provisions – each with different legal elements, different jurisdictional reach, and different facets to the enforcement program. The anti-bribery provisions of the FCPA are codified at 15 U.S.C. §§ 78dd-1, 78dd-2, and 78dd-3. The accounting provisions are codified at 15 U.S.C § 78(m)(b). In this section, we describe the anti-bribery provisions of the FCPA.

1. ELEMENTS OF A VIOLATION

The anti-bribery provisions prohibit any offer, payment, promise, or authorization to pay money or anything of value to any foreign official, political party, or candidates for public office, intended to influence any act or decision in order to assist in obtaining or retaining business. "Anything of value" may include cash, gifts, travel, meals, and entertainment.

In addition, the FCPA proscribes payments made to third parties while "knowing" that a portion or all of the payments will be used by the third party as bribes to foreign officials. As described in greater detail below, the FCPA defines "knowledge" broadly, intending to capture instances where a person deliberately avoids knowledge of a third party's bribe payment.

2. JURISDICTION OF THE ANTI-BRIBERY PROVISIONS

The anti-bribery provisions of the FCPA are broken into three separate sections, each containing different jurisdictional elements. First, the statute applies to "[e]very issuer which has a class of securities registered pursuant to section 78l of this title and every issuer which is required to file reports pursuant to section 78o(d) of this title." Officers, directors, employees, or agents of issuers may also be subject to jurisdiction under the FCPA by virtue of their relationship with the issuer.

This applies both to issuers based inside and outside the U.S., including the many Indian companies listing shares on U.S. exchanges through the vehicle of American Depository Receipts. At the moment, over a dozen Indian companies list shares on U.S. exchanges, and are therefore subject to jurisdiction under the FCPA. Many of the major recent FCPA enforcement actions have involved non-U.S. companies, confirming that this basis for jurisdiction is not theoretical. Importantly for U.S.-based issuers, the FCPA applies to any conduct, anywhere in the world: there does not need to be a U.S. territorial nexus.

Second, the anti-bribery provisions of the FCPA apply to so-called "domestic concerns," an unusual term that applies to two categories of persons. The first category covers private companies organized under the laws of the U.S., or that have their principal place of business in the U.S. Officers, directors, employees, or agents of private U.S. companies may also be subject to jurisdiction under the FCPA by virtue of their relationship with the domestic concern, even if they are not themselves U.S. citizens. Natural persons who are citizens, nationals, or residents of the U.S. are also considered "domestic concerns." As with U.S.-based issuers, the FCPA applies to domestic concerns for any conduct, anywhere in the world: there does not need to be a U.S. territorial nexus, nor does there need to be any use of the means or instrumentalities of interstate commerce.

Finally, the anti-bribery provisions reach certain corporate and natural persons that do not qualify as either issuers or domestic concerns. A key for this type of jurisdiction is whether conduct occurred "while in the territory of the United States." Indian companies may find themselves subject to an enforcement action if there was some act in furtherance of the violation that took place within the territory of the U.S.

3. DEFINITION OF "FOREIGN OFFICIAL" AND INDIAN GOVERNMENT INVOLVEMENT IN THE ECONOMY

The FCPA defines a "foreign official" 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." Under this definition, a "foreign official" would clearly include a very significant number of officials in India, such as military officers in charge of procurement contracts or ministry-level officials.

Furthermore, because the definition reaches to "employees… of a foreign government… instrumentality," the FCPA may extend to people not intuitively identified as government officials. Government-owned or government-controlled business or enterprises are an important and wide-spread feature of the Indian economy, and many FCPA enforcement actions involve state-owned enterprises. For example, there have been FCPA enforcement actions involving doctors employed by state-owned hospitals; officials at government-controlled airports; employees at government-owned steel mills; employees of one country's national oil company; and, employees of a state-owned telecommunications company.

This is an uncertain and therefore risky area of the FCPA. The notion of who constitutes a government official should be carefully considered by companies doing business in India, and companies must focus on such factors as the level of share ownership, board composition, and other facts of the control exercised by the government over the company.

4. APPLICATION OF THE FCPA'S "FACILITATION PAYMENTS" EXCEPTION IN INDIA

An important challenge of doing business in India involves responding to solicitations of small-scale bribery for such basic government-provided services as telephone or power, medical services, or customs clearance. These solicitations are often to obtain a service for which one is already entitled. Indeed, a recent BribeLine report by the non-governmental organization Trace International observed that "[s]eventy-seven percent of reported bribe demands in India were related to the avoidance of harm, including securing the timely delivery of a service to which the reporter was already entitled (such as clearing customs or having a telephone line installed) and receiving payment for services already rendered…"

Bribes in India often are low value and high in frequency. A 2007 report on corruption by Transparency International India related to the trucking industry observed that "[t]rucks plying on road pays anywhere between Rs 211 and Rs 266 as bribe money per day depending upon the route." The study observed:

> [T]ruckers pay bribes at every stage of their operations, which starts with getting registration and fitness certificates, and for issuance and renewal of interstate and national permits. The reason for paying bribe, while on road, include plying overloaded trucks, traffic violations, parking at no-parking places or entering no- entry zone, and in the payment of toll and other taxes like octroi, sales tax etc.

According to the BribeLine Report, "cases of bribery demands in India over a 16 month period reveals that more than half of the reported bribe demands were for $100 or less, and approximately 84% of the reported demands were for $5,000 or less." The report states:

> The greatest sources of bribe demands, in order of descending frequency, were from national level government officials (33%), the police (30%), state/provincial officials and employees (16%), and city officials (10%). A further analysis of the specific Indian ministries requesting bribes at the national level shows that 13% of those demands originated from the national office of Customs and 9% each were from the national offices of Taxation and Water. Bribe demands were also reported being made from individuals affiliated with the Justice System, Visas & Immigration, Mines & Minerals, Construction, Defense, Energy, Foreign Affairs, Forestry, Health

> Services, Information/Communication and Land.

The FCPA contains an exception for "any facilitating or expediting payment ... the purpose of which is to expedite or to secure the performance of a routine governmental action." A "routine governmental action" is defined in the statute as "only an action which is ordinarily and commonly performed by a foreign official," and a number of examples are offered, including:

> obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country; processing governmental papers, such as visas and work orders; providing police protection, mail pick-up and delivery, or scheduling inspections associated with contract performance or inspections related to transit of goods across country[.]

There is no monetary limit set in the statute, and U.S. enforcement authorities have made very clear that this exception will be narrowly construed when making an evaluation whether to institute an enforcement action.

Despite the superficial appeal of this exception, particularly in the context of frequent demands for small bribe payments for seemingly routine services, the line between "routine governmental action" and "assisting in obtaining or retaining business" can in practice be very difficult to define with certainty, creating real risks for those companies availing themselves of the statutory exception. Moreover, as explained elsewhere in this issue of the India Law News, Indian law does not contain an analogous exception for facilitating payments. Thus, what might be permitted under U.S. law could be barred under Indian law. Furthermore, under the soon-to-be-implemented UK Bribery Act, there is no analogous exception. Of particular note, in November, 2009 the Organization for Economic Co-operation and Development (OECD) announced a new recommendation at the OECD's celebration of "International Anti-Corruption Day" and the Tenth Anniversary of the "Entry into Force of the OECD Anti-Bribery Convention." In its recommendation, the OECD sought to do away with the FCPA's exception for facilitating payments.

Finally, U.S. enforcement authorities have made very clear that, where a permissible "facilitating payment" has been made, it must be clearly and accurately documented. Thus, for issuers, the books and records of the company must indicate how much was spent on facilitating payments, the name and position of the recipient, and there must be appropriate internal compliance controls to ensure that the payments indeed qualify for the exception. These are very challenging policies to apply with consistent discipline.

5. AFFIRMATIVE DEFENSES

The FCPA contains affirmative defenses for two types of conduct. First, if "the payment, gift, offer, or promise of anything of value that was made, was lawful under the written laws and regulations of the foreign official's [ ] country," the affirmative defence applies. Importantly, the local law must be "written," so that local practice, customary, or unwritten enforcement policies do not qualify. In a recent FCPA prosecution against investor Frederic Bourke, a U.S. federal trial court sharply limited the availability of this defence, so this defence offers only very limited protection under the FCPA.

The second affirmative defense is much more commonly used. Where "the payment, gift, offer, or promise of anything of value that was made, was a reasonable and bona fide expenditure, such as travel and lodging expenses, incurred by or on behalf of a foreign official, party, party official, or candidate," the affirmative defense may apply. Any such expense must, though, be "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."

For companies electing to incur expenses on behalf of government officials, it is very important to develop appropriate compliance controls to ensure that these expenses are properly approved and documented. A

number of FCPA enforcement action have focused on travel, lodging and entertainment provided by U.S. companies to foreign officials, confirming the U.S. enforcement policy that such expenses must be appropriately controlled.

III. ACCOUNTING PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT

The FCPA's accounting provisions – *applicable only to issuers* – compliment the anti-bribery provisions by requiring issuers to maintain accounting accuracy and transparency, and to strengthen internal controls. As noted above, an "issuer" under the FCPA may be based in the U.S. or elsewhere, and over a dozen Indian companies list shares on U.S. exchanges. The accounting provisions therefore apply to each of these India-based issuers, as do the anti-bribery provisions described above.

The accounting provisions contain two subsections, termed the "books and records" and "internal controls" provisions. The "books and records" component of the FCPA requires all issuers 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."

The "internal controls" provisions of the FCPA require issuers to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

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

IV. PENALTIES FOR COMPANIES AND INDIVIDUALS

Corporations and individuals who violate the FCPA face significant sanctions. The average corporate monetary sanction in 2010 exceeded $100 million, and many individuals are in prison right now as a result of FCPA convictions or guilty pleas. Dozens more individuals await trial or sentencing.

For corporations, criminal penalties may reach up to $2 million for each violation of the anti-bribery provisions and criminal fines of up to $25 million for issuers that violate the accounting provision. Corporations found liable for either criminal or civil FCPA violations may have to disgorge proceeds associated with improper payments; may be subject to suspension and debarment actions limiting business opportunities with the U.S. government; and, may be subject to oversight for a period of time by an independent compliance monitor, which reports to the DOJ.

For individuals, conviction of an anti-bribery violation may result in up to five years in prison and up to $250,000 in fines per violation. For accounting violations, criminal penalties for individuals are up to $5 million and 20 years imprisonment. The FCPA prohibits companies from paying any fines levied against individuals, either directly or indirectly. The government may also levy equitable remedies on individuals, such as an injunction that bars them from serving as a director or officer.

V. MANAGING THE RISKS OF LIABILITY FOR THE CONDUCT OF OTHERS: CONSULTANTS, AGENTS AND OTHER THIRD PARTY INTERMEDIARIES

Companies doing business in India frequently enlist third parties such as agents, distributors and consultants, to identify business opportunities, obtain market intelligence, and interact with government agencies for such routine matters as tax, customs and lobbying.

The FCPA risks associated with using these kinds of intermediaries are acute, as the FCPA prohibits doing indirectly that which would be prohibited if done directly. The statute addresses this in two ways. First, the anti-bribery provision prohibits payments to "any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official…" This means that anyone subject to the FCPA is barred from using a third party intermediary, *knowing* that the third party will make an improper payment.

Second, the FCPA contains a definition of "knowledge" intended to address circumstances where a person might shield themselves from knowledge by quipping "I don't want to know." The FCPA provides, in part, that "[w]hen knowledge of a particular circumstance is required knowledge is established if a person is aware of a high probability of the existence of such circumstance, unless the person actually believes that such circumstance does not exist." Thus, payments to third parties made while "knowing" that all or part of the payment will be received either directly or indirectly by a foreign official, render such payments illegal. When faced with the decision whether to obtain information confirming or refuting that a payment will be made, one takes a great risk in remaining "willfully blind" or "deliberately ignorant" to the information simply in order to circumvent FCPA liability.

Today, the majority of FCPA enforcement cases brought by the DOJ and the SEC involve the use of third party intermediaries. To manage the risks that the conduct of another party will create FCPA liability, companies have become much more vigilant about the intermediaries they hire, and managing those intermediaries to eliminate corruption risks. There are many helpful lists of "red flag" questions to ask before entering into an intermediary relationship, including:

- Whether the agent is related to or has a close relationship with a public official.
- Requests for false invoices or invoices with inadequate support for charges.
- Fees exceeding normal market rates.
- Whether the third party will sign an FCPA compliance certification.
- Unusual methods of payment, such as outside of India or to another third party.
- Lack of credentials or experience.

VI. MERGERS, ACQUISITIONS AND JOINT VENTURES

Mergers, acquisitions and joint ventures serve as important instruments for companies entering the Indian market, and these commercial activities are likely to continue or increase in frequency. Under the FCPA, however, a merger or acquisition may not extinguish liability for past unlawful conduct by the acquired company, according to a DOJ Opinion Procedure Release, and joint ventures present significant compliance risks.

FCPA prosecutions stemming from mergers, acquisitions, and joint ventures are increasingly common, but there are ways to mitigate risks presented by M&A. Companies contemplating mergers and acquisitions in India and elsewhere will be well-served to conduct FCPA-specific due diligence to evaluate and address any potential FCPA problems before the deal closes. Basic strategies to finalize deals in order to minimize FCPA liability are essential, including a comprehensive, risk-based diligence process; reviewing relevant financial and accounting records and key employee emails; interviewing employees; assessing the corruption level in the Indian target's industry; identifying the target's business involving government officials and agencies; reviewing government contracts, licenses, registrations and other permissions to do business; reviewing the company's use of third party intermediaries, including agents, representatives, distributors, consultants, lobbyists and others; reviewing relevant third party agreements for appropriate anti-corruption language; evaluating the target's anti-corruption policies and procedures; requesting information concerning any prior anti-corruption problems and investigations; including FCPA compliance and resolution of FCPA issues as conditions to closing; where appropriate, voluntarily

disclosing to the Justice Department and SEC any past illicit activities before closing; cooperating with any U.S. government investigation; and remediating illicit activities by terminating relationships with employees and third party intermediaries, entering into new contracts, and conducting effective compliance training.

VII. COMPLIANCE POLICIES AND PROCEDURES

Compliance with U.S. and Indian anti-corruption laws poses crucial challenges for companies doing business in India, but companies can seek to minimize anti-corruption liability by creating, implementing, and enforcing a robust compliance program. A structured compliance program acts both to educate employees about prohibited conduct and to deter misconduct at an early stage. U.S. enforcement authorities have made clear that companies with effective corporate compliance policies will receive credit for those programs during settlement negotiations or charging decisions, and that those without effective policies may receive harsher punishments. The SEC and the Justice Department have each announced that the quality of a company's compliance policies will be considered in determining penalties for businesses violating U.S. law. In several cases, the penalties imposed by U.S. enforcement authorities reflected, in part, their view that the company's compliance program was inadequate.

VIII. CONCLUSIONS

Corruption presents serious legal and commercial risks in many countries, including India. These corruption risks present daily challenges to companies and executives working in India, and to counsel advising clients on how to operate successfully in India. Although India's anti-corruption laws may have been under-enforced in the past, the Indian government has recently taken a strong public stand against corruption. This has been more than rhetoric, as the number of high-profile corruption investigations has increased, and there are vigorous calls for additional investigations. Companies operating in India cannot escape scrutiny given the breadth and reach of the U.S. FCPA, and the stringency of the Indian law.

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