Global Issues: Compliance – Law Firms

FCPA Due Diligence When Selecting A Contractor In A Foreign Country

The Editor interviews ***Andrew Melsheimer****, Associate in the International Energy Practice of Thompson & Knight LLP in Dallas.*

Editor: **Please give our readers some background on your practice at Thompson & Knight.**

Melsheimer: Thompson & Knight's international energy practitioners advise clients whose activities are primarily related to oil and gas exploration and production around the world. We typically represent foreign companies and individuals investing in the U.S. or in third countries as well as U.S. companies and individuals investing abroad.

Editor: **Could you briefly discuss the Foreign Corrupt Practices Act ("FCPA") and its impact on transactions outside the U.S.?**

Melsheimer: The FCPA is a U.S. federal statute that criminalizes the bribery of foreign officials anywhere in the world for the purpose of influencing an official decision to obtain a business benefit.

Editor: **I understand that many of your deals in foreign countries are joint ventures, which makes the exposure to the FCPA a little different than it would be for a U.S. company making an acquisition.**

Melsheimer: The FCPA is an important aspect of international transactions and there is the potential for it to be overlooked when companies form joint ventures or hire local contractors. For example, many countries have laws known as "forced marriages" that require foreign investors to have a local partner, either an individual or company, who will engage in certain activities related to the investment. Some countries even dictate the choice of a partner. In this case, the FCPA will inevitably come into play because a foreign government is telling a U.S. company whom it must do business with in order to maintain or obtain an investment in that foreign country. For example, some West African countries require any type of licensee for a concession to associate with a local service provider. Basically, a U.S. company is not going to be able to avoid contracting with a local individual or company while operating in that particular country.

Editor: **And I suppose the local West African company is partly owned by the government?**

Melsheimer: FCPA compliance is easier when the local representative is an individual because it is easier to verify whether the individual is a government official. Due diligence is much more important when contracting with local companies. The issue with the FCPA arises as to who is behind the curtain. On first glance, the company could be very legitimate – it could be the only shop in town. However, once you start performing some diligence and further investigation of who owns and manages the company and the company's policies and practices, what you discover may well implicate the FCPA. You may need to have an open dialogue with this potential partner, explaining the risks associated with its activities and demanding that certain activities cease; in certain circumstances, you may not be able to associate yourself with this company. It's even more crucial to understand the relationship when you're dealing with countries that have forced marriage requirements. But this issue is not necessarily limited to countries with forced marriage requirements. This happens around the world.

Andrew Melsheimer

Editor: **How do you enforce your demands?**

Melsheimer: It can be difficult. You do the best diligence possible and then take measures to minimize any potential exposure to the FCPA. To do that, it is helpful to have language in your agreement that ensures the local partner understands the FCPA, what actions violate it, and the consequences of any violation. The partner should also understand local laws relating to bribery and payments to government officials. In some instances, it is advisable to have an automatic termination clause in the event of such a breach. These are examples of measures you can take to help protect yourself and minimize the impact of a violation. Yet, despite your best efforts, you may not be able to absolutely prevent a violation.

Editor: Are there certain decisions that are non-discretionary which the FCPA doesn't apply to, such as application forms, etc.?

Melsheimer: Yes. There are ordinary transactions with a foreign government that do not implicate the FCPA. I think it's best to look at this in the context of an example. Let's say a foreign country opens up its deep waters for oil and gas exploration, and there are several U.S. companies interested in participating in the bid round. Many countries will require you to pay some type of application fee, post a bond, submit some documentation, and fill out certain forms. Because of the requirement to do those transactions under the local law, these activities would not implicate the FCPA. However, the FCPA could be implicated if one of the participating companies decides to give expensive gifts to some oil ministry officials while the bidding process is still open. Such an activity raises the suspicion that its sole purpose is to obtain the concession over the other companies that are participating in the bid round. This is a clear example, but there are any number of ways a company could achieve its ultimate purpose, *i.e.*, to influence the outcome. However, the ordinary participation in the bid round – doing what is required by regulations to participate in and fairly compete for the concession – would not implicate the FCPA.

Editor: What role does the FCPA play in selecting a contractor in a foreign country?

Melsheimer: The FCPA sets parameters for engaging a foreign contractor. It helps a company develop a strategy and diligence process when selecting venture partners, service contractors, or local service providers. It provides guidance as to what questions to ask when conducting your diligence. With respect to local contractors, the most important language of the FCPA is the requirement that no payment or other form of consideration be made to a foreign official, any foreign political party or party official, any candidate for political office, or any other person, while knowing that this payment or promise to pay will be passed on to one of the above. The FCPA is broad enough to encompass almost all government officials. And although family members of foreign officials are not specifically addressed in the FCPA, they often have influence over those who make outcome determinative decisions. Thus, there is a gray area in the FCPA. For example, you are required to have a local contractor to service oil rigs. You discover that the owner of the service company is the wife of the oil minister. Is the FCPA implicated?

Obviously, if you ask a local company, "Do you bribe government officials?" the answer would inevitably be no, but that should not end the investigation. Companies should be asking local banks, accountants, lawyers and service providers: what's the competence, expertise, and reputation of that company or individual? What are the company's contacts with important government officials and government decision makers? What is the particular person's experience, education, prior government and military service, and family and business relationships? Companies should also ask: how was this person or company introduced or recommended to the U.S. company? How do they handle their compensation structure? Does this company have some type of policy or practice related to payments to government officials? I think the most important thing to take away from this discussion is companies should not be afraid to ask questions. Your friends in the community and contacts within the government can be helpful sources of information.

Editor: **Is there any way to mitigate the damages if a company stumbles and deals with someone who does have government ties?**

Melsheimer: The U.S. government is clear as to what its expectations are. This is detailed on the U.S. Department of Justice (DOJ) Web site: "To avoid being held liable for corrupt third-party payment, U.S. companies are encouraged to exercise due diligence, and to take all necessary precautions to ensure that they have formed a business relationship with reputable and qualified partners and representatives." To the extent that a U.S. company shows it has asked the relevant questions; consulted local law firms, accounting firms and financial institutions; contacted the U.S. Embassy and the Commerce and State Departments; talked to community leaders – all of these measures are helpful in meeting the expectations of the DOJ.

It is obvious that a U.S. company should be wary of dealing with a local service provider with an army general on its board. It is less obvious when dealing with the brother of the education minister. Again, the involvement of a family member is not a violation of the FCPA per se. However, to the extent family members have influence on the decision-making process or the decision-makers themselves, such could implicate the FCPA. Because of the breadth of the FCPA and the degree of discretion in enforcement policy, we're in a gray area where careful consideration is mandated.

Editor: As a U.S. company operating abroad, how do I protect myself?

Melsheimer: First, educate yourself about the FCPA and document what you've done for your diligence. Include in your contract that the provider comply with the FCPA. Have in your agreement with the local service provider some type of contractual provision not to pass money on to third parties that could potentially violate the FCPA. It should be ordinary practice to insist that the service provider open his books to you, especially in the case of a joint venture partner. Include a contractual provision not to deal with particular governmental entities and/or relatives.

Using an example based on an actual DOJ opinion, suppose a U.S. company engages a foreign company partly owned by the relative of a foreign official to assist in its business with the government. The relative has no influence over any decision. To avoid implicating the FCPA or even being put on the defensive in an inquiry by the DOJ, the U.S. company is better protected by having the relative agree not to initiate any meetings with the government on behalf of the U.S. company. The unfortunate situation a lot of companies will find themselves in is that they have complied with the FCPA and have followed the rules, and under the language of the text, they have not violated the FCPA. However, they are put on the defensive because of the appearance that influence was somehow used. Therefore, the more a company can do to protect itself from even the appearance of impropriety, even though its actions are completely legitimate, the better.

Editor: **What are the potential penalties for violating the FCPA?**

Melsheimer: There are two components to the FCPA: criminal and civil penalties. For individuals, the criminal penalties can be fines up to $100,000 or imprisonment up to five years, or both. For businesses, the criminal penalty is fines up to $2 million per violation. The FCPA also provides for civil fines up to $10,000 against any firm that violates the anti-bribery provisions of the FCPA and civil penalties against any officer, director, employee, or agent of a firm which willfully violates the anti-bribery provisions. There is also the risk of a disgorgement of proceeds earned in the illegal transaction. If the offense results in some type of pecuniary gain or loss, the corporation can be fined up to an amount that is greater than twice the gain or twice the gross loss.

Editor: **If a company comes forward to report itself to the SEC or the DOJ once it realizes it has violated the FCPA, does that help to mitigate the penalty?**

Melsheimer: The current thinking in those agencies is to show leniency to a company who voluntarily discloses as compared to one who does not.

Editor: Besides due diligence, are there other measures that a U.S. company can take to limit its exposure to liability under the FCPA?

Melsheimer: We already touched on having a sound contractual provision in any agreement with a third party. Additionally, if there are doubts that are raised – barring extreme time constraints, which I appreciate many of these transactions may be under – the FCPA provides for the ability to obtain an advisory opinion from the DOJ prior to proceeding with any contractual agreement. As long as you are truthful and disclose a complete set of facts prior to proceeding with the transaction, the attorney general will give you a rebuttable presumption that the conduct contained in that opinion conforms with the DOJ enforcement policy. However, be warned that these opinions are good for only those who sign the request and cannot be relied upon by third parties.

Please email the interviewee at andrew.melsheimer@tklaw.com with questions about this interview.