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**CORPORATE LAW UPDATE****Managing FCPA Risk Through Due Diligence**

Any company doing business abroad is likely aware of the Foreign Corrupt Practices Act (FCPA) and the increased focus on its provisions by the Department of Justice (DOJ) and the Securities and Exchange Commission—the two agencies charged with its enforcement. In the past three years, those agencies have steadily ramped up the number of FCPA investigations and brought charges focused both on companies and individuals. At least 65 public companies have disclosed internal or government investigations, and the DOJ has stated that it has opened 120 investigations. How many of these investigations will result in charges being filed is anyone's guess, but there are no signs of an abatement in FCPA enforcement activities.

One of the highest areas of FCPA risk for companies operating abroad is the selection of foreign sales representatives and third-party agents. For good business and legal reasons, companies are paying increased attention to the screening of third parties who may act on their behalf in foreign countries. The government has made it clear that it expects companies to vet their prospective foreign business partners diligently and to exercise continuing oversight of the ones they select. Due diligence should enable a company to assure that the agent has the experience and expertise to do the job and is an important factor if it must argue later that it was never on notice that the agent was likely to engage in improper activity. Companies should carefully document their efforts by keeping a file on each agent they consider and, whether the agent is selected or not, include documentation of the reasons the agent was selected or rejected.

**RED FLAGS THAT SIGNIFY HIGHER RISK**

The due diligence process generally has three steps: an initial questionnaire to be completed by the prospective business partner; efforts to uncover publicly available information about the agent that will, among other things, help a company determine the accuracy of the responses to the questionnaire; and regular monitoring and oversight of partners that are selected. At each stage, companies should adopt a risk-based approach that pays close attention to what DOJ officials have identified in guidance as “red flags” or warning signs of possible trouble. None of these circumstances is disqualifying on its own, but each is an indication that the company should inquire further. Take heed if the prospective agent:

- Refuses to certify on a regular basis its compliance with anti-bribery or FCPA requirements;
- Refuses to complete a questionnaire regarding its ownership, qualifications and willingness to accept anti-corruption safeguards in a contract that would set forth business terms;
- Does not appear to be qualified to perform the duties for which it is engaged to assist your company;

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- Has a principal that is related to, or is, a government official;
- Has been recommended by a government official, or by someone on the basis of the agent's "friends in high places";
- Is located in a country with a reputation for corruption and bribery;
- Works in an industry that has a history of corruption problems;
- Demands compensation that is not commensurate with the fees and commissions normally paid for such services;
- Requests that commissions be paid in a different country, to a different party or in cash or untraceable funds;
- Is unwilling to submit to periodic audits and to commit to financial transparency;
- Relies heavily on political or government contacts as opposed to knowledgeable staff and the investment of time to promote your company's interests;
- Refuses or is unable to develop or implement a market strategy and to document efforts undertaken on your company's behalf;
- Asks that the representation be kept secret; and/or
- Has had problems in its relationships with other foreign companies.

#### **QUESTIONS FOR PROSPECTIVE AGENT**

Companies usually require that the prospective agent complete a questionnaire about itself and about whether it will agree to certain prophylactic contractual provisions. These questionnaires will vary depending on the nature of the business and the location of the prospective third-party partner, but certain basic questions should be included:

- Identify all of the owners and their percentage of ownership, as well as any parent, subsidiary, affiliate or any other entity that, in whole or in part, has common ownership.
- Similarly, do the owners of the third party own any part of any other business (and the identity of that business)?
- Does the government or any official or instrumentality of the government have any ownership or other financial interest in the third party?
- Identify the principal officers of the third party, with a description of their backgrounds and qualifications, including whether they have ever served in a position in government or with a political party, and whether they are related to any government or political party official.
- Provide a description of the third party's experience or any other basis on which they believe they are qualified to do the kind of work required.



- Has the entity, its owners or officers, or any entity with which they are now or previously have been affiliated, ever been charged with any sort of crime, fraud or bribery, or been suspended from doing business for any reason?
- Does the third party anticipate hiring an agent or some other party to do any part of the work on your behalf? Would they agree that they cannot do so without your consent?
- Identify all banking relationships and credit references, and provide consent for you to contact those entities.
- A description of the third party's internal controls, policies, record keeping, etc. that are designed to prevent corruption and bribery. Is the third party willing to have you examine those things before contracting?
- Provide the names of the persons who will be providing services on your company's behalf, to the extent they are not also owners.
- Is the third party willing to represent and warrant that it understands and will abide by the restrictions of the FCPA?
- Will the third party agree to written contract provisions that provide that:
  - You can have access to its books and records on an annual basis.
  - Its personnel will submit to periodic training that you will provide on FCPA compliance.
  - It will certify compliance annually.
  - It will inform you promptly of any changes in the business that would change any of its answers on the questionnaire.
- If allowable under local law (and this varies widely by jurisdiction), will the third party agree that you can suspend payment in the event of any investigation of improper conduct, and terminate the relationship either at will (probably not allowable) or based on any reasonable suspicion of an FCPA violation?

### **REVIEWING QUESTIONNAIRE RESPONSES AND PUBLICLY AVAILABLE INFORMATION**

Once you obtain complete and satisfactory responses to your questionnaire, you will need to try to determine whether those responses are accurate, and whether there is any other *publicly available* information that will enable you to assess the third party's business reputation, its qualifications and its ties to the government. Many companies engage professional firms to conduct this aspect of due diligence to ensure consistency of work product, diligence and documentation. Such outside firms generally provide assurances that they are relying only on publicly available information and can also offer familiarity with local languages and information sources. Whether going to an outside firm or conducting the work internally, however, it is important that the due diligence not be done by the sales force (or other company personnel) that might ultimately be working with the third party.<sup>1</sup>



## ONGOING MONITORING OF AGENTS

During a company's relationship with a foreign third-party agent, it must continue to monitor the agent's performance. The company should insist that the agent provide regular written substantive and financial reports, and review those reports carefully. Companies subject to FCPA liability are often requiring agents to submit to periodic audits and recertifications, and to provide other assurances that the agent is operating in a manner that will not expose the company to FCPA liability. While personnel in the field can handle the day-to-day oversight of the relationship, it is important to have periodic review of the agent's performance by company personnel who do not interact regularly with the agent. Some of the red flags to watch for in this context are:

- Vague, non-specific descriptions of payments made in journal entries.
- Documents that conceal the true identify of an in-country representative or agent.
- Payment descriptions that do not correspond to the appropriate account.
- General purpose or miscellaneous accounts that can be used to hide improper payments.
- Over-invoicing or false invoices.
- Unrecorded accounts or transactions.
- Travel and expense forms with incomplete or inaccurate information.
- Misstatement of transactions, e.g., recording a payment to the wrong payee.
- Unwillingness to fulfill contractual obligations to submit to audit or recertification.

Conducting due diligence on foreign agents is only one part of a comprehensive risk-based compliance program. A successful FCPA compliance program requires buy-in from all parts of the company, particularly those in the field who will work with the agents on a day-to-day basis. Including this topic in compliance training is essential. As with many things, an investment in prevention is far less expensive than having to deal with the problem.

## FOR MORE INFORMATION

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<sup>1</sup> The DOJ also encourages companies to inquire about the third party's reputation with the U.S. Embassy or Consulate. See *Lay Person's Guide to the FCPA*, available at <http://www.usdoj.gov/criminal/fraud/docs/dojdpcb.html>. Anecdotal evidence suggests that this step rarely provides significant information. In addition, companies can consult the World Bank's list of firms that it has reprimanded or barred from participating in its programs because of fraud or other corruption.