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Corruption and the Arab Spring: Compliance Implications for International Companies

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To paraphrase Mao, a revolution, not being a dinner party, is a messy and unpredictable affair with winners and losers emerging in chaotic and sometimes haphazard fashion. For international investors and businesses, the prospects are rarely bright, at least in the near term. Foreign commercial interests were notable losers in some of the last century's most important revolutions. During the Russian Revolution, foreign investors lost their wallets; in Cuba, Americans lost their sugar and their casinos; and after the Islamic revolution in Iran, international oil companies lost their wells.

The recent wave of Arab Spring upheavals that continues to ripple across the southern and eastern shores of the Mediterranean may present the threats common to foreign businesses caught in the midst of revolution, including extortion, nationalization, expropriation, and physical violence against executives and employees. These modern revolutions also pose new challenges to international firms, as evidence or allegations that they engaged in corrupt behavior may be made public through documents in a ransacked government ministry building, or through an incarcerated former official, an enterprising journalist or prosecutor in the new regime, or a whistleblower within the foreign company itself. If such allegations come to the attention of U.S. authorities or other governments, the company could face severe criminal and civil penalties for violations of the Foreign Corrupt Practices Act ("FCPA"), the U.K. Bribery Act, and similar anti-corruption laws, in addition to significant business ramifications.

In this context, companies should be fully aware of the corruption risks they face in the Middle East, North Africa and elsewhere in the world, and they should develop a plan to address these risks by understanding applicable laws and regulations in countries where they may be subject to charges of bribing foreign officials. To minimize their corruption risk, companies also should conduct due diligence on local commercial operations and business partners. Companies must act promptly to investigate, and in some instances self-report to regulators such as the U.S. Department of Justice ("DOJ") when there is a credible indication that misconduct has occurred.

The Arab Spring Revolts and Endemic Corruption

The geographical sweep of the Arab Spring covers a region with significant natural resources and a growing population, making it attractive for a wide range of industries, including oil and gas, mining, construction, defense, financial services, tourism, shipping, agriculture, pharmaceuticals, and telecommunications. High levels of corruption, however, have posed challenges to foreign businesses in this area even in the best of times. For example, Transparency International's Corruption Perceptions Index for 2010 – the year before governments began to topple – shows that countries in the region scored in the middle and lower tiers, with Tunisia ranked 59 out of 178 countries surveyed, Egypt ranked 98, and Libya ranked near the bottom at 146. This environment of pervasive corruption raises the costs of doing business, especially for international corporations perceived

to be affluent, and exposes those companies to potential legal liability and reputational harm for the misconduct of their employees and agents.

For international companies, the bribery-related risks in the region are raised even higher by the Arab Spring revolts given that the movement is largely rooted in anger against official corruption. In Tunisia, for example, where the Arab Spring began, protesters first took to the streets on a large scale in December 2010 following the self-immolation of Mohamed Bouazizi, a street vendor reacting to harassment from local officials allegedly seeking bribes. Similarly, in Egypt there is intense scrutiny on the Mubarak family's assets and business interests. Meanwhile, the tools of online social media, including Facebook, Twitter, and YouTube, allow protesters, journalists, and whistleblowers to air corruption grievances on the global stage at the click of a button.

In addition, internal upheaval fosters uncertainty, incentivizing government officials to press commercial enterprises for extraordinary payments, thereby further increasing corruption risk. Bribes may be sought either to provide the regime with the means to survive, or to enrich an official facing the prospect of losing his privileged status and the illegitimate income that such privilege affords. This pattern was evident in late Saddam Hussein-era Iraq, where illicit funds allegedly were directed to the regime through kickbacks extorted under the U.N. Oil for Food program. This scheme involved, among other things, the alleged diversion of a percentage of Iraqi oil sales back to the Iraqi government, and a similar kickback arrangement involving payments from companies supplying food, medicine, and other humanitarian goods that qualified for purchase under the program.

In the event a revolt succeeds, the wholesale replacement of government often poses similar bribery risks. A country's new leaders may look to foreign businesses as an attractive source of funds to support their fragile rule, or they may perceive only a narrow window of opportunity during which to profit personally from control over the levers of state power. Finally, the new regime may investigate allegations of corruption involving their predecessors in order to redress historical wrongs, or simply to neutralize political opponents and punish their supporters. In this case, assistance from the United States and other foreign governments is often necessary to track suspected illicit payments or the transfer of ill-gotten wealth to foreign bank accounts. The involvement of U.S. and other regulators in this fashion raises the prospect that potential bribery violations will be brought to their attention and subjected to investigation. Such scrutiny on a particular leader or regime could lead to a string of probes involving multiple companies, similar to the "industry sweeps" initiated by U.S. regulators with respect to sectors including oil and gas, pharmaceuticals, and financial services.

At the same time, western governments are increasing their capacity to identify and freeze or seize assets tied to corruption. For example, the DOJ recently established the Kleptocracy Asset Recovery Initiative, designed to identify the proceeds of foreign bribery that are located in the United States and recover them through civil forfeiture. The Swiss government, meanwhile, announced in early 2011 that it was freezing all assets held in the name of former Tunisian President Zine al Abidine Ben Ali, Egyptian President Hosni Mubarak, and Libyan leader Moammar Gadhafi, in addition to certain members of their families, close associates, and other government officials. Later in 2011, Switzerland added Syrian President Bashar al Assad and other senior Syrian

officials to the asset freeze list. Ultimately, these frozen assets likely will be repatriated if authorities in each country provide sufficient evidence that the assets were obtained illegally.

FCPA Enforcement Actions Involving the Middle East and North Africa

In any of the aforementioned scenarios, there is risk that corrupt payments may come to the attention of regulators in the United States and elsewhere, exposing companies to significant criminal and civil penalties. Indeed, the history of FCPA enforcement actions involving the Middle East and North Africa confirms that the region presents significant corruption risks, and demonstrates that enforcement agencies actively are pursuing suspected offenders doing business there. For example, in 2011 the U.S. Securities and Exchange Commission ("SEC") reportedly initiated an investigation related to a financial services firm's alleged work on behalf of Libya's sovereign wealth fund.[1] A survey of significant FCPA cases involving the Middle East and North Africa illustrates the importance of having a sophisticated knowledge of anti-bribery laws, implementing effective compliance programs, performing due diligence, and deftly handling questions related to voluntary self-disclosure and cooperation with U.S. and other government authorities.

In a 2010 case resulting in a $400 million criminal penalty, a defense company admitted, among other things, to making false statements to the U.S. government in connection with the company's alleged provision of substantial benefits to an influential Saudi official. While the defense company did not admit that these benefits (including automobiles, real estate and personal items) constituted bribes, it did admit that they were not subjected to the type of anti-bribery due diligence and review that the company had committed previously to undertake in written correspondence to the U.S. Department of Defense. Similarly, the company admitted that payments totaling the equivalent of over $25 million to the Swiss bank account of an intermediary were not scrutinized, even though there was a high probability that the intermediary would transfer part of these payments to the same influential Saudi official. Thus, while this case did not involve direct allegations of FCPA violations, it highlights the importance that regulators place on due diligence and compliance, and the need for companies to review carefully payments and other benefits provided to foreign officials, their dependents, agents or associates.

In an early case involving a U.S. engineering company, the DOJ alleged that the company made corrupt payments to an Egyptian official in return for his assistance with the engineering company's efforts to win contracts with the United States Agency for International Development ("USAID") in Egypt.[2] To settle these charges, the engineer company consented to entry of a final judgment requiring it to pay a $400,000 civil fine and imposing various compliance and reporting obligations. According to the government's allegations, which the engineering company neither admitted nor denied, the company paid for first class travel to the United States for the official and his family to recommend the engineering company for a contract that USAID was then considering. The complaint also alleged that the engineering company provided advance payments to cover per diem expenses for the official that were 50% in excess of the USAID-imposed per diem limits. The engineering company also allegedly paid for most of the travel and entertainment costs incurred by the official and his family, notwithstanding that the per diem payments were already made. This case

illustrates that travel and entertainment provided to foreign officials should be monitored closely for reasonableness because regulators may consider such expenditures to be inappropriate benefits that violate the FCPA.

Other FCPA cases involving allegations of corruption in the Middle East and North Africa illustrate that problematic business practices often are not confined to one country, but rather pervade throughout a company's regional or even global operations. For example, the 2007 case of a United States refrigeration and air conditioning company began with the company's investigation of alleged illicit payments to Iraqi officials in connection with the U.N. Oil for Food program.[3] This investigation then led to the discovery of hundreds of additional alleged kickbacks paid to obtain and retain government contracts in Bahrain, Egypt, the United Arab Emirates, and elsewhere. To settle the DOJ's FCPA charges resulting from these payments, the company entered into a three-year deferred prosecution agreement requiring it to pay a $10 million criminal penalty. In connection with a related complaint brought by the SEC, the company also consented to entry of a final judgment ordering it to pay over $10 million in disgorgement and interest as well as a $2 million civil penalty.[4]

Similarly, a U.S. manufacturer of equipment for the power industry pleaded guilty in 2009 to charges that it allegedly made over 200 corrupt payments in more than 30 countries, including in the Middle East.[5] The company's plea resulted in an $18.2 million criminal fine, and in related cases seven former company executives pleaded guilty to violating or conspiring to violate the FCPA.[6]

Protecting Your Company From Arab Spring Fallout

What can foreign companies operating in the Middle East and North Africa do to protect themselves in the prevailing environment of increased corruption risk? First, companies should evaluate their policies and procedures to ensure they are up to date, tailored to the business, and effective to deter and detect any wrongdoing. Of particular importance are elements such as a clear code of conduct that is communicated to employees, officers, and directors through periodic training; effective financial and accounting policies designed to prevent and detect misconduct; and anti-corruption due diligence procedures applicable to the engagement of agents, consultants and other business partners. Companies also should appoint one or more senior corporate officers with responsibility for the implementation and oversight of the company's compliance program, and companies should have disciplinary procedures in place to address potential FCPA violations and other ethical violations.

Controls such as these are often described by regulators themselves as key components of a robust compliance program. Indeed, it is noteworthy that in a recent FCPA case against a real estate fund manager in China, the DOJ described the lengths to which the manager's employer, a financial services firm, went to ensure compliance with the company's stringent FCPA and other policies.[8] For example, the manager was trained on anti-corruption policies at least seven times over the course of seven years, and he received no less than 35 FCPA compliance reminders. In addition, the DOJ observed that the financial services firm's compliance department monitored transactions, conducted random audits, did testing to identify potentially illicit payments, and conducted extensive due diligence on third party business

partners. To ensure that a compliance program meets these standards and achieves maximum effectiveness, companies should consider the engagement of outside experts to advise on the program's design, implementation, and periodic review. If strong procedures are found to be lacking in any area, companies must act swiftly to remedy them.

In addition to ensuring that procedures are in place to evaluate any government connections or ethical and reputational issues associated with new business partners, companies also should examine or reexamine existing relationships. When a new regime takes power, it often scrutinizes the former regime's associations with agents, consultants, lobbyists and other business facilitators. Companies should evaluate their relationships with such parties and determine whether any of them are government officials, relatives of government officials, or individuals and entities closely associated with the government. There should be a strong business case to justify the selection of government officials or their associates as business partners, and if such a justification cannot be formulated then the relationship should be re-evaluated.

If a problem is identified, whether with a third party or a company's own employee, prompt remediation is essential in order to prevent future violations and to demonstrate the company's commitment to compliance in the event the matter ever comes to the attention of regulators. A company that has identified problems should consult experienced FCPA counsel concerning appropriate responses. Whether self-disclosure to U.S. or other regulators is appropriate will be a fact-specific determination based on the risk of local fallout and other factors.

Whatever the nature and extent of a company's business in the Middle East and North Africa, prompt action should be undertaken to mitigate corruption risk in the region. In such a volatile political climate, doing nothing is often an unwise choice and can lead to unexpected problems with serious ramifications. In light of the extreme unrest that continues to grip the region and threaten the survival of the old order, preparation is key.

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Cadwalader, Mr. Bondi was a member of the executive staff of the SEC, serving as Counsel to SEC Commissioners Troy Paredes and Paul Atkins for enforcement actions and regulatory rulemaking. He also served on the steering committee for the SEC's "Strategic Plan for Fiscal Years 2010-2015" and on several working groups related to enforcement initiatives. While at the SEC, Brad was detailed to the Financial Crisis Inquiry Commission, a bipartisan commission established by Congress to investigate the causes of the financial crisis, where he served as deputy general counsel and assistant director. Mr. Bondi also served briefly as a Special Assistant United States Attorney for criminal prosecutions in the Eastern District of Virginia.

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[1] Press Release, BAE Systems PLC Pleads Guilty and Ordered to Pay $400 Million Criminal Fine, Department of Justice (Mar. 1, 2010).

[2] *United States v. Metcalf & Eddy, Inc.,* No. 1-99-CV 12566 (D. Mass. 1999).

[3] Press Release, Justice Department Agrees to Defer Prosecution of York International Corporation in Connection With Payment of Kickbacks Under the U.N. Oil For Food Program, Department of Justice (Oct. 1, 2007).

[4] Press Release, SEC Files Settled Foreign Corrupt Practices Act Charges Against York International Corporation, Securities and Exchange Commission (Oct. 1, 2007).

[5] Press Release, Control Components Inc. Pleads Guilty to Foreign Bribery Charges and Agrees to Pay $18.2 Million Criminal Fine, Department of Justice (Jul. 31, 2009).

[6] C.M. Matthews, "Seventh CCI Exec Pleads Guilty in FCPA Case," Wall St. J., Jun. 15, 2012. See also "Seventh Defendant in CCI Case Pleads Guilty, Leaving One Defendant for Trial," The FCPA Report, Vol. 1. No. 2, (Jun. 20, 2012).