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THIRD PARTIES

Qui Facit per Alium, Facit per Se: Best Practices for Third-Party Due Diligence

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The FCPA, enacted by Congress in 1977, makes it a crime to bribe foreign government officials, either directly or indirectly, in order to obtain or retain business. Thus, pursuant to the FCPA, it is unlawful to make a payment to a third party, i.e., an intermediary, if a company knows or should know that all or a portion of the payment will go directly or indirectly to a foreign official in order to obtain or retain business. For many companies, especially those with operations abroad, intermediaries are a critical part of their business operations. It is through them that they are able to carry out their day-to-day operations. As the list of typical intermediaries below illustrates, the number of intermediaries most companies are likely to have can be vast and extensive:

- Subsidiaries and Affiliates
- Consultants
- Sales Representatives
- Distributers
- Subcontractors
- Franchises
- Joint Venture Partners
- Agents
- Lawyers
- Accountants

Nearly all of the alleged bribes in the FCPA enforcement actions commenced by the DOJ and SEC this year – totaling almost $600 million in corporate fines – plainly illustrate that a company's failure to know, monitor and audit its intermediaries can have significant consequences for a company and its senior executives. See "Top DOJ and SEC Officials Discuss FCPA Enforcement Priorities and Mechanics," The FCPA Report, Vol. 3, No. 7 (Apr. 2, 2014).

For example, the DOJ and SEC's recent enforcement action against Alcoa Inc. (Alcoa) and its subsidiary Alcoa World Alumina LLC (Alcoa World) is particularly illustrative. See "$384 Million Alcoa Civil and Criminal FCPA Settlement Highlights the Risks of Third-Party Relationships," The FCPA Report, Vol. 3, No. 2 (Jan. 22, 2014).

The charges against Alcoa and its subsidiaries stemmed from an agreement between Alcoa World and the Kingdom of Bahrain's majority-owned aluminum smelter, Aluminum Bahrain (Alba). According to the DOJ's Information, in the late 1980s, certain members of the Bahraini Royal Family requested that Alcoa of Australia, another Alcoa subsidiary, retain

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certain shell companies owned by a consultant.

According to the DOJ, for approximately 20 years, the Alcoa subsidiaries sold alumina to Alba through sale contracts entered into with the shell entities. The insertion of an intermediary into their relationship, according to the DOJ, allowed the consultant to mark up the price of the alumina being sold to Alba and to also collect "commissions." The consultant allegedly used the mark-ups and commissions to enrich himself and to pay bribes to certain senior government officials of Bahrain. In January 2014, Alcoa World pleaded guilty to one count of violating the FCPA's anti-bribery provisions and agreed to pay $223 million. Alcoa, in turn, consented to the filing of a settled administrative proceeding charging FCPA bribery, books-and-records and internal controls violations and imposing $161 million in disgorgement. Alcoa's combined $384 million settlement is the fifth-largest FCPA settlement of all time.

Step 1: "Knowing Your Representatives" Before Retention

The first step that a company should take to ensure that its intermediaries do not run afoul of the FCPA or other anti-corruption regimes is to require that its employees properly diligence and screen the intermediaries that they seek to retain. Best practices include pre-clearance, pre-retention due diligence and a written contract.

Pre-Clearance

A company's anti-corruption policies and procedures should require that anyone seeking to retain an intermediary outside the U.S. must first pre-clear it with its legal or compliance department. This will enable the legal or compliance department to track the intermediaries that the company retains abroad and it will also permit the legal or compliance department to assist the employee in conducting the necessary due diligence and monitoring.

Pre-Retention Due Diligence

A company's anti-corruption policies and procedures should require that its employees conduct due diligence on an intermediary before it is retained, including requiring the intermediary to complete a compliance questionnaire that seeks information regarding, among other things: (1) whether any employees, officers, affiliates, or their close family members are government officials; (2) the countries in which work will be performed; (3) the countries in which the intermediary has performed work in the past; and (4) whether there are any criminal records or public records indicating past corruption on its part.

Written Contract

A company's anti-corruption policies and procedures should require that all

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intermediaries enter into a written agreement with the company to govern their relationship. The agreement should include, among other things, provisions requiring the intermediary to:

- comply with anti-bribery laws;
- obtain the company's prior approval of any sub-intermediary it intends to retain;
- allow the company to audit the intermediary's books and records if it believes that the intermediary may have breached the compliance-related provisions of the agreement; and
- grant the company the right to terminate the intermediary as a result of any breach of anti-bribery laws and regulations or representations related to such matters.

See The FCPA Report's series on third-party contracts, "A Guide to Anti-Corruption Representations in Third-Party Contracts: Nine Clauses to Include (Part One of Two)," The FCPA Report, Vol. 3, No. 13 (Jun. 25, 2014); "Clauses for High-Risk Situations and Enforcement Strategies (Part Two of Two)," Vol. 3, No. 14 (Jul. 9, 2014).

Step 2: Continued Monitoring and Auditing of Intermediaries

The company's policies and procedures regarding intermediaries should not end at vetting the intermediary, conducting due diligence and entering into a satisfactory written agreement. See "Mitigating Bribery Risks Using Financial Controls, Risk Assessments and Leveraging Internal Resources," The FCPA Report, Vol. 3, No. 18 (Sep. 10, 2014).

Anti-corruption policies and procedures should also require employees to monitor and audit intermediaries for as long as they represent the company. Below are some recommended best practices with regard to this step in the compliance process:

Risk Assessment

Using a risk-assessment model will ensure that the appropriate amount of diligence and oversight is undertaken for those intermediaries that pose a greater risk to the company while at the same time requiring some amount of diligence and monitoring for all intermediaries.

Companies should assess the risk of corruption in the intermediary's country and industry by, among other things, considering the following questions:

1) In what countries does the intermediary conduct its business?

- What is the Transparency International ranking for those countries?

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- What is the company's internal experience with regard to corruption in those countries?
- What is the intermediary's level of government involvement in carrying out its business in those countries?

2) What are the industry risks for that intermediary?

- Has the intermediary's industry been a focus of significant FCPA enforcement (such as oil and gas and telecom)?

3) What is the intermediary's business model?

- Is it heavily reliant on licenses?
- Does it sell services to the government or state owned entities?

Monitor Based on Risk

The level and extent of monitoring that a company will impose on an intermediary should be on a sliding scale calibrated with the risk assessment – more monitoring and resources should be provided to those that are deemed more risky and less monitoring and fewer resources to intermediaries on the lower end of the risk scale. Less intrusive practices include requesting sample transaction documents or financial records, telephone interviews and desk audits; more intrusive practices for riskier third parties include on-site compliance and financial audits.

Re-Assess the Risk

Because industry and country dynamics routinely change, a company should periodically conduct a risk re-assessment of its intermediaries and re-allocate, as necessary, resources and the level of scrutiny it will apply. Generally, a company should re-assess the risk of its intermediaries every 12-18 months.

Train Employees

A company should also train and make its employees aware of conduct or activity that suggests an intermediary may be engaging in corrupt conduct. For example, the DOJ and SEC's Resource Guide to the U.S. Foreign Corrupt Practices Act identifies common red flags that an intermediary may be engaging in corrupt conduct:

- Excessive or unusually high compensation to third-party agents or consultants
- Unreasonably large discounts to third-party distributors
- Third-party "consulting agreements" that include only vaguely described services
- The third-party consultant is in a different line of business than that for which it has been engaged
- The third party is related to or closely associated with the foreign official
- The third party became part of the transaction at the express request or insistence of the foreign official

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- The third party is merely a shell company incorporated in an offshore jurisdiction
- The third party requests payment to offshore bank accounts
- A company should require that its intermediaries certify on an annual basis to its compliance with all anti-corruption laws

Integrate Third Parties Into the Compliance Program

A company should not only make the company's Code of Ethics and policies and procedures available in the intermediary's respective language, but should provide robust in-person training. The company should make sure it is integrating intermediaries into the company's whistleblower policies and procedures and encourage the intermediaries and its employees to report complaints through the company's whistleblower hotline.

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