SMOKESHOP

THE INDUSTRY AUTHORITY ON TOBACCO RETAILING

Official Publication of the International Premium Cigar & Pipe Retailers Association (IPCPR) | February 2013

IN PREMIUM CIGARS

Dominican Republic Still Dominates

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Beware the Foreign Corrupt Practices Act

The hand of U.S. law reaches overseas, and the FCPA can prove to be a trap for the unwary tobacco product exporter.

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Exporting tobacco products to foreign markets presents a significant opportunity for manufacturers to increase sales. Great opportunities, however, bring with them legal risks and compliance issues. Gaining access to new markets and achieving market penetration in foreign countries will involve working, at least at some level, with foreign government officials. Whether your company's sales representatives make those contacts directly or work through foreign agents, the risk of improper and illegal payments to government officials will arise in many countries. It is critical that your company understands the laws governing these interactions and takes appropriate steps to comply with those laws.

The Foreign Corrupt Practices Act (FCPA), was enacted in 1977 in the wake of public outcry to the Watergate scandal and in response to government investigations that led to a report from the U.S. Securities and Exchange Commission (SEC) detailing illegal payments by over 400 United States companies to non-United States governmental officials, politicians, and political parties. The FCPA contains two separate requirements to discourage bribery.

First, the statute's "anti-bribery" provisions makes it a crime to offer or give anything of value to a foreign government official, a foreign political party, a foreign party official, or a foreign political candidate in order to obtain or retain business for or with, or to direct business to, any person.

Second, the statute's "books and records" provision requires that companies make and keep accurate books and records and devise and maintain an adequate system of internal accounting controls.

The FCPA's anti-bribery provision applies broadly to any company with its principal place of business in the United States, while the record-keeping provision only applies to companies with securities registered with the SEC and companies that must file reports with the SEC. Importantly, even if your company does not have any direct foreign operations, it can be held liable for a FCPA violation committed by a foreign agent of your company, such as a business consultant or sales agent.

The FCPA prohibits acts that are committed "corruptly"—in other words, payments intended to induce the recipient to misuse his or her official position. In addition, to be a violation, the payment must have been made to obtain or retain business. However, this requirement is read broadly. For example, payments designed to lessen customs or tax liability are considered as intended to obtain or retain business.

Bribes can come in all shapes and sizes and so, the FCPA prohibits the giving of "anything of value." There is no minimum threshold amount in the Act for corrupt gifts or payments. Regardless of size, to violate the statute, the payor must have intent to improperly influence the government official into misusing their position. Companies are not prohibited from giving gifts, but should not use gifts to disguise bribes. In the same manner, a company cannot make a charitable contribution as a pretext to provide a bribe to a government official.

The FCPA broadly defines the term "foreign official" to include any officer or employee (including low-level employees and officials) of a foreign government or any department, agency, or instrumentality of the government, including government-owned or government-controlled businesses and enterprises, and public international organizations, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality or public international organization. The FCPA also prohibits corrupt payments to foreign political parties, officials of foreign political parties, or any candidate for foreign political office.

Generally, the Department of Justice

(DOJ) and the SEC share responsibility for enforcing the FCPA. Specifically, the SEC is responsible for civil enforcement against "issuers" (i.e., publicly traded companies), while the DOJ is responsible for civil enforcement against non-public companies and criminal enforcement against both issuers and non-public companies. Penalties for violation of the FCPA are severe and potentially devastating for both corporations and individuals, and include imprisonment for individuals and fines for corporations and individuals. Statutory criminal penalties for individuals include fines up to $100,000 per violation and/or imprisonment up to five years. Individual directors, officers, and employees of companies may be prosecuted, even if the company for which they work is not. Companies may be fined up to $2 million per violation. The FCPA also allows a civil action for a fine of up to $10,000 against any firm that violates the anti-bribery provisions of the FCPA, and against any director, officer, employee or agent of a company who willfully violates the anti-bribery provisions of the Act. For example, the SEC filed 734 enforcement actions for its fiscal year ending September 30, 2012, and obtained orders in that same year requiring the payment of more than $3 billion in penalties and disgorgement.

The FCPA does contain one exception and two affirmative defenses. Under the "grease payment" exception, a facilitating payment to a foreign official is legal if the purpose of the payment is to obtain the performance of a "routine governmental action." A routine governmental action must be truly routine. Examples include the issuance of permits, licenses, or other official documents or the processing of routine governmental papers such as visas. Routine governmental action means that no discretion is exercised by the foreign government official in performing the activity.

The two affirmative defenses include a payment that is lawful under the written laws and regulations of the foreign official's country (this is extremely difficult to satisfy); and a payment that is a reasonable and bona fide expenditure, such as travel and lodging expenses, directly related to either the promotion, explanation, or demonstration of a company's services, or to the execution or performance of a specific contract with a foreign government or agency.

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The first defense is rarely, if ever, available. While the second defense is relied upon much more frequently, even under the second defense the payment must be reasonable and for a legitimate purpose.

Many companies doing business in foreign countries will often engage a local individual or company to assist them in navigating the landscape. Although these consultants may facilitate business transactions and provide advice on local customs and manners, there are potential risks involved with utilizing third parties abroad. For purposes of liability under the FCPA, it does not matter whether a corrupt payment is made directly or indirectly. Thus, it is also a violation of the FCPA if a payment is paid to a third party "knowing" that it would be passed through to a government official.

The FCPA's definition of "knowing" goes beyond actual knowledge. A firm belief that the third party will pass through all or part of the payment to a government official, or an awareness of facts that create a "high probability" of such a pass-through, constitute knowledge under the Act. As a result, the vast majority of recent FCPA cases brought by the government involve conduct by third parties as liability can be attached indirectly through the misconduct of a company's agents, consultants, suppliers, and/or distributors.

Agents present fairly straightforward cases for analyzing FCPA exposure. Under traditional corporate agency law, a third party creates corporate liability for the principal so long as there is a principal-agent relationship and the agent is acting within the scope of its employment, even where the agent may be acting contrary to the employment policies. A sales agent clearly represents the company when, for example, it seeks to secure a government contract on behalf of its principal company. If such an agent pays a bribe to obtain the contract, the company will be responsible for the FCPA violation if it participates in, approves, knows about, or, in some cases, is willfully blind to the violation.

For example, in a recent case in the Second Circuit Court of Appeals involving the FCPA, United States v. Kozeny, 667 F.3d 122 (2d Cir. 2011), the Court held that the DOJ may establish that a defendant participated in a bribery scheme without presenting any evidence that the defendant had actual knowledge of corruption or any evidence that the defendant paid any bribes to foreign officials.

Fredrick Bourke was convicted after five weeks of trial testimony describing his alleged participation in a scheme to bribe senior government officials in connection with the privatization of the Azerbaijan state-owned oil company, Socar. The case largely focused on the FCPA's knowledge element and whether Bourke, as an investor, had sufficient knowledge of the bribery scheme. Prosecutors asserted that Bourke invested almost $8 million in the attempt at privatization of Socar with "knowledge" that his co-defendant had offered bribes

to the senior government officials to secure the deal. Without evidence of Bourke's actual knowledge or proof that he made any payments himself, the prosecutors presented circumstantial evidence suggesting that Bourke should have known of the bribery scheme based on the pervasive corruption in Azerbaijan generally, his co-defendant's reputation as the "Pirate of Prague," Bourke's voicing of concerns about whether his co-defendant and company were, in fact, paying bribes, and Bourke's creation of an American advisory company to shield himself from FCPA liability.

While Bourke appealed several issues, most significant was his challenge to the district court's jury instruction on "conscious avoidance." Bourke argued that the instruction was improper because it lacked any factual predicate. The Court disagreed, finding that from the evidence,"[t]aken together, a rational juror could conclude that Bourke deliberately avoided confirming his suspicions that Kozeny and his cohorts may be paying bribes," and that "this same evidence may also be used to infer that Bourke actually knew about the crimes."

Finally, the Court rejected Bourke's argument that the conscious avoidance charge improperly allowed the jury to convict him based on negligence, rather than based on evidence that he avoided learning the truth. The Court also found no error in the district court allowing in evidence of the testimony of others with access to the same sources of information as Bourke who were able to discern the scheme and avoid participation in it. Such evidence, according to the Court, does not allow for a conviction based on negligence, but rather, supports the government's argument "that Bourke refrained from asking his attorneys to undertake the same due diligence done by [others] because Bourke was consciously avoiding learning about the bribes."

The DOJ and SEC have identified some common red flags associated with third parties that companies should be aware of:

- *excessive commissions 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;*
- *the third party is merely a shell company incorporated in an offshore jurisdiction; and;*
- *the third party requests payment to offshore bank accounts.*

Companies should keep in mind that they can suffer harsh consequences even if they are not ultimately convicted of a violation of the Act as mere indictment under the FCPA can trigger its own set of sanctions. Indictments can result in the loss of U.S. Government financing and insurance, and suspension or debarment from U.S. Government contracts and licenses to operate both in the United States and abroad. FCPA prosecutions also often include charges of other criminal violations, such as mail and wire fraud and conspiracy, further compounding the potential penalties. Those actions can move forward even if the Company is not convicted of the FCPA offense.

As discussed, acts of third-party agents, distributors, subcontractors and business partners can create FCPA liability for the company if bribes are made or even offered. The government assumes you have conducted reasonable due diligence background investigations on your agents and have determined they are not involved in illegal conduct. As a result, it is important to understand who your third party agents are, how many you have, why you are using them, and who in your company has authority to enter into a contract with them. Companies would be also be wise to put in place compliance programs and other internal controls tailored to its particular circumstances and geared to ward off the claims of third-party misconduct.

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