

Anti-Corruption: If you are not part of the solution; you are the problem

Introduction

Fighting corruption in India has entered a new phase. In recent times, newspapers are filled with reports and analyses of alleged acts of bribery common in India. Of course, fighting corruption has become a global priority particularly with the international reach of the anti-corruption laws and how damaging such behavior can be. Much of the impetus in the increased attention results from US leadership fighting supply-side bribery and corruption due to America's fast-growing prosecution of violations of its Foreign Corrupt Practices Act ("FCPA"). Fueled by a number of international conventions and increased enforcement in the member states of the OECD and by more transparency in international transactions, the United Kingdom has also passed its own Anti-bribery Act in 2010. The subject is one of great concern to Indian corporations generally, and particularly for those who are linked with US/UK and Europe. This newsletter focuses on issues for US companies doing business in India and Indian companies doing business in US in light of FCPA and corresponding Indian law, the Prevention of Corruption Act, 1988 ("POCA").

1. The Legal Framework

1.1 FCPA

Mandated with its principal object is to check corrupt practices among US companies and its employees regardless of where they are located, the FCPA makes it unlawful for certain classes of persons and entities to make payments to foreign government officials in order to assist in obtaining or retaining business. The term person includes US listed companies operating globally, foreign companies who qualify as "issuers" in the US as well as employees of the subsidiaries. The Department of Justice ("DOJ") and the Securities Exchange Commission ("SEC") prosecute FCPA violators; SEC is the securities regulator whose focus is on civil violations related to issuers¹ while the DOJ concentrates on criminal violations. It is essential to remember that the long-arm reach of the FCPA has expanded significantly and there is no territoriality nexus or requirement to implicate a person. Thus, these regulators can reach out and investigate improper payments made by US companies, their foreign subsidiaries obligated to comply with FCPA and citizens overseas.

There are two distinct sets of provisions; anti-bribery and books and records and internal controls provisions. As noted above, the former prohibits any kind of payment (direct or indirect) to secure or gain an improper favor or advantage. It is not necessary that money should exchange hands; rather, anything of value² or even a promise to pay to a foreign official³ is barred. The accounting provisions require "issuers" to make and keep books, records and accounts in detail, accurately and should fairly reflect transactions, devise and maintain a system

¹ Any company including foreign companies who are authorized to issue their securities on a US stock exchange

² This is rather wide and includes cash, its equivalent, and, among other things, discounts, gifts, use of materials, facilities or equipment, entertainment, travel, lodging and even promise of future employment

³ It means "...any officer or employee of a foreign government or any department, agency or instrumentality thereof [. . .] or any person acting in an official capacity for or on behalf of any such government, department, agency, or instrumentality"

of internal accounting controls. There is one exception i.e., facilitation payments in order to expedite or secure the performance of a routine governmental action (discussed further below).

1.2 POCA

India too has its own equivalent since 1988 – POCA. This law also prohibits taking of bribe or any other gratification⁴ by a public official.⁵ Gratification too is a wide term and includes money or non-cash benefits as well. POCA applies in India, to Indian citizens, Indian citizens residing abroad and even to foreigners in India. Under POCA, offenders are public officials (existing or prospective) who accept a bribe; bribe givers; and intermediaries who exercise influence over such officials. It is important that gratification must be for doing or abstaining to do an official act. A mere demand or solicitation by a public servant amounts to an offence and it is not necessary that the act is actually performed; receipt of gratification simply completes the offence. Further, the FCPA exception is not a carve-out in India and, thus, payments for routine government acts are an offense.

With a new company law in place since 2013 with greater focus on corporate governance, companies are under an obligation to keep “true and fair accounts” and payments with an illegal purpose cannot be recorded as expenses and if done so, ramifications are wide. The government, both at central and state level is empowered to appoint special judges to try any offence punishable under POCA including conspiracies or abetment of any offences.

2. The Exception and Small Cash Payments

While most corporations have their gifts, hospitality and entertainment limits, code of conduct and zero tolerance policies in place, the reality in-country and on the ground may be different. While large pay-outs or favors may be simpler to track, the challenge arises when bribes are camouflaged through petty cash payments. Specifically, companies may use petty cash to make small payments, say up to INR 3,000 or about USD 60 consistently to government agencies to secure absence of obstructions in a process. The question that arises is whether such payments come within the ambit of FCPA exception of routine governmental action, even though Indian law does not allow for this exception. Under the FCPA, such routine actions include those performed by foreign officials ordinarily and exclude decisions about awarding new business or continuing business with a particular party. These cover, for instance:

- obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country;
- processing governmental papers, such as visas and work orders;
- providing police protection, mail pick-up and delivery;
- scheduling inspections associated with contract performance or inspections related to transit of goods across country;
- providing phone service, power and water supply;

⁴ Gratification is defined in terms of anything, which gives satisfaction to the recipient of any kind

⁵ The expression used is “public servant” and is defined rather widely under section 2(c) of POCA with about nine different categories of persons including judges, government officers, governing body members of universities etc.

- loading and unloading cargo, or protecting perishable products or commodities from deterioration; or actions of a similar nature.⁶

In the US, generally the exception is viewed narrowly plus the justification of the size of the payment is not a defense. Small, frequent payments will be equivalent to a significant bribe if the intent and objective is to bribe. Corrupt intent may be inferred from repeated conduct as well as through description of payments in the accounting entries which often tend to be vague, unclear, sans details thereby raising doubts about their authenticity. Failure to record properly can compel a reasonable inference about their actual character – i.e., payments made to bribe officials to secure favors. In essence, while conducting internal compliance audits due regard has to be paid on the categorization and frequency of such payments and, if further inquiry raises more doubts about their objective, they must be necessarily stopped.

3. Enforcement

There have been numerous instances in the last decade or so where FCPA proceedings involving bribery in India were initiated against US corporations, their Indian subsidiaries and/or company officers. According to the DOJ statistics for 2013, USD 635 million were imposed in civil and criminal penalties imposed. Some cases are described below to demonstrate how the parent company or their officials have been penalized in various instances under FCPA. All the cases below do not relate to India, but the key point is the ability of the US enforcement agencies to reach out anywhere on the globe.

3.1 Goodyear: Subsidiaries paid bribes to secure sales in Africa, and the company agreed to pay USD 16 million to settle the charges. The SEC's order found that Goodyear's subsidiary in Kenya bribed employees of several agencies, including the Kenya Ports Authority, Armed Forces Canteen Organization, Kenyan Air Force, Ministry of Roads. Goodyear violated the books and records and internal control provisions and ordered Goodyear to report its FCPA remediation efforts to the SEC for three years.

3.2 Avon Products: SEC alleged that Avon's Chinese subsidiary paid USD 8 million in cash, gifts, travel, and entertainment to gain access to Chinese officials implementing and overseeing direct selling regulations in China. Again, the books and records failed to accurately record the details and purpose of the payments and the company failed to impose controls in place to detect and prevent payments and gifts to officials by subsidiaries. In December 2014, Avon agreed to pay USD 135M to settle charges and a parallel criminal case.

3.3 Oracle: The SEC's complaint alleged that Oracle violated FCPA's books and records and internal controls provisions by failing to accurately record the side funds that Oracle India maintained with its distributors. Without admitting or denying SEC's allegations, Oracle consented to the entry of a final judgment ordering the company to pay USD 2 million penalty and permanently enjoining it from future violations of these provisions. Essentially, this sum was lowered due to voluntary disclosure of conduct in India and remedial measures taken including firing employees involved in the misconduct and made significant enhancements to its compliance program.

⁶ 15 U.S.C. section 78dd-1(f)(3).

3.4 PwC: Five PwC Indian offices faced action for repeated deficient audits of an Indian outsourcing company, Satyam, and of its financials which enabled massive accounting fraud to go undetected for years. In April 2011, the SEC imposed USD 6 million as penalty which is the largest by a non-US based accounting firm for audit failures indicative of a much larger quality control failure at PwC India.

3.5 Diageo: SEC alleged that Diageo, London based spirits producer made over USD 1.7 million of illicit payments to hundreds of Indian government officials for purchasing and authorizing the sale of its beverages. As a result of the increased sales, Diageo recorded a large profit of USD 11 million. Diageo's books and records did not accurately reflect illicit payments that it made through its Indian subsidiary and thus came under SEC scanner. In July 2011, Diageo paid USD 16 million to settle payments made for securing favors and making (amongst others) extra commission payments to cover payments made.

In the US, the fines are not small by any means, but even more damaging is the impact on reputation, possible termination of government licenses and debarment from government contracting programs, disgorgement of company's profits on contracts secured with improper payments, and appointment of independent watchdogs over violators.

In India, corruption cases are registered by the anti-corruption division of the CBI, India's premier investigating police agency. Further, different categories of police are also empowered to conduct investigations in POCA cases. Any individual can provide information regarding corrupt practice and become an informer. The identity of such an informer is kept secret, even from the court. While the Indian Penal Code and POCA prescribe criminal and civil liability for corruption, the reality is that actions taken against the perpetrators have been far and few in between. These legislations, per se, do not hold a company as an offender, and the primary liability rests on the concerned individual i.e. the bribe receiver. However, companies cannot be absolved completely of liability when there is recurrent evidence of corruption.

Conclusion

With increasing cross-border business activities, governments have either revised their domestic anti-corruption laws, or introduced new ones, come down heavily on violators but, one thing is certain – anti-corruption compliance is exceedingly high on the priority list of General Counsels, Chief Compliance Officers and even the CEOs of large corporations. The heightened scrutiny of FCPA compliance resulting in prosecutions and fines, it is imperative for U.S. companies operating in India to recognize the risks of violations of FCPA can entail. To this end, managements must work closely with employees to educate them on the scope and application of FCPA to their enterprise; repeatedly train them on best practices and how to identify red-flags, put in place whistle-blower protections and constantly bolster their compliance policies and initiatives so as to insulate themselves. Compliance spend has increased enormously in recent years and the challenging question is how to bring about a mindset change or, rather, a DNA change so that those sitting thousands of miles away do not have to worry about ethics of their operating companies across the globe.

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