

Third Parties

Conducting Effective Anti-Corruption Due Diligence on Third Parties: An Interview with Alice Fisher, Partner at Latham & Watkins LLP

By Nicole Di Schino

Engaging third parties is necessary for most global businesses, but rife with corruption risk. Under the FCPA, a company can be held responsible for any improper payments made on its behalf by a third-party agent or partner, and most of the recent FCPA enforcement actions by the SEC and DOJ have involved the actions of third parties – making the task of conducting due diligence on third parties one of the most critical and complicated issues in FCPA compliance. How should a company efficiently allocate its due diligence resources? What should a company do when its third-party partner is less than forthcoming? Can a party engage a third party even if due diligence raises red flags?

The FCPA Report is publishing a series of interviews with experts from different disciplines on best practices for conducting anti-corruption due diligence on third parties. This article, the first in the series, includes our interview with Alice Fisher, partner at Latham & Watkins LLP. Fisher specializes in white collar criminal investigations, internal investigations and advising clients on a range of criminal matters, including the FCPA. She formerly served as Assistant Attorney General in charge of the Criminal Division of the DOJ.

FCPAR: In your experience, what are the government's expectations with regard to third party vetting?

Fisher: I think the government has been very clear about this particular issue for a long time. The FCPA Guidance, as well as the government's charging documents and deferred

prosecution agreements, demonstrate that the third-party agency issue is considered a risky area and one that the government takes very seriously. I think their expectations include doing diligence, understanding who the company's third-party partners are, and doing what the company can to protect against the risk that its third parties will engage in corrupt behavior. It is very important for companies to fully understand these issues.

FCPAR: What are some examples of third parties in specific industries on which companies should be focusing?

Fisher: The most important third parties are those intermediaries, agents or other third parties that are dealing with a government entity on the company's behalf. That may be a sales agent, a customs official, a tax consultant, a distributor, an agent helping with obtaining licenses or export issues, or lobbyists who are trying to influence the government with regard to the company's business.

Additionally, different industries have different business models regarding how they interact with government entities abroad. For example, a manufacturing company may use third-party distributors to sell its products to governments. In the oil and gas industry, the companies should look at, for example, joint venture partners, local agents that are helping with the procurement process, and also at customs agents, immigration agents or similar parties who are helping get that contract implemented and performed and dealing with the foreign government in that regard.

FCPAR: Should a due diligence procedure be written into the company's policies?

Fisher: Yes. To protect the company against corruption risk and ensure compliance, it is important for a company to globally communicate the policies and procedures that are expected. It is very hard to monitor and control what is happening with due diligence and third parties without a written policy in place to which employees across the globe can conform their conduct.

FCPAR: Should third-party due diligence procedures vary from country to country or should they be uniform in every location?

Fisher: I think most companies that we advise, and probably most companies in general, have a global policy. A global policy makes it easy to have effective controls and to have standards to monitor against, test against and train against. When a policy is global, everybody understands the policy and what procedures are required. From time to time, there are specific local laws or different factors regarding the nature of the business that might be different across the globe and some local countries may want to tweak the operating procedure to add a supplemental local operating procedure. I have seen that in some instances, but generally, most companies have one policy and procedure.

FCPAR: Do you recommend using coding systems to code third parties for risk levels such as red, yellow and green, or using a numbering system to rate the risk for various parties when doing your risk assessment before starting due diligence? [See "Lessons Learned by Motorola Solutions, ExxonMobil and VMWare on the Role of Risk in Designing and Implementing an FCPA Compliance Program," The FCPA Report, Vol. 2, No. 15 (Jul. 24, 2013) (discussing the benefits and drawbacks of coding risks).]

Fisher: It is important for a company's due diligence procedures to be risk based. Some companies accomplish this by using a tiering system. A company may choose to designate different tiers and potentially each tier would get a different level of diligence. For example, a higher level of diligence could be required for: third parties that are dealing directly with the foreign government; third parties dealing with business units that are in high-risk industries or high-risk countries; or third parties operating in areas where there is a particular risk evaluation that warrants a more robust diligence process. A second tier of diligence could be used for vendors that are not interacting with the government but may be implementing the company's operations in some way and could potentially get the company in trouble with regard to corruption liability.

I have also seen policies and procedures where the third-party diligence policy specifically describes what types of agents will go through the full process and what types of agents may just go through a general procurement check process. It's important for companies to consider the nature of the business and the nature of the corruption risk for that type of third party for that particular industry and region. This will help the company determine what level of diligence is really practical for the business and ensure that the resources are devoted appropriately.

FCPAR: Can you give some examples of key information a company should seek to obtain from third parties that would determine their risk level and thus the amount of diligence required? [See also "Six Steps for Converting a 'Paper' FCPA Compliance Program into a Pervasive Culture of Anti-Bribery Compliance (Part One of Two)," The FCPA Report, Vol. 2, No. 4 (Feb. 20, 2013); "Designing Effective FCPA Compliance Programs and Monitoring Third Parties

After the Guidance: An Interview with H. David Kotz, Michael Volkov and Paul Zikmund,” The FCPA Report, Vol. 2, No. 2 (Jan. 23, 2013) (listing elements of a risk assessment).]

Fisher: When a company is deciding how much diligence is required, it should take into account the particular type of service as well as the industry and country of operation. Next, the company should consider whether the third parties are qualified to engage in the services it is hiring them for. What is the business rationale for hiring them? What is their reputation? Have they been investigated in the past or had other corruption problems? What is the valuation and calculation with regard to the payment for their services and can the company ensure that the valuations are appropriate and reasonable and arms’ length? How are those payments going to be made or recorded? Can the company ensure that there are no offshore payments? What will be the extent of the third party’s interaction with the government on the company’s behalf?

FCPAR: What are the methods that companies should be using to obtain that type of information? Are there any methods you would recommend?

Fisher: Often the business operators, the people who are hiring the third party or dealing with the third party on a day-to-day basis, are given ownership of the diligence process. They ensure that the appropriate forms are filled out and the appropriate background checks are completed, often working in conjunction with either legal or compliance. It is important that within the company there are enough checks to make sure that the agents being hired are approved appropriately and go through the appropriate diligence procedures by more than one person within the company.

FCPAR: What are some of the steps that companies should be taking when they are doing diligence on third parties that are deemed a low level of risk? What would you suggest their processes include?

Fisher: Regardless of the third party, it is good from a business perspective to validate that the third party will actually be experienced enough to perform the services that the company is hiring them to perform and that they will actually perform the services. The company should set up a process to check their references; check where their bank accounts are; and check the structure of the third party, as far as ownership goes, to make sure that this third party isn’t actually owned by a government official. A company should verify that kind of information with regard to even low-risk parties because it needs to make sure, from a business perspective, that the third party is somebody it wants to engage.

Even if the company is not going to do a deep dive, it is important that all third parties provide sufficient information.

FCPAR: What are the additional processes and steps if the third party is deemed a high level of risk?

Fisher: For high-risk third parties, the company will likely want a detailed form that the third party fills out with the things listed above and all sorts of other information. For example, it should include: ownership structure, payment information, experience, references and other issues the company would want more information about. After receiving the questionnaire, the company may want to ask follow-up questions. It may even want to do face-to-face interviews with third parties to make sure that they understand that they have to abide by the company’s policies

and procedures. The company may also want to get audit rights and see what the third party's reaction is to the fact that it wants to have the ability to audit that relationship. It may want to call reference checks on the particular agent. Sometimes, depending on the nature of the agent and what the nature of the interaction is going to be with the government entity, the company may also want to use an external investigative resource to get not only public source documentation on the agent but in-country source information and background checks.

FCPAR: When should such external resources be brought in?

Fisher: If it's a high-risk hire or relationship that the company has determined they want more background information on, it can bring in external resources to do those background checks not only from the public sources, but on the ground in country. Also, if the company finds red flags during the diligence process, then it may want to hire external resources to try to track those down and try to clarify them or mitigate them.

FCPAR: What types of red flags might come up that a company could mitigate? Are there red flags that cannot be mitigated?

Fisher: This issue requires a lot of consideration and careful thought. If a red flag is raised, how can the company mitigate and with mitigation, what is the risk profile going forward? Sometimes, having a red flag, even one or two red flags, can be controlled through monitoring, testing, auditing, getting appropriate certification and conducting appropriate oversight. There are other red flags, such as understanding that one of the current high-level officers or employees in the third-party intermediary has engaged in bribery in the

past and had made comments about engaging in corrupt activity during the particular relationship at issue, that may not be able to be mitigated. For example, if the third party has approached the company and said, "Don't worry I can fix this, I know the right officials," and indicates that it may actually make improper payments, that is something that the company cannot mitigate.

FCPAR: What if a third party is not particularly forthcoming during the due diligence process? What, if anything, should a company do then?

Fisher: It depends on the reason they are not particularly forthcoming. The FCPA is a law that has global reach. Different countries have different cultures, different secrecy laws, and different privacy laws. A company needs to be mindful of taking those things into account. [See "Conflicting Compliance Obligations: How to Navigate Data Privacy Laws While Performing Internal Investigations and Promoting FCPA Compliance in the E.U. (Part Two of Three)," The FCPA Report, Vol. 2, No. 2 (Jan. 23, 2013).]

If there's a credible and legitimate reason why the third party is not disclosing a particular piece of information that the company is seeking in diligence, that may be acceptable. Having said that, refusing to provide information in the diligence process can be a red flag in and of itself.

FCPAR: If the withholding of information raises a red flag, what should the company do then?

Fisher: From a practical perspective, the next step is going to be completely dependent on the information that is being withheld. The company can either find the information in another way that gets it comfortable, or it can somehow

quarantine off the issue in a way that it can still get comfortable with the relationship going forward, given all the other protections that it may put in place.

Fortunately or unfortunately, these are all going to be based on the facts and circumstances of a particular relationship and the particular information that is either being withheld or being disclosed. The company has to look at the picture as a whole and I don't think that one issue necessarily prevents it from going forward. But as the problems accumulate, they could raise the risk profile to the extent that the company should decide to seek other agents.

FCPAR: How should due diligence be documented?

Fisher: It's important for diligence to be filed away and documented at the end of the day, especially if there is an issue that comes up later with that particular relationship. A company needs to have the opportunity to demonstrate to the government that it did the diligence and paid attention to the relationship and the background of the agent with regard to corruption controls. That diligence is part of the entire package of control that a company wants to put in place, and retaining that information in a file somewhere is part of the protection that the company is going to want to look back to if there is an issue in the future.

FCPAR: Are there any instances when a company may not want to document the due diligence?

Fisher: If a company is really trying to get the answer right and focus on the issue, I can't think of a reason why it wouldn't want to document it.

FCPAR: What kinds of problems can be uncovered during due diligence that should cause the company to end the relationship? Are there any types of problems that you think a company could work through and continue with the relationship?

Fisher: It's very fact specific. For instance, the third party may reveal that it has uncovered corruption issues in the past, but that issue was related to an employee that engaged in improper behavior in a separate line of business in a separate country. If the third party fired that employee and the investigation was closed and it now has the controls and compliance in place to make sure that doesn't happen again, the company may be able to work through that issue and have a relationship with the third party.

There are other issues that could be deal breakers. For example, if the company finds that the agent is lying to the company or making false statements, or doesn't really have the address it says that it has but has no explanation for that, it might not be good to go forward with the agent.

FCPAR: Should a company update its due diligence periodically and monitor the third parties already onboard? If so, how should this be done and how often?

Fisher: It is important to continue to monitor those third parties that are dealing with government entities on the company's behalf because third parties change; ownership of third parties change; circumstances of third parties change over time. A company should refresh that diligence and look on a regular basis. How regular is going to depend on the risk and the nature and the number of third parties and the resources that the company has to throw at it.