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Top Trends in Aerospace and Defense Industry Anticorruption Enforcement

Industry members and executives aware of industry trends and recent enforcement actions can take necessary compliance steps to minimize risk.

Several recent trends in enforcement of the Foreign Corrupt Practices Act (FCPA or the Act) and the UK Bribery Act (UKBA) in the aerospace and defense industry are critically important to industry executives due to their severity, scope and even undercover nature. We highlight ten such trends and provide real world examples of these trends in action. While all companies conducting business abroad should be concerned about complying with the FCPA, companies in the aerospace and defense industry are potentially more vulnerable to FCPA liability than others.

The aerospace and defense industry is heavily regulated, and industry members and their employees and agents often work with government end-customers. According to Trace International, aerospace and defense industry members have accounted for approximately twelve percent of the world's anticorruption enforcement actions since 1977, second only to the extractive industries like oil and mining.

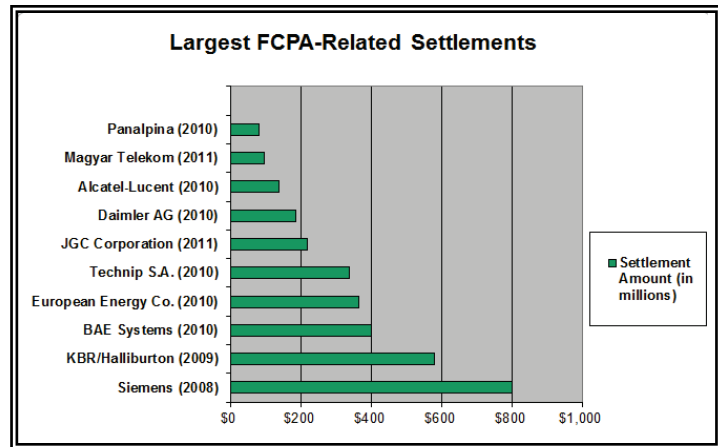
With the enforcement agencies' recent [FCPA Resource Guide](#) as background, this *Client Alert* provides a high-level overview of key aspects of the FCPA and UKBA and highlights recent developments that have impacted companies in the aerospace and defense industry. Readers interested in a more comprehensive discussion of recent trends and case studies involving aerospace and defense companies are encouraged to review our in-depth analysis entitled "[Understanding FCPA Enforcement Trends in the Aerospace and Defense Industry: A Launch Pad to Effective Management of Anticorruption Risks.](#)"

The FCPA

The [FCPA](#) criminalizes corrupt payments to foreign government officials for the purpose of obtaining or retaining business. The Act applies to improper payments made anywhere in the world and covers illegal payments made not only by company employees, but also by subsidiaries, joint venture partners and third party agents. US law enforcement's concept of "foreign official" covers not only officers and employees of foreign governments, but also anyone acting in an official capacity for or on behalf of a government department, agency or "instrumentality thereof," which can include employees of state-owned and state-controlled companies.

The FCPA also contains accounting provisions, known as the books and records provisions, which require companies to maintain books and records in reasonable detail to accurately account for and report all transactions and dispositions of their assets.

The Department of Justice (DOJ) and Securities and Exchange Commission (SEC) jointly enforce the FCPA. Corporations are subject to criminal fines of up to \$2 million per anti-bribery violation. Violations of the accounting provisions can subject corporations to fines of up to \$25 million. Individuals face criminal penalties of up to \$100,000 in fines and five years in prison. On the civil side, companies and individuals face fines of \$16,000 per anti-bribery violation. The collateral consequences of FCPA enforcement actions, including the forced retention of outside monitors and debarment from export privileges or government contracting, can be more costly for industry companies than criminal and civil fines.



The UKBA

The [UKBA](#) is broader, both in terms of scope and territorial reach, than the FCPA. Unlike the FCPA, which only targets bribe-givers, the UKBA contains two general offenses: active bribery, meaning offering, promising or giving a bribe; and passive bribery, or requesting, agreeing to receive or accepting a bribe. What's more, the UKBA targets *all* bribery, including bribery that is entirely within the private sector. The UKBA also creates a new form of corporate liability for *failing to prevent* bribery and provides for only one defense—that an organization had “adequate procedures” in place to prevent bribery.

The UKBA's territorial coverage is extensive. The UKBA governs all acts that take place within the UK, regardless of where the organization or individual who committed the act is based. In addition, the UKBA's anti-bribery provisions apply to acts committed outside the UK if the actor had a “close connection” to the UK. For individuals, this means a person who is a British national or resident; for companies, this means a body incorporated in the UK or a Scottish partnership. The failure to prevent bribery offense applies even more generally to all companies “carrying on business, or part of a business” in the UK.

Anticorruption Legislation in BRIC Countries

Although the FCPA and UKBA are the primary laws that will impact our clients, other countries have become increasingly active in their anticorruption efforts in recent years. In the span of just a few months, some of the world's most powerful emerging nations considered or passed laws criminalizing foreign public bribery. Effective May 2011, China amended its criminal code to make paying bribes to foreign government officials a crime. That same month, the Russian President signed into law a measure that imposes criminal sanctions on companies and individuals who make corrupt payments to foreign public officials. Lawmakers in India and Brazil have also considered similar anticorruption laws, but to date neither country has passed such legislation.

Ten Takeaways from Recent Anticorruption Enforcement Actions Against Aerospace and Defense Companies

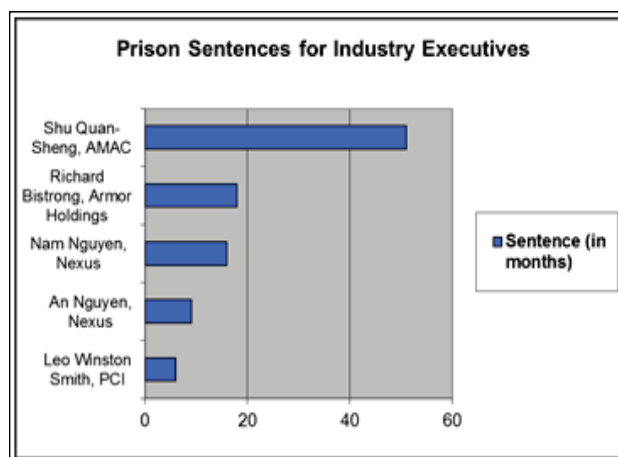
Aerospace and defense companies are particularly vulnerable to exposure under anticorruption laws for several reasons, among them:

- Industry companies often serve government end-customers, and are therefore in constant contact with foreign government officials;
- Industry companies regularly hire agents and foreign consultants to handle their on-the-ground transactions with host country officials; and
- The industry is heavily-regulated, resulting in greater scrutiny by government agencies and officials.

Industry members and executives who are aware of industry trends and recent enforcement actions can take the necessary compliance steps to minimize their risks.

1. **The Use of Third-Party Agents May Be The Single Riskiest Practice.** Over half of all aerospace and defense industry enforcement actions involve bribe payments by third-party agents working on behalf of aerospace and defense companies. Since companies generally cannot insulate themselves from FCPA liability by claiming ignorance of the fact that their agents paid bribes to foreign government officials on their behalves, it is critically important to vet and continuously monitor third-party agents. In 2011, Armor Holdings Inc. paid over \$15 million to settle criminal and civil charges that its subsidiary provided more than \$200,000 in commission to an agent, knowing that the agent was passing on some of the funds to a United Nations official in exchange for confidential bid information.

2. **Industry Executives Could Face Jail Time for Their Roles in Bribery Schemes.** One cornerstone of the government's FCPA enforcement strategy is to target corporate executives and sentence them to lengthy prison terms or impose costly civil fines. Aerospace and defense industry executives are no exception. In 2012, an executive of Armor Holdings Inc. was sentenced to 18 months in prison for his role in making and concealing \$4.4 million in illegal payments in order to obtain contracts abroad. In 2008, the President of AMAC International was



sentenced to 51 months in prison after pleading guilty to making illegal payments to Chinese officials to win a government contract. In 2009, the former President of ACL Technologies Inc. paid a \$35,000 civil penalty to settle charges that he authorized illegal payments to an agent in Egypt, knowing or disregarding the high probability that the agent would funnel the payments to Egyptian Air Force officials.

3. **DOJ Is Turning to Undercover Law Enforcement Tactics to Investigate Industry Members.** DOJ arrested 22 defense industry executives in Las Vegas during the 2010 SHOT Show Convention in the first major use of undercover law enforcement tactics, including audio and video surveillance, in the

history of the FCPA. Notably, none of the 22 industry executives were ultimately convicted of FCPA violations. Trials against the first two groups of defendants resulted in mistrials or acquittals. A federal judge eventually dismissed the charges against all the defendants, including three who had earlier pled guilty.

4. **The “Public Authority Defense” May Be Successful in Cases Involving National Security.** The UKBA provides an express exemption for corrupt payments that are necessary for the proper exercise of any function of an intelligence service or armed force. Although the FCPA’s anti-bribery provisions do not expressly exempt bribes paid for national security reasons, the Act’s books and records provisions indicate that the so-called “public authority defense” may be successfully used to mount a defense against FCPA charges. Under the Act, the duty to maintain accurate books and records does not apply to acts related to “matters concerning the national security of the United States” provided that such acts are based on a specific, written directive of a head of a federal department or agency. In one FCPA case, the former head of a New York merchant bank charged with making \$80 million in corrupt payments to government officials in Kazakhstan argued that he made the payments under the control and with the knowledge of several US government agencies, including the CIA. After seven years of litigation, the case ended with the executive pleading guilty to one count of a misdemeanor tax violation and receiving no fine or jail time.
5. **Multi-Jurisdictional Enforcement Actions and Follow-On Shareholder Lawsuits Could Lead to Even Larger Penalties.** Increasing multi-jurisdictional coordination in anticorruption investigations means that companies must consider that disclosing wrongful conduct to one country’s authorities may lead to investigations by other jurisdictions. In February 2010, a large European defense contractor settled anticorruption charges in the US and the UK. In the US, the contractor agreed to pay \$400 million to settle allegations that it knowingly made false statements to various government agencies about payments by third party agents to secure government contacts. Across the Atlantic, the company agreed to pay £30 million to settle allegations that it engaged in corruption in connection with contracts in Tanzania, the Czech Republic, South Africa and elsewhere.

Although private parties cannot enforce the FCPA, civil claimants may file shareholder derivative suits or other securities lawsuits in the wake of government investigations. In a 2007 lawsuit, which was eventually dismissed, shareholders of the City of Harper Woods Michigan Employee’s Retirement System alleged that directors and executives of BAE Systems breached their fiduciary duties and wasted corporate assets based on the company’s alleged bribe payments. Likewise, Faro Technologies Inc. paid \$7.4 million to settle a pair of shareholder lawsuits alleging that its officers and directors breached their fiduciary duties and benefited from inflated stock prices after failing to disclose alleged FCPA violations.

6. **The Existence of Successor Liability for Acts of Joint Venture and Merger Partners Means That Comprehensive Due Diligence Is Critical.** Successor liability in the FCPA context means that companies can be held liable for bribery activities committed by their joint venture and merger partners, even if the activities at issue occurred *before* the joint venture or merger took place. Consequently, pre-deal due diligence and post-deal monitoring of joint venture and merger partners are critical. US authorities have announced that they will generally only take action against successor companies in cases of egregious and sustained violations or where the successor company directly participated in the violations or failed to stop them post-acquisition. Given the risks, the discovery of FCPA violations

during due diligence could derail an otherwise viable transaction, such as the 2004 deal between Titan and Lockheed Martin, which stalled after Lockheed Martin discovered in pre-closing due diligence that Titan had made improper payments to consultants in Benin, Saudi Arabia and East Asia.

- 7. Operating in Certain Developing Nations Presents Heightened Risks.** Although recent industry enforcement actions involve alleged bribe payments in countries throughout the world, there are unique risks associated with doing business in certain countries. In some developing nations,



corruption is widespread and the legal infrastructure needed to combat corruption is lacking. The fact that many companies in countries like China are state-owned adds an additional layer of complexity. The need for industry companies to obtain government permits, licenses, or other approvals through processes that are rife with corruption can also exacerbate the FCPA risks associated with doing business in developing economies.

- 8. Even Dealings With Commercial Airlines Must Be Scrutinized If There Is a Degree of Government Ownership.** Many aerospace and defense companies do business with commercial airlines that are owned by the government. Because employees of state-owned and state-controlled entities are considered "foreign officials" under the FCPA, industry companies should not focus their FCPA compliance efforts solely on government customers. In 2012, the NORDAM Group, Inc., an aircraft maintenance, repair and overhaul provider based in Oklahoma, agreed to pay a \$2 million criminal fine as a result of allegations that it made \$1.5 million in corrupt payments to employees of state-owned airlines in China in order to obtain maintenance contracts from the airlines.

- 9. Satellite Companies Face Emerging Risks.** Satellite companies represent one area of overlap between the aerospace and defense industry and the telecommunications industry, which law enforcement has aggressively targeted in recent years. In 2012, UK authorities announced that they were investigating a company owned by a European defense contractor for alleged bribe payments to win a contract with a Middle Eastern country to upgrade its satellite and intranet systems. Given the continued growth and reliance upon satellite communications systems in the global economy, the potential anticorruption risks should be carefully assessed and appropriate compliance programs and internal controls implemented.

- 10. US Law Enforcement Has Other Tools in Its Prosecution Arsenal That Are Often Used in Conjunction With the FCPA.** The overlapping enforcement of anticorruption and export controls laws are particularly relevant to aerospace and defense companies who manufacture and sell military products subject to the International Traffic in Arms Regulations, known as the ITAR. DOJ has also sporadically used the Travel Act, a 50-year-old statute passed to combat organized crime and racketeering, which essentially federalizes state bribery statutes and allows prosecutors to use the FCPA to go after bribery that is entirely within the private sector. In a string of recent FCPA actions, the government alleged violations of the Travel Act under the commercial bribery statutes of Alabama, New Jersey and California in conjunction with the FCPA. US enforcement authorities also

rely on money laundering, asset forfeiture, mail and wire fraud, tax and conspiracy laws in connection with FCPA enforcement actions.

Latham & Watkins' Industry Group Platform

Latham & Watkins has been advising major clients in the aerospace and defense industry for decades and brings a deep knowledge and understanding of the business and legal challenges clients in the industry face. We represent private companies and government entities on a wide range of bet-the-company regulatory, transactional and litigation matters. Through our unique industry group platform, we are able to effectively deploy the vast and diverse resources resident in our 31 offices across the globe to address any legal needs our clients face.

Latham & Watkins attorneys have counseled hundreds of clients on compliance, enforcement and disclosure issues arising under the FCPA and have conducted numerous internal investigations for both US and foreign companies into potential violations of the FCPA. Implementing an effective compliance program not only reduces the risks that FCPA violations may occur, but also lessens the severity of the consequences should companies face enforcement actions. Latham & Watkins has assisted companies in formulating risk-based compliance programs, implementing anticorruption policies and procedures and developing training programs. For more information about the Latham & Watkins Aerospace, Defense & Government Services Industry Group or any of the trends and case studies discussed in this *Client Alert*, we encourage you to review ["Understanding FCPA Enforcement Trends in the Aerospace and Defense Industry: A Launch Pad to Effective Management of Anticorruption Risks."](#)

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