

Alerts & Publications

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Financial Services Industry and Individual Investors Face Increasing Scrutiny and Risks Under the Foreign Corrupt Practices Act

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Late Summer 2009 saw a number of new developments in the Foreign Corrupt Practices Act ("FCPA") enforcement and examination arenas that will assuredly have an impact on the financial services industry and investors. Collectively, these developments are a reminder that Wall Street cannot escape the uptick in anti-corruption enforcement both in the United States and overseas.

FINRA's Focus on the FCPA

On September 15, 2009, Michael G. Rufino, Senior Vice President for Member Firm Regulation at the Financial Industry Regulatory Authority ("FINRA"), announced that FINRA would begin examining broker-dealers for compliance with the FCPA in the fourth quarter of 2009. FINRA previously mentioned its plan to focus on FCPA compliance in its 2009 Examination Priorities Letter, when it wrote:

FINRA reminds firms of their obligations under the Foreign Corrupt Practices Act (FCPA). The FCPA prohibits any person or entity from giving or promising anything of value to a foreign government official, political party or party official with the intent to influence that official . . . to obtain or retain business. This applies to all U.S. individuals and companies, and includes the actions of any agents working on their behalf. The FCPA also requires all companies that are publicly traded

in the U.S. to maintain accurate books and records and to implement adequate internal controls to provide reasonable assurance that transactions are recorded properly.[1]

This pronouncement will force broker-dealers with international footprints to examine their existing FCPA compliance programs and benchmark them against ever-rising government expectations. And, as that process gets underway, it is likely FCPA issues will surface.

In addition to FINRA's FCPA examination efforts, the SEC continues to increase its FCPA enforcement focus. On August 5, 2009, SEC Director of Enforcement Robert Khuzami announced the creation of five specialized units within the Division of Enforcement, one of which will focus on the FCPA. As Khuzami noted:

The [FCPA] unit will focus on new and proactive approaches to identifying violations of the Foreign Corrupt Practice Act, which prohibits U.S. companies from bribing foreign officials for government contracts and other business. While [the SEC has] been active in this area, more needs to be done, including being more proactive in investigations, working more closely with our foreign counterparts, and taking a more global approach to these violations.[2]

The likely effect of the SEC's FCPA unit, if it fulfills its potential, will be increased cooperation between the SEC and its overseas counterparts, greater institutional FCPA knowledge, and more "industry-wide" investigations.[3]

United States v. Kozeny et al.

Evidence of the increased risk to the financial services industry and individual investors for violating the FCPA is the July 10, 2009 conviction of Frederic Bourke in the Southern District of New York. Bourke, an entrepreneur famous in-part for co-founding the purse designer Dooney & Bourke, was convicted of conspiring to violate the FCPA by a Manhattan jury for bribes paid to Azerbaijan government officials in 1998. Bourke was not, however, the individual that offered, arranged, or paid the bribes. Rather, Bourke was an investor in a group seeking to purchase the state-owned Azeri oil company, SOCAR, who had knowledge of the bribes, or could have had knowledge of the bribes had he completed adequate due diligence.

In an effort to ensure SOCAR's acquisition, members of Bourke's investment group paid Azeri officials millions of dollars, in addition to providing other things of value, in an attempt to rig the auction in which SOCAR would be sold so that only Bourke's investment group could prevail. The plan did not succeed, however, and Bourke and other investors, including Omega Advisors, Inc.,[4] lost over \$150 million when the group's leader, Viktor Kozeny, allegedly stole the money.

Kozeny is an Irish citizen of Czech descent who, by the time he allegedly

stole Bourke's investment, had already become known as the "Pirate of Prague" for embezzling money from his other investment clients in the unregulated investment environment following the fall of communism and the Soviet Union.[5]

That Bourke's investment group did not succeed in purchasing SOCAR – and Bourke lost his \$8 million investment – was no bar to prosecution under the FCPA. Nor was it a bar to prosecution that Bourke may not have been aware of the corrupt payments. On the latter point, the United States successfully argued that Bourke was guilty of violating the FCPA because he could have known about the corrupt payments if he had conducted adequate due diligence, but instead "consciously avoided" learning about them.

In an interview after the verdict was announced, the foreperson on Bourke's jury indicated the scope of the FCPA risk to ill-prepared investors when he stated: "It was Kozeny, it was Azerbaijan, it was a foreign country. We thought [Bourke] knew and definitely could have known. ***He's an investor. It's his job to know.***"[6]

A key lesson of the Bourke conviction is that parties investing overseas, particularly in regions with a history of corruption, must undertake due diligence and implement controls to ensure that no part of their investment – or any funds from co-investors – are used to make improper payments. As the words of the jury foreperson make clear, jurors share the view of the U.S. enforcement authorities that it is the "job" of the investors to avoid such risks. Lack of actual knowledge will not be an excuse.

Morgan Stanley's Chinese Real Estate Business

Bourke is not the only one who has had problems with the FCPA. On February 11, 2009, Morgan Stanley filed a Form 8-K with the SEC that included the following: "Morgan Stanley announced today that it has recently uncovered actions initiated by an employee based in China in an overseas real estate subsidiary that appear to have violated the Foreign Corrupt Practices Act. Morgan Stanley terminated the employee, reported the activity to appropriate authorities and is continuing to investigate the matter."[7] The full extent of the consequences to Morgan Stanley remains unknown, however, as the investigation is ongoing.

Lessons

For the financial services industry and individual investors, FINRA's announcement, Bourke's conviction, Omega Advisors Inc.'s settlement with DOJ, and the ongoing investigation of Morgan Stanley highlight the impact of the FCPA on the financial services industry. No longer is enforcement of the FCPA limited to traditional manufacturing and extractive industries. Rather, with the new SEC unit destined to get underway over the next few months, Wall Street now faces heightened risks of corruption investigations and prosecutions.

The lawyers in O'Melveny's FCPA Practice are actively engaged in

conducting internal investigations and transactional due diligence around the world; responding to criminal and regulatory enforcement inquiries and proceedings, as well as related administrative and civil actions; evaluating and implementing compliance programs, and providing prospective advice about issues in international business transactions. Our clients include US and international companies, among them Fortune 100 manufacturers, the world's largest financial institutions, diversified U.S. and offshore companies, and corporate executives. For more information on the FCPA, see the Sixth Edition of the O'Melveny and Myers FCPA handbook, *available* here, at O'Melveny's website.

[1] See 2009 FINRA Examination Priorities Letter from Robert C. Errico, Grace B. Vogel, and Thomas R. Gira to Executive Representatives (Mar. 9, 2009), *available* here.

[2] Robert Khuzami, Director, SEC Division of Enforcement, Remarks to the New York City Bar Association (Aug. 5, 2009), *available* here.

[3] See New FCPA Team at the SEC, WrageBlog (Sept. 4, 2009).

[4] For its part in the bid to acquire SOCAR, on July 6, 2007, Omega Advisors, Inc. entered into a non-prosecution agreement with the DOJ and agreed to forfeit \$500,000. The DOJ press release announcing the settlement is available here, at the DOJ's website.

[5] Kozeny was also indicted for his role in corrupt payments, but he is currently in exile in the Bahamas and the United States is appealing the decision refusing to extradite Kozeny to the United States for trial.

[6] For further detail on the facts of Bourke's case, see David Glovin, *Bourke Convicted of Bribery in Kozeny's Azerbaijan Oil Deal*, Bloomberg, July 11, 2009, here.

[7] Morgan Stanley's Form 8-K is available at here, at the SEC's website.