

Foreign Corrupt Practices Act Update

On April 26, 2007, the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) announced significant Foreign Corrupt Practices Act (FCPA) settlements with Baker Hughes Incorporated (Baker Hughes). The criminal and enforcement settlements total \$44 million in fines and penalties representing the largest monetary settlement ever imposed in an FCPA investigation.

In the criminal case, a subsidiary of Baker Hughes, Baker Hughes Services International, Inc. (BHSI), pleaded guilty to 3 counts: violations of the anti-bribery provisions of the FCPA, conspiracy to violate the FCPA, and aiding and abetting the falsification of the books and records of its parent company, Baker Hughes. The charges relate to the payment of \$4.1 million to a consulting firm in connection with a Kazakhstan oil services contract. In addition to the subsidiary's guilty plea, a criminal Information filed against Baker Hughes was resolved by a deferred prosecution agreement.

The complaint filed by the SEC addresses broader activity than the criminal charges. It details numerous potential FCPA violations and inadequate internal controls involving agents and brokers in Uzbekistan, Russia, Indonesia, Nigeria and Angola. The complaint specifically focuses on Baker Hughes's failure to implement sufficient internal controls to determine whether payments were for "legitimate services, whether the payments would be shared with government officials, or whether these payments would be accurately recorded in Baker Hughes' books and records." The SEC also specifically noted in its press release that "Baker Hughes committed widespread and egregious violations of the FCPA while subject to a prior Commission cease-and-desist Order."

These settlements with Baker Hughes reflect apparent impatience by government with companies that are "repeat offenders." This is the second "repeat offender" FCPA case in recent months. In February, the DOJ prosecuted various subsidiaries of Vetco International Ltd. including a subsidiary, Vetco Gray UK, that pleaded guilty to an FCPA violation in 2001. That subsidiary, ABB Vetco Gray Ltd. was later sold and became Vetco Gray UK. The group that acquired the ABB company requested an FCPA opinion from the DOJ dealing with successor liability at the time of the acquisition. The DOJ opinion relied on the company to institute and implement a compliance system and internal controls sufficient to detect FCPA violations. Nevertheless, the corrupt activity continued after the acquisition.

Similarly, Baker Hughes had a prior FCPA history. A SEC cease-and-desist order against Baker Hughes was entered in 2001, which related to payments on behalf of Baker Hughes by an accounting firm in connection with an Indonesian tax assessment. As part of the prior settlement, the company committed to implementing enhanced FCPA compliance procedures. Much, but not all, of the activity detailed in the current settlement postdates the prior settlement. As a result, despite the DOJ's and the SEC's acknowledgement that Baker Hughes cooperated with their investigations and voluntarily disclosed its wrongdoing, the settlements seem intended to send a strong enforcement message. They include a significant monetary settlement, multiple criminal pleas **and** a deferred prosecution agreement with stringent terms.

Facts

According to the filed pleadings in the criminal case, the government of Kazakhstan and the State

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owned Kazakhoil entered into an agreement with a consortium of four international oil companies for the purpose of developing and operating a giant oil field. In February of 2000, BHSI submitted a bid on behalf of Baker Hughes to perform comprehensive services such as project management, oil drilling and support services in connection with the Karachaganak contract.

In early September of 2000, Baker Hughes received unofficial notification that its bid was successful. However, soon thereafter, a Kazakhoil official demanded and BHSI agreed to pay a commission to "Consulting Firm A" located on the Isle of Man in order for Baker Hughes to win the Karachaganak contract.

In October 2000, Baker Hughes won the Karachaganak contract. From May 2001 through November 2003, Baker Hughes made commission payments to Consulting Firm A totaling \$4.1 million which represented 2.0% of the revenue earned by Baker Hughes and its subcontractors on the project. Consulting Firm A performed no services for Baker Hughes. The government charged that Baker Hughes failed to properly account for the purported commission payments to Consulting Firm A by improperly characterizing the bribes as legitimate "commissions," "fees," or "legal services." BHSI understood that the payments were to be transferred to undisclosed official(s) of Kazakhoil in exchange for which Baker Hughes and BHSI would receive the contract to provide services on the Karachaganak contract.

The Settlements

The DOJ agreement with Baker Hughes called for a recommended criminal fine of \$11 million. The SEC settlement included more than \$23 million in disgorgement of profits and a \$10 million civil penalty.

The deferred prosecution and plea agreements with the DOJ include several interesting terms. The agreements require the adoption of a rigorous compliance code. Specifically, the agreements dictate aspects of that code including training and certifications by management. The agreements also detail, at length, due diligence procedures that must be used and documented in contracting with agents and business partners. The adequacy of the required compliance initiatives will be reviewed by an Independent Monitor for three years. Any recommendations by the monitor concerning compliance must ultimately be implemented by the company.

The deferred prosecution agreement with the DOJ also reflects the changing climate for requests by DOJ for a waiver of the attorney-client privilege. Baker Hughes is required to "cooperate" during the two-year term of the agreement by reporting any corrupt payments. Apparently, as a result of the new policies contained in the December 12, 2006 "McNulty Memo," the deferred prosecution agreement allows the company to refuse to waive the attorney-client privilege. The DOJ, however, reserves the right to consider the refusal to waive the privilege in evaluating the company's cooperation.

Lessons Learned

Enforcement of the FCPA by the DOJ and SEC is increasing. In cases over the last few years, both agencies have shown an expansive view of their jurisdiction over foreign companies. In recent months, the FBI has committed additional resources out of headquarters to these investigations and the Fraud Section in the Criminal Division has likewise sought to increase its profile. Companies need to focus on the efficacy of their compliance programs. Existing programs need to be periodically audited to ensure that they incorporate "best practices" especially as those practices are defined by recent prosecutions and settlements. The Baker Hughes cases reemphasizes the need for appropriate due diligence when dealing with agents, consultants and brokers. The disruptive nature and high monetary costs of internal investigations after a problem is discovered far outweigh the costs of implementing well-designed programs before potential FCPA violations arise. Although both the DOJ and SEC claim to reward voluntary disclosure, it is clear that they also consider when and why compliance programs fail in deciding on the appropriate remedy.

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