

THE FOREIGN CORRUPT PRACTICES ACT IN THE PRIVATE EQUITY ERA: EXTRACTING A HIDDEN ELEMENT

INTRODUCTION

A. *The Report*

In 1976, the U.S. Securities and Exchange Commission (SEC) submitted to Congress the results of an extensive investigation into accounts of questionable payments made by U.S. corporations overseas.¹ The report's findings were nothing short of tremendous: more than 400 companies voluntarily admitted to making improper or illegal payments.² Of those companies, a significant number were publicly held, and more than 100 hailed from the ranks of the Fortune 500.³ Taken together, the questionable payments exceeded \$300 million and spanned a broad range of U.S. industries.⁴

However extraordinary its findings, the SEC's report could not have come as much of a shock. Indeed, the SEC had captured a snapshot of a prevailing culture of corruption long since absorbed by the global economy.⁵ In an era of rapid economic development in the third world, an era in which multinational corporations wrestled for market share in undeveloped and often anarchic economies, the bribery of foreign officials was understood to occur as a matter of course.⁶ In this environment, corporations intent on expanding internationally while keeping their finances above-board faced a competitive disadvantage.⁷

That Congress previously had been willing to tolerate these practices is testimony to the importance it (or, more precisely, members of the respective

¹ SEC. & EXCH. COMM'N, 94TH CONG., REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES 1 (Comm. Print 1976).

² H.R. REP. NO. 95-640, at 4 (1977), available at <http://www.usdoj.gov/criminal/fraud/fcpa/history/1977/houseprt.html>.

³ *Id.*

⁴ *Id.*

⁵ See JEFFERY BIALOS & GREGORY HUSISIAN, THE FOREIGN CORRUPT PRACTICES ACT: COPING WITH CORRUPTION IN TRANSITIONAL ECONOMIES 9-12 (1997).

⁶ *Id.* at 12-13.

⁷ See *id.* at 26-27 (observing that the unilateral nature of the Foreign Corrupt Practices Act created an "unlevel playing field" for U.S. companies).

banking and finance committees) placed on the uninhibited expansion of U.S. businesses overseas.⁸ The SEC's contribution was to give the issue a palpable and public texture—a development that made congressional consideration unavoidable. Far from a legislative revelation, Congress's decision to turn its eye to foreign corruption reflected a shifting calculus—a shift that, unsurprisingly, coincided with the final months of the Watergate investigation.⁹ In 1977, one year after the SEC released its unsettling report, Congress responded by passing the Foreign Corrupt Practices Act (FCPA).¹⁰ The purpose of the law was straightforward: to prohibit corporate bribery abroad and encourage rigorous and faithful bookkeeping at home.¹¹

B. The Age of Expansion

Before discussing the law in further detail, it is worth exploring some of the distinctions between today's corporate landscape and the one upon which Congress looked when it drafted the bill. If the SEC Report made one thing clear to the 94th Congress, it was that corrupt activity often followed in the wake of expansions of corporate operations overseas.¹² Prior to the passage of the FCPA, federal law did not forbid companies from making corrupt payments to foreign officials.¹³ When the SEC successfully prosecuted a company for an illicit payment, it was because the agency could prove that the company failed to disclose a "material" transaction in violation of U.S. securities law.¹⁴ Not surprisingly, many U.S.-based multinational corporations made a habit of using foreign subsidiaries as conduits to pass off corrupt payments.¹⁵ Conscious of this pattern, Congress built vicarious liability

⁸ In fact, Congress initially considered a much softer, disclosure-based approach to regulating corruption. See H.R. REP. NO. 95-640, at 19 (1977).

⁹ See H. Lowell Brown, *Parent-Subsidiary Liability Under the Foreign Corrupt Practices Act*, 50 BAYLOR L. REV. 1, 2-3 (1998) (arguing that the Watergate investigation brought the issue of corruption to the forefront of public discussion).

¹⁰ Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78m, 78dd-1, 78dd-2, 78dd-3, 78ff (2006).

¹¹ See H.R. REP. NO. 95-640, at 4-6; 15 U.S.C. § 78m(b).

¹² See DONALD R. CRUVER, *COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT: A GUIDE FOR U.S. FIRMS DOING BUSINESS IN THE INTERNATIONAL MARKETPLACE* 3-5 (2d ed. 1999) (referencing a number of instances detailed in the SEC report involving large, multinational U.S. corporations and their foreign affiliates).

¹³ *Id.* at 2.

¹⁴ *Id.* at 2-3.

¹⁵ See, e.g., *id.* at 4 (referencing the SEC's prosecution of the General Tire & Rubber Company, during which the company admitted that foreign affiliates had paid, in total, more than \$10 million in bribes in three separate countries).

provisions into the FCPA to deter circuitous payments and to encourage parent corporations to proactively monitor the conduct of their subsidiaries.¹⁶

While the parent-subsidiary model of expansion is still prevalent today—in fact, one practitioner’s review of recent FCPA enforcement activity reveals that most FCPA actions arise from such relationships¹⁷—and while multinational expansion is still a significant engine of economic growth,¹⁸ this Comment focuses on the more contemporary trend of international private equity investment. In particular, it poses three critical questions. First, does the FCPA, as adopted and as historically interpreted and enforced, reflect certain assumptions regarding the relationship between the U.S. investor and the foreign investee? Second, if it does, what is the nature of the presumed relationship, and to what extent should the application of the law vary in a different context? Third, are there principles or policy objectives that might prove instructive in applying these provisions in a modern, more complex investment environment? This Comment takes the position that such assumptions pervade the FCPA and its history of enforcement. Further, it argues that those assumptions must be parsed and carefully considered before applying the FCPA in a new context.

C. The Emergence of Private Equity

While private sector finance has existed for decades, international private equity (or at least our contemporary understanding of the term) took hold in the mid-1990s, by which point a global consensus had emerged that private companies, as opposed to states and large banks, would play an increasingly important role in financing investment and development in emerging markets.¹⁹ For purposes of this Comment, private equity refers to financing for privately held companies from third-party investors seeking above-market rates of return.²⁰ Private equity is a valuable source of financing for small and

¹⁶ H.R. REP. NO. 95-640, at 12. The House Report cites a survey of public documents filed with the SEC revealing that, at the time of the filings, at least 64 publicly held companies had made corrupt payments through foreign subsidiaries. *Id.* at 12 n.2.

¹⁷ See DANFORTH NEWCOMB & PHILLIP UROFSKY, SHEARMAN & STERLING LLP, FCPA DIGEST OF CASES AND REVIEW RELEASES RELATING TO BRIBES TO FOREIGN OFFICIALS UNDER THE FOREIGN CORRUPT PRACTICES ACT OF 1977 (2008), available at http://www.shearman.com/files/upload/FCPA_Digest.pdf.

¹⁸ See Earl H. Fry, *North American Economic Integration: Policy Options 2* (Ctr. for Strategic & Int’l Studies, Policy Papers on the Americas, vol. 14, study 8, 2003).

¹⁹ Roger Leeds & Julie Sunderland, *Private Equity Investing in Emerging Markets*, J. APPLIED CORP. FIN., Fall 2003, at 111.

²⁰ *Id.*

mid-sized companies, many of which have risk profiles that make it difficult to raise capital through conventional channels.²¹ Private equity was popularized as a gap-filling vehicle, a source of capital for those companies large enough to seek external finance but not yet mature enough to obtain it from major lenders or public equity investors.²² Somewhere along the way, the private equity model matured from a chic cottage industry to a \$100 billion-plus investment sector.²³ It is from this vantage point that this Comment considers the historical context of the FCPA.

D. Critical Distinctions

When contrasted with the expansion-intensive trends of the 1970s, the rise of the private equity model brings some important distinctions to light. First, consider motivation. As already alluded to, multinational corporations sending capital overseas were historically motivated by their thirst for expansion.²⁴ As many do today, these corporations entered developing markets in search of economies of scale and lower operating costs.²⁵ Their motivation was strategic, their approach hands-on. In these instances, foreign subsidiaries typically operated as extensions of their U.S. parent corporations, often clearly identifiable with the U.S. company and, in some instances, bearing its name.²⁶

Contrast the typical private equity investor. Whether institutional or individual, private equity investors are purely profit-driven.²⁷ Once an attractive rate of return draws their eye, regulations permitting, their money is all but certain to follow.²⁸ Put differently, private equity investors are not concerned with strategic expansion and exposure, but only with financial

²¹ *Id.* at 111–12.

²² *Id.*

²³ JAMES M. SCHELL, PRIVATE EQUITY FUNDS: BUSINESS STRUCTURE AND OPERATIONS § 1.01 (2007); John C. McIlwraith, *The Outlook for the Private Equity Market*, 51 CASE W. RES. L. REV. 423, 425–26 (2001).

²⁴ Michael J. Moser & Seung Chong, *How Private Equity Investors Can Avoid Directors' Liability*, INT'L FIN. L. REV., Mar. 2003, at 23.

²⁵ PETER DICKEN, GLOBAL SHIFT: RESHAPING THE 21ST CENTURY 26–51 (4th ed. 2003).

²⁶ See generally NEWCOMB & UROFSKY, *supra* note 17 (listing a number of examples of parent-subsidiary relationships in which the subsidiaries are clearly identifiable with the parents, such as York International Corp./York Air Conditioning & Refrigeration, Inc., and Willbros Group Inc./Willbros International).

²⁷ See N. MITCHELL, YOUNG VENTURE CAPITAL SOC'Y, HIGHER RETURNS, HIGHER RISK ~ PRIVATE EQUITY INVESTMENTS IN EMERGING MARKETS (2006), available at [http://www.yvcs.org/uploads/1139265064Higher>Returns,HigherRisk_PE in Emerging Mkt.pdf](http://www.yvcs.org/uploads/1139265064Higher>Returns,HigherRisk_PE%20in%20Emerging%20Mkt.pdf) (discussing the private equity market's shift to emerging markets); SCHELL, *supra* note 23, §§ 1.02[3], 2.01 (noting that fund managers often encounter a “no excuses” attitude from investors when it comes to financial returns).

²⁸ SCHELL, *supra* note 23, §§ 1.02[3], 2.01.

fundamentals. This leads to a second distinction. As bottom-line-driven investors, private equity players are typically ready and willing to take their hands off the wheel.²⁹ Whereas overseas expansion often requires extensive involvement on behalf of the parent company in order to ensure an efficient integration of the foreign operation, private equity firms are less likely to play a hands-on role in the day-to-day management of a venture.³⁰ This is especially true in the international private equity context, where fund managers, lacking specific industry expertise and knowledge of foreign business customs, often rely on local partners to pilot operations.³¹ Further, when an investor does retain significant contractual rights, it is usually reactive control—typically in the form of limited veto rights over major corporate decisions—instead of proactive control over day-to-day operations.³² It is important to emphasize that these companies are merely investment targets (as opposed to strategic extensions of a parent corporation) and thus will often retain their original foreign identity.

An additional distinction relates to timing. In contrast to the long-term investment of capital and resources likely to be involved in a typical corporate expansion, private equity deals often progress on expedited timelines. Unlike operating companies that enjoy a perpetual existence, private equity funds, by their terms, are limited-life vehicles—most are required to be liquidated by a specific date.³³ As a result, these funds look to exit an investment when their financial returns are optimized, and the arrangement with the target company will often facilitate some form of liquidity event to allow for the return of the investment.³⁴ The short-term nature of this investment horizon makes it less likely that it will enjoy substantial influence over the operations of the foreign company. These distinctions must be kept in mind as this Comment considers

²⁹ Joseph A. McCahery & Erik P.M. Vermeulen, *The Contractual Governance of Private Equity and Hedge Funds* (2007), available at [http://www.iccwbo.org/uploadedFiles/Governance of Private Equity and Hedge Funds.pdf](http://www.iccwbo.org/uploadedFiles/Governance%20of%20Private%20Equity%20and%20Hedge%20Funds.pdf); see also Kenneth Anderson, *Three Roles for the Private Equity Market in Foreign Investments: Comment on Mailander's "Searching for Liquidity,"* 13 AM. U. INT'L L. REV. 125, 128 (1997).

³⁰ See McCahery & Vermeulen, *supra* note 29.

³¹ Leeds & Sunderland, *supra* note 19, at 114–15 (discussing common tensions between private equity firms and local managers).

³² Peter H. Sullivan & Geoffrey Lim, Lombard Investments, Inc., *Corporate Governance and Private Equity*, in GLOBAL CORPORATE GOVERNANCE GUIDE 2004, available at http://www.globalcorporategovernance.com/023_027.htm.

³³ SCHELL, *supra* note 23, § 9.02[1].

³⁴ See Valentine V. Craig, *Merchant Banking: Past and Present*, FDIC BANKING REV., Fall 2001, at 31–32, available at www.fdic.gov/bank/analytical/banking/2001sep/br2001v14n1art2.pdf (noting that these investment structures often have “contractually fixed” lives that end when the capital interest is repurchased).

the appropriate scope of the application of the FCPA to the private equity model.

Part I of this Comment provides an overview of the FCPA, with a particular focus on the various channels of liability built into the law's anti-bribery provisions. Part II examines the ascendance of the private equity sector, beginning with a brief history of its development and presenting two representative investment scenarios, which will help to guide the analysis in Part V. Part III of this Comment explores the legislative history surrounding the FCPA's passage in 1977, as well as its subsequent amendments, with the aim of extracting a set of guiding principles that will prove instructive in applying the law in the private equity setting. Part IV examines recent FCPA enforcement activity in search of any pertinent applications of the law's principles and policies. With these conclusions in mind, Part V uses a basic factual illustration to reexamine the two principal private equity scenarios in order to determine whether and to what extent FCPA liability might attach. Finally, the Conclusion suggests an approach to applying the policy and purposes of the FCPA to the foreign private equity model as it exists in the current investment climate.

I. AN OVERVIEW OF THE FOREIGN CORRUPT PRACTICES ACT

The FCPA consists of two main components: the books and records provisions and the anti-bribery provisions.³⁵ Aside from their scope and application, the two sections vary in some conceptually important ways. The books and records section, for instance, is fundamentally prescriptive; it contains an intricate set of accounting and recordkeeping guidelines intended to reduce the likelihood of corruption among complying corporations.³⁶ In contrast, the anti-bribery component operates proscriptively to punish companies found to have engaged in corrupt activities overseas.³⁷

A. *Books and Records*

The books and records section of the FCPA extends only to issuers—those companies that list securities and are required to make periodic reports

³⁵ 15 U.S.C. §§ 78dd-1, 78dd-2, 78m(b) (2006).

³⁶ See 15 U.S.C. § 78m(b); STUART H. DEMING, *THE FOREIGN CORRUPT PRACTICES ACT AND THE NEW INTERNATIONAL NORMS* 21–22 (2005).

³⁷ See 15 U.S.C. §§ 78dd-1, 78dd-2.

pursuant to the Securities and Exchange Act.³⁸ As already indicated, these provisions lay out general accounting guidelines to ensure that financial statements accurately and in good faith reflect the financial health of the issuer. In addition, this section of the FCPA requires issuers to institutionalize honest recordkeeping through disclosure requirements, monitoring programs, and internal control systems.³⁹ The SEC, which traditionally has jurisdiction over issuers, is responsible for enforcing the books and records provisions.⁴⁰

B. Anti-Bribery

The anti-bribery provisions are, at least from a contemporary standpoint, the focal point of the FCPA.⁴¹ By and large, this section of the law prohibits the payment of anything of value if the payer has knowledge that the payment's purpose is to corruptly influence a government decision overseas.⁴²

1. Jurisdiction

The anti-bribery component of the FCPA casts a wider jurisdictional net than its recordkeeping counterpart. Along with issuers, the anti-bribery provisions apply to "domestic concerns," the law's catchall term for any individual or non-issuer business entity with even the slightest hint of legal personality.⁴³ Specifically, Congress defines domestic concern to include:

(A) any individual who is a citizen, national, or resident of the United States; and

(B) any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws . . . of the United States.⁴⁴

³⁸ 15 U.S.C. § 78m(b)(2)(A).

³⁹ 15 U.S.C. §§ 78m(b)(2)(B)(i)–(iv); *see also* SEC v. Benson, 657 F. Supp. 1122, 1132 (S.D.N.Y. 1987).

⁴⁰ 15 U.S.C. § 78m(b); Notification of Enactment of Foreign Corrupt Practices Act of 1977, 43 Fed. Reg. 7752 (Feb. 16, 1978).

⁴¹ *See* Brown, *supra* note 9, at 4–7 (noting that the anti-bribery provisions have always proved more controversial than the books and records provisions).

⁴² *See* 15 U.S.C. §§ 78dd-1, 78dd-2.

⁴³ *Id.* § 78dd-2.

⁴⁴ *Id.* § 78dd-2(h)(1). This prohibition also applies to any individual "officer, director, employee or agent . . . acting on behalf of such domestic concern." *Id.* § 78dd-2(a). Because private equity firms are almost always privately held, this will be the section of the anti-bribery provisions most relevant to this Comment.

Additionally, the FCPA extends jurisdiction to any individual or entity—regardless of nationality or principal place of business—that, while in the territory of the United States, acts in furtherance of a corrupt payment abroad.⁴⁵ This extension, the result of a 1998 amendment to the law, represents a jurisdictional high-water mark for the FCPA, as it authorized enforcement against extraterritorial conduct.⁴⁶

2. *Statutory Elements*

In order to establish liability under the FCPA, the government must demonstrate that an issuer, domestic concern, or any other person (assuming in the case of any other person that the individual or entity acted within the territory of the United States) acted: (1) making use of a means or instrumentality of interstate commerce; (2) corruptly; (3) in furtherance of a payment, offer, or promise; (4) of anything of value; (5) to any foreign official, any foreign political party, any foreign political party official, any candidate for foreign office, or any other person while knowing that any portion of the payment or the promise to pay would be passed on to one of the foregoing; (6) for the purpose of influencing an official act or decision of the person; (7) to obtain or secure business.⁴⁷

While each element has proven rich in substance and complexity, the narrow scope of this Comment's inquiry requires a focus on those elements that have unique application in the private equity context. For instance, the first clause of element (5), as far as it relates to foreign officials, has no special relevance to the structure of a private equity deal and thus, for analytical purposes, can be held constant. This is true of any FCPA provision relating to the back-end of a bribery scheme. This Comment is similarly unconcerned with instances of liability occasioned by the direct payment from a U.S. company to a foreign official. In such instances, it does not matter whether the bribing party is a private equity firm or a sole proprietor; in either case, liability is direct and definitive. Also of little concern are the limited situations where the government invokes the FCPA to assert jurisdiction over a foreign

⁴⁵ *Id.* § 78dd-3.

⁴⁶ The International Anti-Bribery and Fair Competition Act, Pub. L. No. 105-366, 112 Stat. 3302 (1998); George J. Terwilliger III, *FCPA Enforcement: Acts of Subsidiaries*, NAT'L L.J., Apr. 18, 2005, at 13.

⁴⁷ 15 U.S.C. § 78dd-2(a).

entity directly.⁴⁸ Rather, for the purposes of this Comment, the rubber hits the road where prevailing theories of vicarious liability under the FCPA are tested against the novel and innovative business structures native to the private equity sector.

3. *Vicarious Liability*

Foreign bribery schemes often involve third-party agents and elaborate networks of conduits.⁴⁹ Acknowledging this, Congress was careful to lay clear statutory groundwork to discourage U.S. entities from making corrupt payments indirectly.⁵⁰ There are three independent theories of vicarious liability under the FCPA.

First, liability will attach to an entity for payments to a third party if such payments were made with the knowledge that all or a portion of the payments would be offered or given, directly or indirectly, to a foreign official.⁵¹ As a predicate to establishing liability under a knowledge theory, the anti-bribery provisions require a demonstration that the domestic concern acted “in furtherance” of the corrupt payment or offer.⁵² This inquiry is straightforward when the payment is direct—from the wallet of one company to the bank account of a government official.⁵³ The question is less clear-cut, but still readily understood, when one considers a payment made to an intermediary with the awareness that it would be passed along as a bribe.⁵⁴ But what about an investor’s non-earmarked payment to the general account of a foreign company as part of its committed capital contribution? If a company official later draws from that account to finance a corrupt payment, can the investor be

⁴⁸ As a result of the 1998 amendments to the law, it is now possible to assert prescriptive jurisdiction over a foreign entity so long as part of the conduct in furtherance of the bribe took place in the United States. *See id.* § 78dd-3; Brown, *supra* note 9, at 19 n.60.

⁴⁹ H.R. REP. NO. 95-640, at 12 (1977).

⁵⁰ *Id.*; *see also* 15 U.S.C. § 78dd-2(a)(3) (prohibiting the payment of anything of value to “any person, while knowing that all or a portion of such money or thing of value will be offered . . . to any foreign official”).

⁵¹ 15 U.S.C. §§ 78dd-1(a)(3) (issuers), 78dd-2(a)(3) (domestic concerns); *see also* SEC Charges Baker Hughes with Foreign Bribery and with Violating 2001 Commission Cease-and-Desist Order, Litigation Release No. 20094 (Apr. 26, 2007), *available at* <http://www.sec.gov/litigation/litreleases/2007/lr20094.htm> [hereinafter Litigation Release No. 20094] (U.S. provider of oil products charged with violations of the FCPA for paying approximately \$5.2 million to foreign agents while knowing that “some or all of the money was intended to bribe government officials”).

⁵² 15 U.S.C. § 78dd-2(a).

⁵³ *See* Litigation Release No. 20094, *supra* note 51.

⁵⁴ *See In re Gore*, Exchange Act Release No. 38,343, 63 SEC 2435 (Feb. 27, 1997), *available at* 1997 WL 94186.

said to have acted in furtherance of the bribe? This is a question that will inevitably arise when one considers the FCPA in the private equity context, a question unaddressed in the legislative history. One scholar suggests that whether such preliminary acts constitute acting in furtherance of a payment will be adjudicated on a case-by-case basis.⁵⁵

Second, an entity is vicariously liable under the FCPA if it authorizes a third party to offer or pay anything of value to a foreign official.⁵⁶ This theory holds true even in the event that money does not change hands between the entity and third party. So long as the third party makes the payment on behalf of the entity, the entity's express or implicit authorization will trigger liability.⁵⁷

Finally, like most statutes of its kind, the FCPA incorporates the well-established principle of corporate law that holds a company liable for the illicit conduct of its "alter egos"—those entities with which it has institutional and operational ties so close that it becomes necessary to pierce the corporate veil that separates them.⁵⁸ The effect of this principle is to unify the two entities for the purpose of establishing liability.⁵⁹ Notably, this agency theory of liability still requires knowledge on the part of the principal.⁶⁰

II. THE PRIVATE EQUITY MODEL

Notwithstanding confusion to the contrary, private equity refers less to a type of investment than to a vehicle of investment and, to some extent, the investment criteria of that vehicle. Private equity firms pool capital from foundation investors into large funds.⁶¹ It is typical for a private equity firm to be set up as a limited liability company or partnership.⁶² In this capacity, the firm's manager plays the role of a general partner, and its investors function as passive limited partners or non-manager members.⁶³ Firms call capital from these funds to purchase companies or stakes of companies they deem to be

⁵⁵ BIALOS & HUSISIAN, *supra* note 5, at 33 n.18.

⁵⁶ 15 U.S.C. § 78dd-2(a) (prohibiting the "authorization of the giving of anything of value").

⁵⁷ See DEMING, *supra* note 36, at 33.

⁵⁸ Brown, *supra* note 9, at 21.

⁵⁹ *Id.*

⁶⁰ *Id.* at 21–22 n.73 (citing *United Elec., Radio & Mach. Workers of Am. v. 163 Pleasant St. Corp.*, 960 F.2d 1080, 1093 (1st Cir. 1992)).

⁶¹ SCHELL, *supra* note 23, § 1.01.

⁶² *Id.*; Craig, *supra* note 34, at 31.

⁶³ Craig, *supra* note 34, at 31.

undervalued. From the investor's vantage point, the private equity market is illiquid and high-risk, its major enticement being the potential for astronomical (or at least above-market) returns.⁶⁴ The investments are typically raised through private placements exempt from many of the most onerous requirements of state and federal securities laws.⁶⁵ These exemptions are predicated on the assumption that investors are wealthy and sophisticated.⁶⁶ Accordingly, most foundational capital originates from large, institutional investors.⁶⁷

The private equity model of investment is negotiated in nature—that is to say, the structure of an investment will depend on the result of a bargaining process between the investing equity group (the Fund) and the targeted growth company (the Company).⁶⁸ These negotiations touch on a range of considerations, the most important of which concern the degree of control ceded to the Fund and the percentage of return the firm receives from growth in the Company's profits. These negotiations often yield intricate and highly involved legal arrangements that bear little resemblance to the traditional parent-subsidary model. Indeed, in instances when the investing firm reserves a seat on the investee's board of directors, the appointed director will typically sit on a number of similar boards and is unlikely to have any prior relationship with other board members.⁶⁹ Regardless of its varying degrees of intricacy, the private equity model can be crudely distilled into a three-step process: (1) purchase a stake in an undervalued company; (2) increase the company's profitability; and (3) sell the stake in the company.

A private equity investment can assume a number of forms. However, in assessing the risk of liability, the most important variable to consider is the size of the equity investor's stake in the Company. The traditional domestic private equity model involved the purchase of a majority stake in the investee.⁷⁰ Historically, investors financed these purchases by putting up a small portion

⁶⁴ Susan E. Woodward, Sand Hill Econometrics, Measuring Risk and Performance for Private Equity (Aug. 11, 2004), <http://www.sandhillecon.com/pdf/MeasuringRiskPerformance.pdf>.

⁶⁵ SCHELL, *supra* note 23, § 8.01.

⁶⁶ *Id.*

⁶⁷ See Craig, *supra* note 34, at 31–32.

⁶⁸ See Private Equity—Impact Executives, <http://www.impactexecutives.com/industry-sectors/private-equity.html> (last visited June 18, 2009); Larkspur Capital, Private Equity, <http://www.larkspur.com/services-PE.html> (last visited June 18, 2009).

⁶⁹ Moser & Chong, *supra* note 24, at 23. Compare this to a traditional investment by a multinational corporation, in which the parent company fills the board with its own staff. *Id.*

⁷⁰ McIlwraith, *supra* note 23, at 424.

of the cost and leveraging the rest against the investee's assets, pieces of which were often sold after the transaction.⁷¹

While leveraged buyouts still occur today, it has become increasingly common for private equity firms to pay for purchases with capital on hand.⁷² Such firms are now also more likely to take minority positions in a broad array of companies, thereby diversifying their investment risk.⁷³ In fact, many fund documents require the fund to limit the amount of its assets invested in any one company, typically by value or percentage of the fund's assets.⁷⁴ Minority investments are particularly common in the international context, where the combination of higher risk and the need for local partners makes majority buyouts less plausible.⁷⁵ In any case, the size of the investment will ultimately shape the degree of influence reserved to the Fund over the governance of the Company. Such influence can range from a seat on the Company's board of directors to veto rights over certain policy decisions to the ability of the investor to initiate corporate action and appoint management, i.e. effective control.⁷⁶

This Comment examines two models of private equity investment, both representative of a varying degree of investor control. These models are simplistic by design and in no way intended to represent the full spectrum of private equity investments. Rather, it is hoped that these hypothetical investments will provide a more concrete framework for examining the principles and policies underlying the FCPA.

Model A:

Fund A, a U.S. private equity firm, purchases a 66% stake in Company A, a privately held foreign corporation. By virtue of the percentage of its

⁷¹ ALEX BANCE, EUROPEAN PRIVATE EQUITY & VENTURE CAPITAL ASSOC., WHY AND HOW TO INVEST IN PRIVATE EQUITY 3 (2004), available at http://www.vengrow.com/downloads/Why_and_How_to_Invest.pdf.

⁷² McIlwraith, *supra* note 23, at 434.

⁷³ Moser & Chong, *supra* note 24, at 23.

⁷⁴ See SCHELL, *supra* note 23, § 9.07[2][b]. Schell states that:

In the case of most private equity funds, a policy concerning diversification is imposed as a contractual requirement. In many cases, a private equity fund will generally not be allowed to invest more than 20 to 25 percent of its total Capital Commitments in the securities of any single Portfolio Company.

Id.

⁷⁵ See Leeds & Sunderland, *supra* note 19, at 111–12.

⁷⁶ McIlwraith, *supra* note 23, at 425–27.

ownership interest, Fund A acquires the requisite control under Company A's organizational documents (a combination of its charter, shareholder agreement, and applicable corporate law) to initiate policy changes. Fund A is vested with plenary veto rights over any issues put to vote before the shareholder and assumes control of the board of directors. This leaves Fund A with control over the choice of Company A's day-to-day managers and officers. Fund A can also elect to control as much or as little of the day-to-day operations as it chooses. This model most closely resembles the parent-subsiary structure prevalent in the U.S. foreign expansion climate at the time of adoption of the FCPA.⁷⁷

Depending on the foreign country, corporate laws may preserve residual voting rights for Company A's minority shareholders. Otherwise, such rights might vest in minority shareholders through contractual agreement.⁷⁸ In either case, the product of Model A is a corporate arrangement under which Fund A retains affirmative managerial control subject to particular residual rights retained by Company A's minority shareholders.

Model B:

This model (the most divergent from the parent-subsiary structure and the one on which this Comment focuses) is the flipside of Model A. Fund B, a U.S. private equity firm, purchases a 25 percent stake in Company B, a privately held foreign corporation. Having only purchased a minority stake, Fund B is left with whatever remaining control vests in it by its shareholders' agreement or relevant corporate law. As is the case for Fund A in Model A, such control might manifest through representation on a board of directors (proportionate to its ownership interest), or through voting rights over particular subject matters, typically major corporate actions or capital events. The ultimate result is a negative form of control—an ability to reject certain major decisions without the ability to initiate or compel particular actions.

⁷⁷ H.R. REP. NO. 95-640, at 12 (1977).

⁷⁸ Sullivan & Lim, *supra* note 32.

III. LEGISLATIVE HISTORY OF THE FCPA

A. *Control*

As already discussed, a U.S. entity will be held directly liable under basic principles of agency law for the conduct of a foreign subsidiary found, for all practical purposes, to be operating as that entity's alter-ego.⁷⁹ Although this Comment focuses on the significance of control as a component of an FCPA case, putting these alter-ego instances aside (as they are unlikely to appear with any frequency in the private equity context), the legislative history does not state the degree of an entity's control over a foreign corporation as an expressly required element and, without more, such control does not play a dispositive role in determining vicarious liability.⁸⁰ It is instructive to compare Congress's treatment of the issue of control in the two main components of the FCPA.

1. *The Books and Records Provisions and the Concept of Control*

The issue of control has taken center stage throughout the 30-year development of this portion of the law. In their original form, the books and records provisions were surprisingly silent on the issue of vicarious liability.⁸¹ However, the SEC was quick to clarify that the onus was on issuers to ensure that any foreign subsidiary in which they held more than a 20% interest remained in compliance with the books and records provisions.⁸² The SEC later relaxed requirements for issuers holding anywhere between 20% and 50% controlling interests in a foreign subsidiary.⁸³ Instead of holding such issuers strictly liable, the SEC concurred with a congressional proposal that provided that an issuer need only demonstrate a good faith effort to coax the subsidiary into compliance.⁸⁴ Congress codified the SEC's position when it amended the FCPA in 1988.⁸⁵ The 1988 House-Senate conference agreement recognized that "it is unrealistic to expect a minority owner to exert a disproportionate degree of influence over the accounting practices of a subsidiary."⁸⁶ However,

⁷⁹ See *supra* Part I.B.3.

⁸⁰ See DEMING, *supra* note 36, at 34–36.

⁸¹ See Brown, *supra* note 9, at 19.

⁸² See *id.* at 20.

⁸³ *Id.* at 20–21.

⁸⁴ *Id.* at 21.

⁸⁵ See H.R. REP. NO. 100-576, at 919 (1988) (Conf. Rep.), *reprinted in* 1988 U.S.C.C.A.N. 1547, 1948.

⁸⁶ *Id.*

the conference agreement also codified the SEC's strict liability standard for those issuers who took majority positions in foreign subsidiaries.⁸⁷

2. *The Concept of Control in the Anti-Bribery Provisions*

The anti-bribery provisions do not directly address (and never have addressed) the issue of control as it relates to vicarious liability.⁸⁸ That is not to say the issue has never been broached. The House Committee on Interstate and Foreign Commerce brought the issue to light in its first draft of the legislation, which extended the scope of domestic concern to include foreign corporations that were owned or controlled by U.S. nationals.⁸⁹ The Committee went on to define the term "control" as "the power to exercise a controlling influence over the management or policies of a domestic concern."⁹⁰ More particularly, the draft legislation built in a presumption of control for any U.S. entity that owned more than 50% of a foreign corporation.⁹¹

Despite the Committee's best efforts, the House ultimately yielded to the Senate's definition of domestic concern, which sidestepped the direct liability issue by removing the term "control" altogether.⁹² As a result, the anti-bribery provisions are silent with respect to the issue of control. This silence becomes particularly significant when considered in light of the emphasis Congress placed on control in crafting the books and records provisions.⁹³ One possible conclusion that can be drawn from a comparison of the two sets of provisions is that Congress only intended for control to be material to liability for purposes of the books and records provisions.

While this silence is puzzling, neither the statute nor the legislative history affirmatively expresses the view that the degree of control a U.S. entity exercises over a foreign corporation is irrelevant in assessing liability under the FCPA. The reality is that the more control a party has over a foreign subsidiary, be it financial or managerial, the greater the likelihood that the party will expose itself to liability under a theory of knowledge or

⁸⁷ *Id.*

⁸⁸ See DEMING, *supra* note 36, at 34–36.

⁸⁹ H.R. REP. NO. 95-640, at 11 (1977).

⁹⁰ *Id.* at 12.

⁹¹ *Id.* at 12–13.

⁹² See S. REP. NO. 95-114, at 10 (1977).

⁹³ See *supra* Part III.A.1.

authorization.⁹⁴ In fact, it is a central premise of this Comment that control ultimately plays (and should continue to play) a decisive role in determining vicarious liability under the FCPA. This result is as much a function of government restraint as it is a reflection of the prevailing trends in corporate expansion at the time the FCPA was drafted.⁹⁵ In most cases, the structure of and motivation behind this traditional model of expansion made the active involvement of the parent corporation in the management and operation of the subsidiary inevitable.⁹⁶ Not surprisingly, vicarious liability often arose in one of three situations, each fairly unique to the parent-subsidary context: (1) if the illicit transaction had been for the benefit of the parent corporation;⁹⁷ (2) if there was a clear paper trail leading back to the parent corporation; and (3) when the individuals involved in making or authorizing the payments were directors or officers of the parent company.⁹⁸

Moreover, there are some indications in the legislative history that Congress intended for control to play into the equation:

Whether or not a particular situation involves bribery by the corporation or by an individual acting on his own will depend on all the facts and circumstances, including the position of the employee, the care with which the board of directors supervises management, the care with which management supervises employees in sensitive positions and its adherence to the strict accounting standards⁹⁹

B. Knowledge

Another theory of liability that has proved a consistent source of controversy throughout the history of the FCPA is the knowledge requirement. Under the 1977 version of the Act, liability would attach to a parent

⁹⁴ See BIALOS & HUSISIAN, *supra* note 5, at 55–56.

⁹⁵ Most of the SEC's major enforcement actions before the FCPA went into effect targeted large, multinational corporations. See Peter W. Schroth, *The United States and the International Bribery Conventions*, 50 AM. J. COMP. L. 593, 598 (Supp. Fall 2002) (citing SEC v. United Brands Co., Civ. No. 75-0509 (D.D.C. Jan. 27, 1976); SEC v. Gulf Oil Corp., Civ. No. 75-0324 (D.D.C. 1975); SEC v. Philips Petroleum, Civ. No. 75-0308 (D.D.C. 1975)).

⁹⁶ See, e.g., *In re Gore*, Exchange Act Release No. 38,343, 63 SEC 2435 (Feb. 27, 1997), available at 1997 WL 94186. In *Gore*, two senior executives of a large U.S.-based energy company were imputed with knowledge of corrupt payments made by one of the company's foreign subsidiaries to foreign officials. *Gore* is illustrative of how a parent corporation (or, in this case, officers of a parent corporation) can face vicarious liability for the actions of a subsidiary over which it exercises significant institutional control.

⁹⁷ CRUVER, *supra* note 12, at 55 (giving the example of a small sales subsidiary making a payment in order for a large parent corporation to secure a contract).

⁹⁸ *Id.* at 54–55.

⁹⁹ S. REP. NO. 95-114, at 11 (1977).

corporation if it knew or had “reason to know” that funds transferred to its subsidiary would be used illicitly.¹⁰⁰ This was a simple negligence theory, and a widely criticized one at that.¹⁰¹ The thrust of the criticism was that the standard was too vague to allow parent corporations to foresee when and where they might be exposing themselves to liability under the FCPA.¹⁰² While the “reason to know” theory made it easy for the Department of Justice (DOJ) to punish companies that intentionally disregarded the illicit conduct of their subsidiaries, it gave no guidance to companies acting in good faith as to the type of compliance programs and internal controls that would insulate them from liability.¹⁰³ Recognizing this problem, Congress repealed the “reason to know” standard in its 1988 amendment to the law and replaced it with a similarly objective “conscious disregard” standard.¹⁰⁴ Thus, after the 1988 amendments, a parent corporation would face liability for the illicit conduct of its subsidiary if it knew of the conduct or had a firm belief that it was likely to occur.¹⁰⁵ Apparently recognizing that its new knowledge standard left significant room for interpretation, Congress made an effort to clarify:

[T]he Conferees also agreed that the so called “head-in-the-sand” problem—variously described in the pertinent authorities as “conscious disregard,” “willful blindness” or “deliberate ignorance”—should be covered so that management officials could not take refuge from the act’s prohibition by their unwarranted obliviousness to any action (or inaction), language or other “signaling device” that should reasonably alert them of the “high probability” of an FCPA violation.¹⁰⁶

Congress never defined the term “signaling device,” although the SEC and the Justice Department have since compiled examples.¹⁰⁷ In addition, the legislative record seems to incorporate by reference the common law’s recklessness standard as it has been applied in similar contexts.¹⁰⁸

¹⁰⁰ H.R. REP. NO. 100-576, at 919–20 (1988) (Conf. Rep.).

¹⁰¹ BIALOS & HUSISIAN, *supra* note 5, at 37–39; Bartley A. Brennan, *The Foreign Corrupt Practices Act Amendments of 1988: “Death” of a Law*, 15 N.C. J. INT’L L. & COM. REG. 229, 232 (1990).

¹⁰² BIALOS & HUSISIAN, *supra* note 5, at 37–39; Brennan, *supra* note 101, at 232.

¹⁰³ BIALOS & HUSISIAN, *supra* note 5, at 37–39; Brennan, *supra* note 101, at 232.

¹⁰⁴ 15 U.S.C. § 78dd-1(f)(2)(A)(i)–(ii) (2006) (issuers); *id.* §78dd-2(h)(3)(A)(i)–(ii) (domestic concerns).

¹⁰⁵ H.R. REP. NO. 100-576, at 919–20.

¹⁰⁶ *Id.* at 920.

¹⁰⁷ See BIALOS & HUSISIAN, *supra* note 5, app. A (listing DOJ and SEC “red flags”).

¹⁰⁸ H.R. REP. NO. 100-576, at 920. The Conference Report states:

Federal case law has discussed the carefully-drawn elements that comprise the “head-in-the-sand” state of mind in other contexts. The Conferees agree with the reasoning found in such decisions as *United States v. Jewell*, 532 F.2d 679 (9th Cir. 1976); *United States v. Bright*, 517

However, despite intentions to bring more transparency to the anti-bribery provisions, Congress's 1988 amendments arguably substituted one open-ended statutory scheme for another. As with its decision to remove any definition of control from the original statute, Congress's addition of the "conscious disregard" standard reflects a legislative approach that emphasizes flexibility and principles over hard-and-fast rules.

The statute's wording of the knowledge requirement begs an interesting question concerning the potential liability for *de minimis* investors: if knowledge—either actual or constructive—that a payment to a third party will be transmitted in violation of the FCPA is sufficient to establish liability, then what is to keep the government from bringing enforcement actions against a shareholder with a *de minimis* interest that happens to have acquired knowledge of a corrupt payment? Some scholars have posited that the knowledge requirement has a built in control component.¹⁰⁹ According to this theory, even if the requisite knowledge exists, liability will not attach to a parent corporation unless it had sufficient control over the subsidiary to prevent the payment.¹¹⁰ However, the term "knowing" in the statute refers to knowledge that payments made to third parties would be transmitted in violation of the law. There is no express requirement in the legislative history that would form the basis for a conclusion that the defendant was required to have control of the third party for liability to attach. Yet, as this Comment argues, the enforcement history of the FCPA, combined with relevant policy considerations, may compel a different conclusion.

C. The International Anti-Bribery Act of 1998

Acknowledging that the FCPA placed U.S. businesses at a competitive disadvantage with respect to foreign competitors who continued to use illicit means to access foreign markets, Congress empowered the executive branch to pressure U.S. trading partners to pass similar measures.¹¹¹ The result, nearly a decade later, was the Organization for Economic Co-operation and

F.2d 584 (2d Cir. 1975); *United States v. Jacobs*, 470 F.2d 270, 287 n.37 (2d Cir.), *cert. denied sub nom. Lavelle v. United States*, 414 U.S. 821 (1973).

Id.

¹⁰⁹ Brown, *supra* note 9, at 14.

¹¹⁰ *Id.*

¹¹¹ S. REP. NO. 105-277, at 2 (1998), available at <http://www.usdoj.gov/criminal/fraud/fcpa/history/1998/amends/senaterpt.html>; see also U.S. Dep't of Justice, 1998 Amendments Proposed Legislative History, <http://www.usdoj.gov/criminal/fraud/fcpa/history/1998/amends/leghistory.html> (last visited June 18, 2009).

Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention).¹¹² The OECD Convention calls upon its signatories—33 nations, including most of the United States' major trading partners—to criminalize foreign bribery in much the same manner as does the FCPA.¹¹³ Indeed, with few exceptions, the OECD Convention closely mirrors the FCPA's anti-bribery provisions.¹¹⁴ As for the exceptions, Congress passed the International Anti-Bribery Act of 1998 to bring the United States into compliance.¹¹⁵ Importantly, in enforcing its mandates, the OECD Convention calls upon signatories to “broadly” assert territorial jurisdiction and, to the extent possible, to assert nationality jurisdiction.¹¹⁶ Empowered by the Convention, Congress amended “the FCPA to provide for jurisdiction over the acts of U.S. businesses and nationals in furtherance of unlawful payments that take place wholly outside the United States.”¹¹⁷ The practical effect of this amendment was to nullify the law's territorial nexus requirement, which was not much of an effect at all considering that the requirement had always been viewed as a fictional hurdle.¹¹⁸

To summarize, the legislative record provides a number of important insights into Congress's treatment of the third party liability issues under the FCPA. Perhaps most importantly, the record reveals that the level of control a company exercises over a foreign affiliate is not an express prerequisite for liability under the FCPA.¹¹⁹ This being the case, control still operates as a hidden element, a subtext of sorts lurking just below the surface. Indeed, the element of control will color most questions of vicarious liability under the FCPA, and in a fairly significant manner.¹²⁰ Though Congress was silent on this issue as it relates to the anti-bribery provisions, and though some industry scholars insist it does not have independent legal significance,¹²¹ the issue of

¹¹² Organization for Economic Co-operation and Development, Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Dec. 17, 1997, S. TREATY DOC. NO. 105-43, 37 I.L.M. 1 [hereinafter OECD Convention]; see also U.S. Dep't of Justice, *supra* note 111.

¹¹³ See OECD Convention, *supra* note 112, art. 1; International Anti-Bribery and Fair Competition Act, Pub. L. No. 105-366, 112 Stat. 3302 (1998).

¹¹⁴ Compare 15 U.S.C. § 78dd-1(f) (2006), with OECD Convention, *supra* note 112, art. 1.

¹¹⁵ International Anti-Bribery and Fair Competition Act, Pub. L. No. 105-366, 112 Stat. 3302 (1998).

¹¹⁶ OECD Convention, *supra* note 112, art. 4.

¹¹⁷ S. REP. NO. 105-277, at 3 (1998).

¹¹⁸ LUCINDA A. LOW, CLAUDIUS O. SOKENU & DON ZARIN, THE FOREIGN CORRUPT PRACTICES ACT: COPING WITH HEIGHTENED ENFORCEMENT RISKS 27 (2007).

¹¹⁹ See *supra* Part III.A.

¹²⁰ *Id.*

¹²¹ See DEMING, *supra* note 36, at 35.

control—that is, the size of a U.S. entity’s ownership interest in a foreign company—invariably makes a showing in the analysis. In addition, the legislative history reveals a significant evolution of the FCPA’s knowledge requirement.¹²² U.S. companies no longer will be held liable under a simple negligence standard for the actions of their subsidiaries. Rather, for liability to attach, a parent company must consciously disregard the likelihood that a payment made to a third party would be used in violation of the FCPA.¹²³

IV. RECENT ENFORCEMENT ACTIVITY

Over its 30-year life, the FCPA has generated a surprisingly diminutive body of case law.¹²⁴ There is no single explanation for this scarcity.¹²⁵ One reasonable conclusion is that many potential defendants choose to avail themselves of the DOJ’s Opinion Procedure Release process, a system built in to the FCPA to encourage companies to request advisory opinions concerning the legal consequences of proposed conduct.¹²⁶ Not surprisingly, published DOJ opinions have limited precedential value. Proffered opinions only bind the DOJ with respect to the facts at issue and are not intended to reflect the DOJ’s interpretation of the law.¹²⁷ Instead, the opinions are indicative of the DOJ’s current enforcement policies and their relation to the specific facts in the inquiry.¹²⁸

Nevertheless, a careful review of recent DOJ and SEC activity reveals some important enforcement trends. Most importantly, the SEC and DOJ have

¹²² See *supra* Part III.B.

¹²³ See *supra* Part III.B.

¹²⁴ *United States v. Kozeny*, 493 F. Supp. 2d 693, 697 (S.D.N.Y. 2007). The court observed that FCPA-related motions

raise various issues of law that are of first impression in the Second Circuit. Not only is there a dearth of Second Circuit law on these issues, but there has [sic] been surprisingly few decisions throughout the country on the FCPA over the course of the last thirty years—especially with respect to the specific questions raised by these motions.

Id.

¹²⁵ This is not to downplay the role case law has played in developing and applying the FCPA. In fact, the standard statutory language of the FCPA allows courts and scholars to draw upon common principles of criminal law in interpreting its text. See *Stichting ter behartiging van de belangen van oudaandeelhouders in het kapitaal van Saybolt International B.V. v. Schreiber*, 327 F.3d 173, 183 (2d Cir. 2003).

¹²⁶ 15 U.S.C. § 78dd-1(e) (2006) (“The Attorney General . . . shall establish a procedure to provide responses to specific inquiries by issuers concerning conformance of their conduct with the Department of Justice’s present enforcement policy regarding the preceding provisions of this section.”).

¹²⁷ See 28 C.F.R. §§ 80.1–80.16 (2008); BIALOS & HUSISIAN, *supra* note 5, at 57–59.

¹²⁸ BIALOS & HUSISIAN, *supra* note 5, at 57.

become increasingly aggressive in enforcing the FCPA in recent years. Heightened enforcement is manifest both in the number of investigations each agency launches annually, as well as in the range of penalties they seek.¹²⁹ While there is some evidence suggesting that this uptick in activity could be situational,¹³⁰ a number of commentators and practitioners have observed a stronger institutional emphasis on enforcement within both the SEC and DOJ.¹³¹ Whatever the cause, the recent surge in enforcement activity has combined with escalating penalties to bring the FCPA front and center in corporate governance discussions. Corporations are now spending more money than ever in legal fees and compliance costs.¹³² Much of the interest arises from the extraordinary fines being leveled against violators. In one recent case, the United States and Germany closed a two-year investigation into German engineering giant Siemens with the announcement of a \$1.24 billion settlement agreement.¹³³

The DOJ and SEC have targeted most of their recent enforcement actions at large multinational corporations and their foreign subsidiaries.¹³⁴ This trend is significant, as it reflects enforcement authorities' continued inclination to pursue actions against corporations with substantial operational control over their foreign affiliates. That being said, private equity funds are beginning to make an appearance in FCPA actions.

¹²⁹ NEWCOMB & UROFSKY, *supra* note 17, at 2.

¹³⁰ For instance, both agencies have stepped up enforcement activity in the wake of the Iraqi Oil for Food scandal. In the majority of these cases, U.S. and foreign corporations, most in energy or utility sectors, faced liability for kickbacks paid by foreign subsidiaries to the Iraqi government. See Press Release, U.S. Dep't of Justice, Paradigm B.V. Agrees to Pay \$1 Million Penalty to Resolve Foreign Bribery Issues in Multiple Countries (Sept. 24, 2007), available at http://www.fcpaenforcement.com/FILES/tbl_s31Publications%5CFileUpload137%5C4459%5CParadigmBV.pdf; Letter from Steven A. Tyrrell, Chief, Fraud Section, Criminal Div., U.S. Dep't of Justice, to Timothy L. Dickinson, Esq., Paul Hastings Janofsky & Walker (Aug. 21, 2007), available at http://www.foley.com/files/Texttron_non-prosecution.pdf.

¹³¹ See, e.g., Joseph P. Covington, Larry P. Ellsworth & Iris E. Bennett, *FCPA Enforcement Trends*, WHITE COLLAR PRACTICE ALERT (Jenner & Block LLP), Oct. 24, 2007, at 1–2, available at http://www.jenner.com/files/tbl_s20Publications%5CRelatedDocumentsPDFs1252%5C1879%5CFCPAEnforcementTrends.pdf; *The New FCPA Sheriff in Town: You*, LITIGATION LAWFLASH (Morgan, Lewis & Bockius LLP), Nov. 6, 2007, available at http://www.morganlewis.com/pubs/LIT_NewFCPASHerifInTown_6nov07.pdf.

¹³² Fred Shaheen & Natalia Green, *Penalties Get Tougher for FCPA Violations*, NAT'L DEF., Sept. 2005, at 50.

¹³³ Brian Baxter, *Debevoise, Davis Polk Help Siemens Settle FCPA, German Investigations*, AMLAW DAILY, Dec. 15, 2008, <http://amlawdaily.typepad.com/amlawdaily/2008/12/davis-polk-debe.html>.

¹³⁴ See NEWCOMB & UROFSKY, *supra* note 17.

A. *Vetco*

In 2004, a consortium of private equity investors acquired the upstream oil and gas arm of ABB Handels-und Verwaltungs AG (ABB), a large Swiss holding company.¹³⁵ As part of the corporate restructuring that followed, the consortium created Vetco International Ltd. (Vetco), an umbrella parent corporation under which a chain of subsidiary holding companies would operate.¹³⁶ In accordance with the purchase agreement, Vetco Gray, a former ABB subsidiary, pleaded guilty for its involvement in a prolonged bribery scheme involving Nigerian custom officials.¹³⁷ Per the request of the private equity consortium, the DOJ issued an opinion release in which it affirmed that it would not take any enforcement action provided that the acquisition consortium continued to cooperate with authorities and implemented an internal control system to prevent future violations.¹³⁸

This covenant reflects the significant weight enforcement officials place on internal controls and compliance systems as a tool to prevent and identify foreign corrupt practices. Any effective compliance program will have detailed protocols regarding the activities of foreign subsidiaries and branches.¹³⁹ Additionally, a program likely will require the subsidiary's employees to follow certain ethical and procedural guidelines, as well as to submit to educational and training programs.¹⁴⁰

The Vetco story continued in February 2007 when three Vetco subsidiaries entered plea agreements in which they admitted to authorizing illicit payments by a customs clearing company directed at Nigerian officials in charge of reviewing contract bids for oil exploration projects.¹⁴¹ The plea agreements were entered pursuant to a closing agreement between the private equity

¹³⁵ Press Release, U.S. Dep't of Justice, Three Vetco International Ltd. Subsidiaries Plead Guilty to Foreign Bribery and Agree to Pay \$26 Million in Criminal Fines (Feb. 6, 2007), *available at* http://www.usdoj.gov/opa/pr/2007/February/07_crm_075.html [hereinafter Vetco Press Release].

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ Foreign Corrupt Practices Act Review, U.S. Dep't of Justice, Opinion Procedure Release No. 04-02 (July 12, 2004), *available at* <http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2004/0402.html> [hereinafter FCPA Review].

¹³⁹ CRUVER, *supra* note 12, at 35. For instance, the program will require the subsidiary to incorporate the parent corporation's compliance procedures concerning the retention of foreign agents and contractors. *Id.* at 39. The program likely will also "establish a corporate policy that is applicable to the foreign subsidiary and prohibits corrupt payments in violation of either local law or the FCPA." *Id.*

¹⁴⁰ *Id.*

¹⁴¹ Vetco Press Release, *supra* note 135.

consortium and General Electric (GE) concerning GE's purchase of Vetco Gray, one of the subsidiaries involved in the plea agreement.¹⁴² In total, the three subsidiaries agreed to pay \$26 million in criminal penalties, the largest criminal fine levied by the DOJ in an FCPA action to date.¹⁴³

Significantly, the DOJ took no direct legal action against the private equity consortium. This was the case even though the consortium—which consisted of Candover 2001 Fund, 3i Investments PLC, and JP Morgan Partners Global Fund—fully owned each of the subsidiaries that was a party to the plea agreement, and even though it effectively breached the 2004 plea agreement, which obligated it to implement a compliance system that would effectively prevent future violations.¹⁴⁴ Nevertheless, as the exclusive owner of Vetco and each of its subsidiaries, the consortium presumably felt the sting of the enforcement action indirectly. Conveniently, the degree of the consortium's ownership interest negated any need for the DOJ to prosecute the consortium on a theory of vicarious liability.¹⁴⁵

This prosecutorial decision is not surprising. Structurally, the consortium's investment in Vetco followed the private equity model: the capital sourced from a large, diversified fund, and the deal operated on a limited timeline.¹⁴⁶ However, for all practical purposes, the consortium's exclusive ownership of Vetco and its intimate knowledge of the company's history of corruption made this an open-and-shut case, an arrangement resembling many of the traditional parent-subsidiary structures predating the private equity era.¹⁴⁷ That the private equity consortium would ultimately suffer financially for its oversight failures did not require a stretch of the imagination or offend principles of fairness.

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ See FCPA Review, *supra* note 138.

¹⁴⁵ The DOJ was unequivocal in its assignment of fault to the private equity consortium:

The corrupt payments underlying today's guilty pleas continued unabated from the period prior to the acquisition until at least mid-2005, notwithstanding the acquirer's commitments to the Justice Department under the Opinion Release. The sale to new owners, the prior directives issued by the Department of Justice, and Vetco Gray UK's prior FCPA conviction were all taken into account under the U.S. Sentencing Guidelines in calculating the \$12 million criminal fine against Vetco Gray UK Ltd.

Vetco Press Release, *supra* note 135.

¹⁴⁶ See *supra* Part II.

¹⁴⁷ See *supra* notes 12–16 and accompanying text.

B. *Kozeny*

Between 2003 and 2005, the DOJ brought FCPA charges against a number of individuals and companies alleged to have conspired to bribe government officials in the Republic of Azerbaijan as part of an elaborate scheme to profit from the privatization of the Azeri oil industry.¹⁴⁸ The scheme begins and ends with Viktor Kozeny, the lead defendant. Kozeny entered the venture as president and chairman of two investment companies he created in the late 1990s, Oily Rock Group Ltd. (Oily Rock) and Minaret Group Ltd. (Minaret), both of which have their principal place of business in Azerbaijan.¹⁴⁹ Joining Kozeny, Oily Rock, and Minaret in the enterprise were Frederick Bourke, David Pinkerton, Pharos Capital Management, L.P., and Omega Advisers, Inc. (Omega).¹⁵⁰ Kozeny, Bourke, and Pinkerton were charged in a 2005 indictment in the U.S. District Court for the Southern District of New York.¹⁵¹ The extensive, 27-count indictment charged the three individuals with conspiring to make cash payments and corrupt promises to Azeri officials toward the end of securing a more profitable share of SOCAR, the soon-to-be-privatized Azeri oil company.¹⁵²

At the time of his indictment, David Pinkerton was the head of American International Group Inc.'s (AIG) global investment fund.¹⁵³ On Pinkerton's advice, the fund invested \$15 million in a co-investment agreement with Kozeny, Oily Rock, and Minaret.¹⁵⁴ The indictment charged that Pinkerton "caused AIG to make this investment based in part on his understanding that Kozeny had paid and would pay bribes to the Azeri Officials."¹⁵⁵ Between Kozeny, Pinkerton, and Bourke,¹⁵⁶ the DOJ sought \$174 million in penalties.¹⁵⁷ Still in a pretrial posture, the case has yet to yield any judgments on the substance of the indictments.¹⁵⁸

¹⁴⁸ United States v. Kozeny, 493 F. Supp. 2d 693, 698–99 (S.D.N.Y. 2007).

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Id.* Frederick Bourke has since been convicted. David Glovin, *Bourke Convicted of Bribery in Azerbaijan Deal*, BLOOMBERG.COM, July 10, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a.IcUbluPMCg>.

¹⁵² *Kozeny*, 493 F. Supp. 2d at 697; NEWCOMB & UROFSKY, *supra* note 17, at 31.

¹⁵³ *See Kozeny*, 493 F. Supp. 2d at 699.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ Bourke invested his share through Blueport International Ltd., of which he was the principal shareholder. *Id.* at 698.

¹⁵⁷ NEWCOMB & UROFSKY, *supra* note 17, at 31.

¹⁵⁸ *Id.*

In a related action, the DOJ reached a non-prosecution agreement with Omega, one of the investment funds party to Kozeny's consortium.¹⁵⁹ In the course of its discussions with enforcement officials, Omega admitted that Clayton Lewis, one of its investment managers, had knowledge that Kozeny had entered an illicit profit sharing agreement with Azeri officials.¹⁶⁰ Lewis ultimately pled guilty in 2004.¹⁶¹ The non-prosecution agreement, reached in June 2007, provided that Omega would civilly forfeit \$500,000 and continue to cooperate with the DOJ.¹⁶²

At first blush, *United States v. Kozeny* and the jumble of related enforcement actions seem to offer little in the form of instruction for private equity firms. Yet even without the benefit of a court order on the substance of the charges, there are still lessons to be gleaned from the face of the indictments. A closer look at the party structure and the DOJ's choice of defendants yields both comforting and cautionary tales for the private equity industry.

On the cautionary side, Pinkerton's indictment should be enough to send chills down the spines of private equity managers everywhere. The indictment charged Pinkerton with investing money in an investment scheme with the understanding that the enterprise would involve illicit payments to foreign officials.¹⁶³ As far as the record shows, the \$15 million Pinkerton contributed on behalf of AIG was not earmarked for the purpose of paying off foreign officials.¹⁶⁴ Once the money was invested, it became fungible, and Pinkerton ceded complete control of its disposition to the investment consortium. Pinkerton's was a passive investment, a characteristic Model B transaction. The extent of Pinkerton's understanding of the illicit nature of the venture is not clear from the record.¹⁶⁵ Certainly, if the United States had proof that Pinkerton's knowledge was definite, that is, that Pinkerton knew with concrete certainty that his investment was in furtherance of corrupt activity abroad, the indictment would seem reasonable.¹⁶⁶ But could liability have attached if

¹⁵⁹ *Id.*

¹⁶⁰ NEWCOMB & UROFSKY, *supra* note 17, at 30–32 (citing *United States v. Clayton Lewis* (Cr. No. 03-930) (S.D.N.Y., July 2003)).

¹⁶¹ *Id.* at 31.

¹⁶² *Id.* at 32.

¹⁶³ *United States v. Kozeny*, 493 F. Supp. 2d 693, 699 (S.D.N.Y. 2007).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ The FPCA provides that an investment is illegal where the investor knows it is in furtherance of corrupt activity abroad. 15 U.S.C. § 78dd-2(a) (2006).

Pinkerton's "understanding" was nothing more than his awareness that bribing foreign officials was par for the course in the Azeri investment market? Any judgment on the merits of the charges against Pinkerton would turn on the actual scope of his knowledge.¹⁶⁷

Similarly troubling for the private equity industry is the DOJ's decision to indict Omega. Omega's involvement in the venture paralleled that of AIG's; both were brought into the enterprise at the behest of an employee and arguably had the same degree of imputed institutional knowledge through these employees.¹⁶⁸ Why the DOJ indicted Omega and not AIG is not clear from the record. Still, as a hedge fund with a diverse portfolio of investments and limited operational control over the corrupt investment enterprise, Omega is a relatively novel choice for a defendant.¹⁶⁹ If nothing else, the Omega indictment demonstrates the DOJ's willingness to target a private equity institution directly.

The comforting news is that Omega was able to reach a non-prosecution agreement with the DOJ.¹⁷⁰ Ultimately, the DOJ was satisfied with the guilty plea of Lewis, an Omega investment manager. When considered in conjunction with the DOJ's decision not to press charges against AIG (instead focusing on Pinkerton), the Omega non-prosecution agreement demonstrates the DOJ's readiness to limit the scope of its prosecutions to individuals at the forefront of a particular corruption scheme.¹⁷¹ Indeed, since 1990, the DOJ has prosecuted individuals twice as frequently as it has corporations.¹⁷² In many of those cases, individuals acting on behalf of a corporation or one of its subsidiaries knowingly used corporate funds to further corrupt activity.¹⁷³ Principles of agency law incorporated through the FCPA's anti-bribery provisions attach liability to the corporation in these instances.¹⁷⁴ However, as was the case with Omega, if a corporation cooperates and remains aboveboard

¹⁶⁷ *Id.*

¹⁶⁸ *Kozeny*, 493 F. Supp. 2d at 698–99.

¹⁶⁹ Memorandum from Skadden, Arps, Slate, Meagher & Flom to Clients, Hedge Fund Settlement Illustrates Broad Scope of Government FCPA Investigations (July 2007) (on file with author).

¹⁷⁰ *Id.*

¹⁷¹ NEWCOMB & UROFSKY, *supra* note 17, at 4.

¹⁷² *Id.*

¹⁷³ *See, e.g., id.* at 15, 18 (citing *United States v. Jason Edward Steph*, No. 4:08-cr-00307 (S.D. Tex. 2007); *United States v. Si Chan Wooh*, No. 07-cr-244-KI (D. Or. 2007)).

¹⁷⁴ *See supra* Part I.B.3.

about its dealings, the DOJ likely will be amenable to a non-prosecution agreement.¹⁷⁵

V. APPLICATION IN THE PRIVATE EQUITY CONTEXT

This section considers the application of the vicarious liability provisions of the FCPA in the private equity context. With the help of a hypothetical factual illustration, this section considers the provisions of the law as they apply to each of the private equity models described earlier, beginning with Model B.

A. *Illustration*

Imagine that a private equity fund is looking for investment opportunities in the real estate sector of Country X, an emerging market economy. The real estate sector in Country X is notoriously corrupt, and the fund managers are well aware that licensing and zoning decisions are often influenced by bribes from brokers and developers. The Fund chooses to invest in a real estate development firm with, to the best of the directors' knowledge after reasonable due diligence, a clean record as far as corporate bribery goes. The investment agreement builds in a number of boilerplate covenants whereby the development firm agrees to operate in full compliance with U.S. anti-bribery laws. Subsequent to the agreement's consummation, one of the real estate firm's local managers, without the actual knowledge of the Fund, makes a corrupt payment in order to secure the rights to a development project.

It should be noted at the outset that the DOJ takes into account a target market's underlying level of corruption in assessing vicarious liability. The DOJ specifically lists widespread news accounts of corruption in a particular market or industry as a red flag for U.S. investors considering their vulnerability to liability under the FCPA.¹⁷⁶ Thus, in each example below, the private equity fund has already disregarded some degree of risk that its investment will further a corrupt payment.

¹⁷⁵ NEWCOMB & UROFSKY, *supra* note 17, at 32.

¹⁷⁶ BIALOS & HUSISIAN, *supra* note 5, app. A (listing a compilation of "red flags" accumulated by the DOJ and the SEC).

B. *The Models*

Model B:

A threshold question is whether Fund B acted in furtherance of the corrupt payment when it invested capital.¹⁷⁷ Congress never expressly defines “in furtherance,” and the legislative history provides that the issue be analyzed case by case.¹⁷⁸ In this instance, the alleged furthering act was a non-earmarked investment (i.e., the Fund’s capital contribution) made prior to the corrupt payment. Whether Fund B acted in furtherance of the illicit payment likely will turn on whether it satisfies the knowledge requirements.¹⁷⁹ In other words, if knowledge or authority can be imputed from a review of the overall circumstances, then the mere act of funding the investment may be deemed to be the necessary action in furtherance of the corrupt payment.¹⁸⁰ This scenario likely was what played out in the *Kozeny* case, in which Pinkerton’s initial investment was deemed to be in furtherance of the bribery scheme largely because of his “understanding” of the intended use of the funds.¹⁸¹ Therefore, it becomes necessary to consider whether one of the theories of vicarious liability applies in order to determine the existence of this element.

It is clear from the illustration that Fund B did not explicitly authorize the corrupt payment in question. No aspect of the investment agreement can be construed to empower Company B to make bribes on behalf of Fund B. Nor did the Fund authorize the payment or any specific conduct leading up to the payment. In fact, given its lack of control, one could argue that it had no right to authorize any such payment. Accordingly, for vicarious liability to attach to the Fund, it must, at least on these facts, be demonstrated that the Fund had knowledge of the corrupt payment.

The analysis is less straightforward when one considers whether liability would attach under a theory of knowledge. On the given facts, there is no evidence to indicate that Fund B had actual knowledge of the corrupt payment. Thus, liability would turn on whether Fund B was aware of a high likelihood of such a payment at the time it made its investment.¹⁸² Put another way, liability turns on whether Fund B consciously disregarded the risk that by investing in

¹⁷⁷ 15 U.S.C. § 78dd-2(a) (2006).

¹⁷⁸ BIALOS & HUSISIAN, *supra* note 5, at 33 n.18.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *United States v. Kozeny*, 493 F. Supp. 2d 693, 699 (S.D.N.Y. 2007).

¹⁸² 15 U.S.C. § 78dd-2(a) (2006).

Company B, it was acting in furtherance of a corrupt payment. In answering this question, the DOJ would consider what, if any, red flags Fund B ignored in going forward with its investment.¹⁸³ Reports of corruption in Country X's real estate sector—reports of which Fund B was cognizant—certainly fall into the “red flag” category.¹⁸⁴ Indeed, while the facts suggest a good faith effort on the part of Fund B to perform due diligence, it is undeniable that the Fund courted some degree of risk by following through with the transaction.

Courts have yet to address whether that risk, by itself, is sufficient to establish vicarious liability. That said, Congress's 1988 amendments to the law demonstrate its intention to elevate the knowledge threshold not only above the prior “reason to know” standard, but also above the recklessness standard within common law.¹⁸⁵ While investing capital in an emerging and notoriously corrupt industry invites risk, it likely would not climb to the level of conscious disregard contemplated by the FCPA.¹⁸⁶ This is especially true if the investing entity has made a good faith effort to perform due diligence, a matter of custom for most major investors.¹⁸⁷ That the DOJ and the SEC consider an industry's history of FCPA violations as one among a number of potential red flags suggests that this particular red flag by itself is not determinative of liability. This conclusion is also reconcilable with recent enforcement actions against private equity investors. In *Kozeny*, for instance, the DOJ predicated Pinkerton's indictment on a theory of actual knowledge.¹⁸⁸ In the case of *Omega*, the DOJ was able to establish liability by virtue of the ongoing criminal activity of one of the hedge fund's investment managers.¹⁸⁹

The analysis must then turn to the post-transaction conduct of the respective parties—specifically, to the interactions between Fund B and Company B during the period after the investment agreement took effect and before the corrupt payment. The FCPA makes it clear that once invested, Fund B cannot avoid liability by using a “‘head-in-the-sand’ approach.”¹⁹⁰ If in its

¹⁸³ H.R. REP. NO. 100-576, at 919 (1988) (Conf. Rep.).

¹⁸⁴ See BIALOS & HUSISIAN, *supra* note 5, app. A.

¹⁸⁵ H.R. REP. NO. 100-576, at 919.

¹⁸⁶ See 15 U.S.C. § 78-dd-2(h)(3).

¹⁸⁷ See, e.g., NEWCOMB & UROFSKY, *supra* note 17, at 45 (citing *United States v. Syncor Taiwan, Inc.*, Cr. No. 02-1244 (C.D. Cal., Dec. 2002)); U.S. Dep't of Justice, FCPA Opinion Procedure Release 2003-01 (Jan. 15, 2003), available at <http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2003/0301.html> (in each instance, corrupt activity was discovered in the course of a parent or acquiring company's due diligence work).

¹⁸⁸ *United States v. Kozeny*, 493 F. Supp. 2d 693, 699 (S.D.N.Y. 2007).

¹⁸⁹ See NEWCOMB & UROFSKY, *supra* note 17, at 30–32 (citing *United States v. Clayton Lewis*, Cr. No. 03-930 (S.D.N.Y., July 2003)).

¹⁹⁰ H.R. REP. NO. 100-576, at 919–20; see also 15 U.S.C. § 78dd-2(h)(3).

capacity as a minority shareholder, Fund B ignored revealing signals that Company B or one of its agents was securing development rights through bribes, the FCPA will impute knowledge to Fund B on a willful blindness theory.¹⁹¹ But before examining whether any such signals were present, one must look to the original investment agreement to determine the scope of Fund B's authority and influence. After all, as the SEC has illuminated in its enforcement of similar corporate governance statutes, it would be unfair to impute knowledge (and therefore liability) to the Fund for conduct that was simply outside the sphere of its influence.¹⁹²

As Model B illustrates, Fund B has a characteristically negative form of control over Company B. Fund B's minority representation on Company B's board of directors hardly serves as a window into the company's day-to-day operations.¹⁹³ Traditionally, a corporate board of directors convenes infrequently and when it does, often occupies itself with loftier matters.¹⁹⁴ Private equity investors often request representation on corporate boards in order to rest a finger on the pulse of the company—to watch over their capital and, in limited circumstances, to exercise veto rights.¹⁹⁵ While a Fund B representative on the board of directors might be aware of Company B's FCPA compliance program, the representative will have no way of ensuring its application or enforcement.

Assuming the corrupt payment in question did not source from Company B's board of directors, Fund B probably would not be able to detect any of the telltale signals that Company B had not kept finances aboveboard. For instance, cautionary signs such as excessive commissions, the diversion of payments, and over-invoicing remain localized and outside the purview of the board of directors.¹⁹⁶ Nor is it likely that Fund B would be tipped off by periodic financial statements. Such statements are designed to give a picture of

¹⁹¹ H.R. REP. NO. 100-576, at 919–20.

¹⁹² Office of the Chief Accountant, Div. of Corp. Fin., Sec. & Exch. Comm'n, Management Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Frequently Asked Questions (revised Oct. 6, 2004), <http://www.sec.gov/info/accountants/controlfaq1004.htm> [hereinafter Management Report]. Under Sarbanes-Oxley, management is not responsible for reporting on the financial statements and internal controls of either a non-consolidated subsidiary or a consolidated subsidiary with which it has limited contractual rights. *Id.*

¹⁹³ See Moser & Chong, *supra* note 24, at 23.

¹⁹⁴ FOLEY & LARDNER LLP, WHAT PRIVATE EQUITY FIRM DIRECTORS NEED TO KNOW (2007), http://www.foley.com/files/tbl_s31Publications/FileUpload137/4012/PrivateEquityFirmDirectorsNeedKnow.pdf.

¹⁹⁵ See Moser & Chong, *supra* note 24, at 23.

¹⁹⁶ See BIALOS & HUSISIAN, *supra* note 5, app. A.

the overall health of the company and thus are often not itemized in sufficient detail to raise red flags.¹⁹⁷

At the risk of generalizing, one can reasonably conclude that in the straightforward factual illustration provided, a private equity fund following the Model B tradition is unlikely to face liability under the FCPA. This is not to say that minority investors play a trivial role in corporate governance or that they are in any way outside the scope of FCPA enforcement.¹⁹⁸ The FCPA does not discriminate based on the size of a party's ownership interest; having authorized or otherwise ignored the significant likelihood of a corrupt payment, a U.S. entity, whatever its investment, will face vicarious liability under the FCPA.¹⁹⁹ However, this illustration does demonstrate the rather intuitive proposition that for the purposes of the FCPA, the extent of a party's knowledge will inevitably be circumscribed by the structure of its investment agreement.

Model A:

As was the case with Fund B in Model B, Fund A invests with knowledge that the real estate sector in Country X is saturated with corruption. The difference in this hypothetical, of course, is that Fund A takes a majority stake in its target company, Company A. As a result, Fund A has control of the board of directors and the requisite majority stake in the company to initiate policy changes. Fund A will also have the authority to appoint Company A's corporate officers, who in turn will hire employees and, potentially, outside auditors. The structure of the investment agreement brings Fund A much closer to the action on the ground.²⁰⁰ Unlike Fund B in the previous model, Fund A cannot attribute its ignorance of the corrupt payment to the limited nature of its influence over Company A's operations.²⁰¹

Here, Fund A is aware of the prevalence of corruption in emerging economies generally and, more particularly, in Country X's real estate sector. While the facts are silent on the matter, it is apparent that Fund A would be inviting an enforcement action if it moved forward without supplementing the boilerplate FCPA compliance language in the investment agreement with

¹⁹⁷ See Management Report, *supra* note 192.

¹⁹⁸ See *United States v. Kozeny*, 493 F. Supp. 2d 693, 698–99 (S.D.N.Y. 2007); Vetco Press Release, *supra* note 135.

¹⁹⁹ 15 U.S.C. § 78dd-2(a) (2006).

²⁰⁰ CRUVER, *supra* note 12, at 39–40.

²⁰¹ *Id.*

actual procedures and controls.²⁰² The stakes are higher for Fund A, not because it has greater control over management and operations, but rather because that control naturally expands the scope of its ability to inquire and authorize.²⁰³ Put differently, the greater the fund's involvement in the day-to-day operations of Company A, the broader its field of knowledge and its ability to prevent misconduct.²⁰⁴ It was argued in the previous illustration that it would be unreasonable for Fund B, having little to no exposure to Company B's daily operations, to face vicarious liability on a theory of imputed knowledge. Yet where, as in this instance, control is expansive, a presumption that the investor should catch word of, or at the very least develop suspicion of, corrupt activity seems reasonable.

The structure of the investment agreement in Model A also increases the likelihood that liability would attach on a theory of authorization. Fund A need not explicitly authorize an illicit payment for such a theory to prevail.²⁰⁵ Authorization can be implicit under the FCPA if it is demonstrated that a party's conduct constituted ratification or acquiescence in the face of corrupt activity.²⁰⁶ Notably, the legislative history does not develop the theory of authorization in any great detail. As this illustration demonstrates, this theory, at least in its application, seems to overlap with the knowledge theory.²⁰⁷ Further, this scenario is reminiscent of the structure of the parent-subsidary relationship common at the time the FCPA was drafted. It is therefore far more reasonable to require that the Fund institute a system of procedures and controls designed to detect and prevent corrupt payments.²⁰⁸

As we saw in the Vetco case, enforcement authorities place a premium on compliance programs.²⁰⁹ If comprehensive and effectively implemented, such programs demonstrate good faith preventative measures on the part of the U.S. entity.²¹⁰ In this instance, where Fund A's controlling interest in Company A lends itself to the presumption that fund managers will have knowledge of the

²⁰² Vetco Press Release, *supra* note 135 (describing the DOJ Opinion Release, which required that the private equity consortium implement a strict compliance program in order to prevent future abuses).

²⁰³ See *supra* note 96 (discussing *In re Gore*).

²⁰⁴ CRUVER, *supra* note 12, at 38–39.

²⁰⁵ See DEMING, *supra* note 36, at 33.

²⁰⁶ *Id.*

²⁰⁷ In fact, one would be hard pressed to proffer a case, whether real or hypothetical, in which a party faces liability under the authorization theory without also facing liability under the knowledge theory.

²⁰⁸ CRUVER, *supra* note 12, at 39–40.

²⁰⁹ See FCPA Review, *supra* note 138.

²¹⁰ *Id.*

manner in which the company is disbursing money,²¹¹ such a program might be expected.

Ultimately, there are insufficient facts to draw a definitive conclusion as to whether Fund A would be vicariously liable for Company A's corrupt payment. A more thorough inquiry would be fact intensive, and liability would likely turn on the reach of Fund A's supervisory authority as well as the efficacy of any FCPA compliance procedures established before the illicit payment. However, Fund A's potential for liability is, and should be, potentially greater than Fund B's.

C. *A Note on "50/50" Joint Ventures*

When private equity agreements take the form of a joint venture in which the foreign and local shareholders own equal shares of the company, control of the foreign corporation is split evenly.²¹² The shareholder agreement typically stipulates a collaborative arrangement under which the joining companies share equal representation on the board of directors. This creates a system of shared control under which neither party can force a corporate action without the consent of the other.²¹³ Despite the difference in nomenclature, the analytical approach to assessing liability in the joint venture context parallels that of the previous two models.

CONCLUSION

A. *A Growing Sense of Uncertainty*

If the scope of the anti-bribery provisions seems unclear today, it is worth recalling that in its original form, the FCPA attached liability to any issuer or domestic concern that made payments to a third party while knowing or having a reason to know that all or part of the payments would be used toward a corrupt end.²¹⁴ The open-ended nature of the "reason to know" standard left corporate managers uncertain as to the risks of liability. The result, one scholar argues, was a chilling effect within the American business

²¹¹ CRUVER, *supra* note 12, at 41.

²¹² Fifty-fifty is a common dividing point for illustration. Joint ventures, however, can take various shapes and sizes. See Leeds & Sunderland, *supra* note 19.

²¹³ *Id.*

²¹⁴ See H.R. REP. NO. 100-576, at 919 (1988) (Conf. Rep.).

community.²¹⁵ The law's ambiguity left managers tentative, many choosing to pass on "legitimate business opportunities abroad rather than risk violating the Act."²¹⁶ In fact, the vague language of the provision ultimately backfired on the enforcement front, as even the DOJ refused to prosecute under the hazy "reason to know" standard.²¹⁷ As a result, of all the enforcement actions between 1980 and 1988, not a single one turned on the issue of knowledge.²¹⁸

Acknowledging that the language of the statute had paralyzed enforcement efforts and discouraged foreign investment, Congress amended the law in 1988.²¹⁹ Interestingly, while Congress narrowed the knowledge requirement and attempted to crystallize its purpose, it eschewed hard-and-fast language and clear-cut triggers, instead continuing to rely on principles and standards. As we saw earlier, this left many of the law's critics unappeased.²²⁰

Today, the confluence of heightened enforcement activity and the proliferation of foreign capital into emerging markets have combined to raise awareness of the FCPA in corporate boardrooms across America. Judging from the flood of seminars and law firm newsletters on the subject, this awareness is both palpable and substantial.²²¹ While the growing sense of uncertainty in the financial community has not risen to pre-1988 levels, the emergence of the FCPA Compliance group as a fixture in most major international law firms suggests that the specter of FCPA liability looms in corporate boardrooms.

B. Looking Forward

Before considering whether private equity investors deserve special treatment under the FCPA, enforcement authorities must be cognizant of the reality that the private equity model (and in particular the minority investment variation, as in Model B) is a considerable departure from the parent-subsidiary arrangement prevalent at the time the FCPA was drafted.²²² This is true in many respects, though one aspect stands out: Model B-type private

²¹⁵ Laura E. Longobardi, *Reviewing the Situation: What is to be Done with the Foreign Corrupt Practices Act?*, 20 VAND. J. TRANSNAT'L L. 431, 494 (1987).

²¹⁶ *Id.*

²¹⁷ BIALOS & HUSISIAN, *supra* note 5, at 38.

²¹⁸ *Id.*

²¹⁹ See H.R. REP. NO. 100-576.

²²⁰ Terwilliger, *supra* note 46.

²²¹ See FOLEY & LARDNER LLP, *supra* note 194; Memorandum from Skadden, Arps, Slate, Meagher & Flom, *supra* note 169.

²²² See *supra* notes 12-16 and accompanying text.

equity investors operate with limited control of their target companies. Far from being strategic extensions readily identifiable with a parent corporation, these private equity targets are, at least from the perspective of their financiers, limited-life, passive investments.²²³

From this premise, we can infer a second, similarly compelling truth: to hold minority interest private equity investors to the same standard of liability as multinational corporations is to restructure the private equity industry through fiat.²²⁴ Recent enforcement trends suggest that vicarious liability under the FCPA is increasingly likely to turn on a U.S. entity's implementation of an effective compliance program for the foreign investee.²²⁵ Such programs are likely to be rigorous and extensive, yet, in the parent-subsidiary context, still a natural outgrowth of the institutional relationship. The same cannot be said in the Model B private equity context. As already established, passivity is a critical component of this private equity model. In the current competitive climate, it would be difficult to require these firms to invest with the burden of proactively monitoring the affairs of their targets. Such a responsibility could have significant consequences. In fact, this Comment concludes that holding private equity firms to the traditional standard of liability would come at industry-wide costs. In all likelihood, the U.S. firms would become less competitive, and their impact on the international private equity market would likely diminish.²²⁶ This conclusion is consistent with approaches taken in similar statutory schemes.²²⁷

Of course, this could be one cost lawmakers and enforcement officials are willing to stomach. After all, Congress does not customarily exempt entire industries from the prohibitions of a law for matters of financial convenience or market reality.²²⁸ However, in the view of this author, such a wholesale exemption is not required. Thus, while an argument based on a literal reading of the legislative history can be made for applying the FCPA's vicarious

²²³ See *supra* note 33 and accompanying text.

²²⁴ See Sullivan & Lim, *supra* note 32 (noting that “[i]t may be unrealistic to expect an investee company rapidly to adopt world-class governance standards in a developing country where the financial and legal systems are still inchoate”).

²²⁵ Vetco Press Release, *supra* note 135.

²²⁶ See Leeds & Sunderland, *supra* note 19, at 114–15 (noting that foreign target companies are already resistant to outside efforts at corporate governance).

²²⁷ See Management Report, *supra* note 194.

²²⁸ Neither would this Comment support exempting the entire private equity industry. As argued above, Model A-type private equity investments have many of the trappings of the parent-subsidiary structure and likely would invite similar management responsibilities. In such instances, liability is much more likely to attach. See *supra* note 77 and accompanying text.

liability provisions to private equity firms and multinational corporations uniformly, a more reasonable approach would incorporate into the inquiry the element of control. In fact, there is a strong argument to be made that control has always been an integral part of the liability equation.²²⁹ If this is the case, enforcement officials have all the statutory authority and precedent they need to draw legal distinctions between private equity investors and multinationals. From a policy standpoint, it would be sensible to draw such distinctions.

Passed in 1977, the Foreign Corrupt Practices Act has been amended twice, each time a decade after the earlier iteration. While the calendar suggests that the law is due for another round of changes, perhaps we can dispense with legislative action in this decade and instead rely on a thoughtful application of the statute's policies and purposes to this emerging financial model.

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²²⁹ See *supra* notes 79–99 and accompanying text.

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