# Global Distributor Risk Management
## Warsaw, Poland
## 17 May 2013

**International MedTech Compliance Conference**

# Panelists

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- Contents of this presentation and statements made should be interpreted as personal views. Examples given are not meant to be 'best practices' or definite statements of how an issue should or will be treated. Every organization is unique and circumstances at two organizations may yield differing but equally valid responses to the same issue.
- Presenters are not giving any advice or counsel, nor legal or consulting advice. Audience should consult with own counsel before adapting or changing a practice or policy.

# Agenda

- Legal Background
- Enforcement Actions
- Mitigating Risks
  - Who is a Third Party Intermediary
  - Due Diligence in Selection of Third Party Intermediaries
  - Contractual Provisions
  - Roles and Responsibilities
  - Auditing and Monitoring
  - Training
  - Termination

# Legal Background

# FCPA Basics

- **Two components to the FCPA**
  - *Anti-bribery provisions* prohibit giving, offering to give, or authorizing giving money or anything of value—directly or <u>indirectly</u>—to foreign officials or third parties acting on their behalf, when payment is made to obtain or retain business
  - *Accounting provisions* require companies traded on US exchanges to maintain accurate books and records and establish effective internal controls

- **Creates liability for individuals and companies**
  - Criminal/Civil: U.S. Department of Justice (DOJ)
  - Civil: Securities and Exchange Commission (SEC)

# FCPA Basics

- The FCPA prohibits corrupt payments through third parties
  - Includes joint venture partners, consultants, agents, and distributors
- It is unlawful to make a payment to a third party while knowing all or a portion of that payment will go directly or indirectly to a foreign official
  - Knowing = Actual Knowledge
  - Knowing = Conscious Avoidance
- Knowledge under FCPA can be established if you are aware of a ***high probability*** of the existence of a fact and you ***consciously avoid*** confirming it

# UK Bribery Act of 2010

- The UK Bribery Act of 2010
  - Applies to bribery of private individuals and companies (commercial bribery), as well as government officials
  - Both givers and recipients of bribes may face up to 10 years' imprisonment and unlimited fines
  - Companies may face unlimited fines
    - The only defense to a corporate charge under the Act is that the company had "adequate procedures" in place to prevent bribery
- UK citizens, residents, companies, and companies with presence in the UK are subject to the UKBA
- The UKBA does not contain a "facilitating payments" exception

# FCPA Cases Involving Third Parties

# Distributors

- AGA Medical (2008)
  - AGA held liable for actions of its Chinese distributor
  - AGA's distributor paid kickbacks in the form of "rewards" and "rebates" (ranging from $300 to $1000 per product purchased) to public hospital physicians
  - AGA's distributor in China paid patent officials to approve patents for AGA products
  - $2 million criminal penalty, three-year DPA, and monitor

# Joint Ventures

- TSKJ (2009 – 2011)
  - TKSJ was a four-company JV to build liquefied natural gas facilities on Bonny Island, Nigeria
  - The JV's "steering committee," including members of all four companies, paid approximately $51 million in bribes for $6 billion in contracts to a corporation, which was 49% owned by the Nigerian government
  - KBR was charged with anti-bribery violations; the other three JV members were charged with conspiracy and aiding and abetting the violation
    - Technip S.A. (2010) – $240M criminal fine, $98M disgorgement, and compliance monitor for two years
    - Snamprogetti Netherlands B.V. and parent company ENI S.p.A. of Italy (2010) – $240M criminal fine, $125M disgorgement
    - Kellogg Brown and Root LLC ("KBR") and parent company Halliburton (2009) – $402M criminal fine, $177M disgorgement, compliance monitor for three years, and retention of a compliance program consultant
    - JGC Corporation (2011) – $218.8M criminal fine and retention of a compliance program consultant

# Doing Business with a Third Party After Identifying Red Flags

- York International Corp. (2007)
  - York, a manufacturing company, and its subsidiaries paid bribes to government officials in various countries in exchange for contracts for government projects, including through third-party agents who submitted fake invoices without performing bona fide services
    - York knew or should have known that its subsidiaries in the relevant regions did not perform due diligence consistently on third parties and should have known that no due diligence was done on the “consultants” who submitted the fake invoices
    - If York’s management had established a process to review these files, it would have been “immediately apparent” that the consultancy arrangements were a sham
  - $12M criminal and civil fines and $10M in disgorgement and prejudgment interest

# Doing Business with a Third Party After Identifying Red Flags

- InVision, Inc. (2005)
  - InVision was aware of a high probability that its sales agents or distributors paid or offered to pay bribes to foreign officials in China, the Philippines, and Thailand in exchange for the sale of InVision's airport security screening product designed to detect explosives in passenger baggage
  - InVision had been told by its agents about requests for payments to government officials and that its agents had given gifts to government officials
  - $800K criminal fine, $500K civil penalty, and $589K in disgorgement and prejudgment interest

# Importance of Conducting Sufficient Due Diligence

- Tyco International Ltd. (2006)
  - Tyco acquired affiliates in Brazil and South Korea even though its due diligence revealed that illicit payments to government officials were common in Brazil and South Korea, as well as in the relevant industries
  - Employees of Tyco's Brazil affiliate paid bribes to officials in exchange for government contracts
  - 60% of the contracts during the relevant time period involved payments to government officials, which were made through "lobbyists" retained for this purpose
  - Used false invoices from companies owned by employees to obtain the funds and conceal the payments
  - $50M civil penalty

# Importance of Conducting Sufficient Due Diligence

- Paradigm B.V. (2007)
  - Made payments to government officials at state-owned oil companies in various countries made through third-party agents in exchange for contracts for Paradigm's geological software
  - Paid $22.5K to a British West Indies company recommended as a consultant by a government official in Kazakhstan
  - Paradigm performed no due diligence, did not execute a written agreement, and did not appear to receive any services from the third party
  - $1M criminal fine and compliance monitor

# Mitigating Risks

# Due Diligence - Definition

**Process**

**to ensure that relevant information is reviewed and properly taken into account**

before entering into a new agreement ***or***

when renewing an agreement with a TPI

***proactive and continuous monitoring***

# Due Diligence and the US Department of Justice

"U.S. companies are encouraged to exercise due diligence and to take all necessary precautions to ensure that they have formed a business relationship with **reputable** and **qualified** partners and representatives."

[1]*Lay-Person's Guide to FCPA, USDOJ, June 2001*

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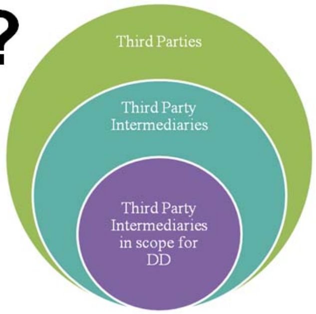
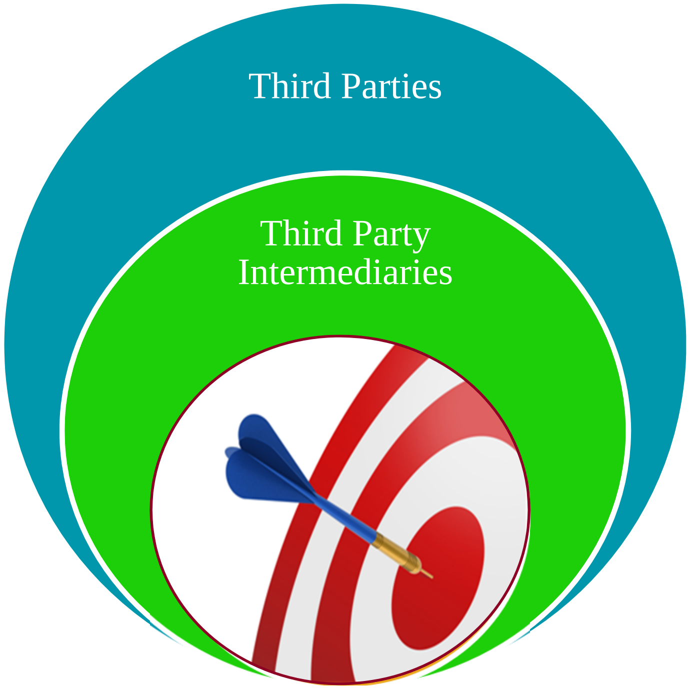
*USDOJ = US Department of Justice*

# From Third Party to TPI in scope?

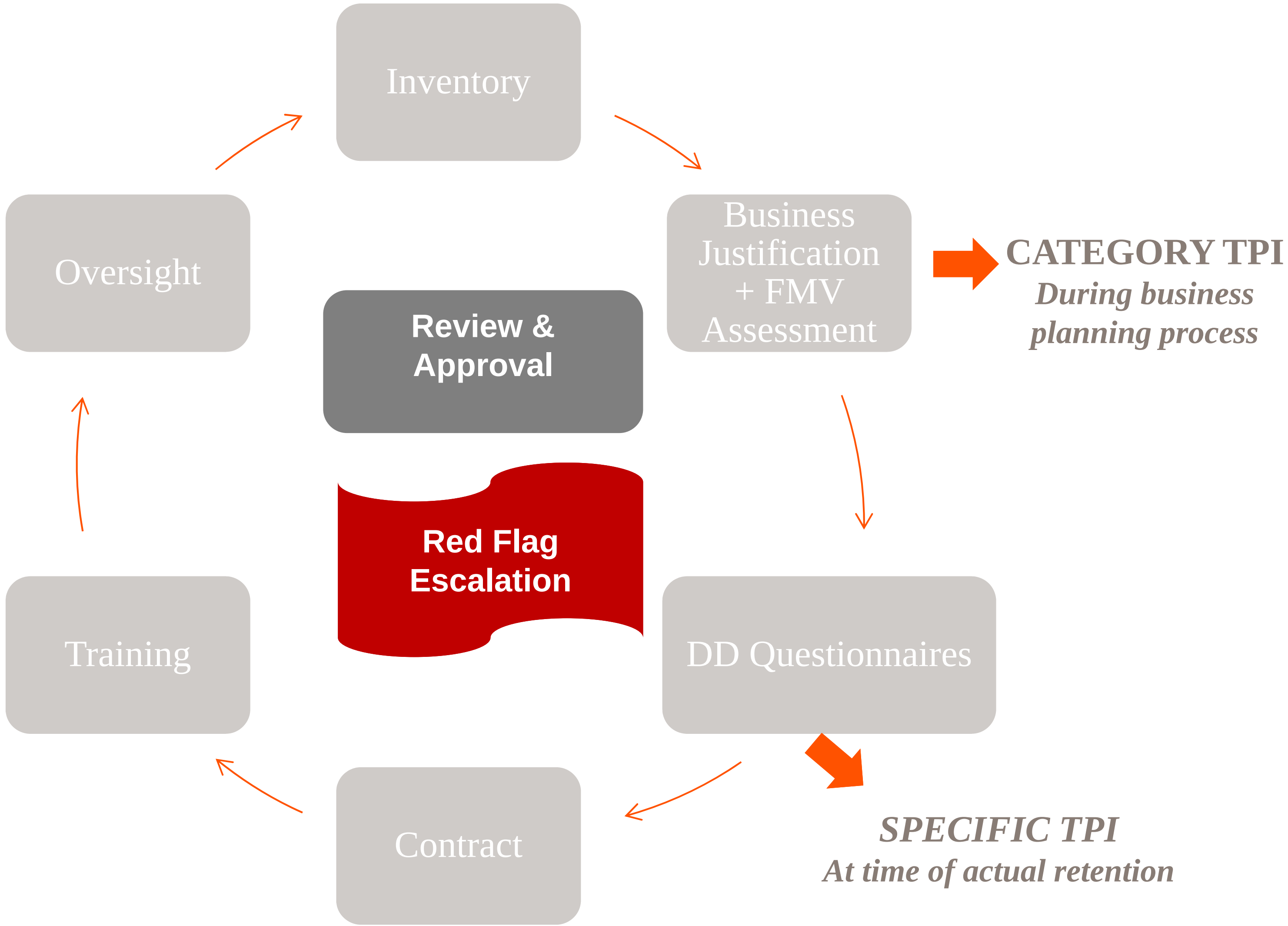



3 key questions:

1. What does the third party do?
2. Do they act / perform services on behalf of your company?
3. If yes, is it to GOs and HCPs?



# TPI Management : ongoing DD process



# Due Diligence Process Timeline

***New TPI*** → ***Active TPI***

**Start**

**Due Diligence Process initiated**
- Business justification
- Fair Market Value Assessment
- DD Questionnaires

**Finalisation of DD Assessment**

Contract

Training TPI before service starts

**12 months**

- Business Justification
- Fair Market Value Assessment

Retraining TPI

TPI Annual Certification

**24 months**

- Business Justification
- Fair Market Value Assessment

Retraining TPI

TPI Annual Certification

**36 months**

**Renewal Due Diligence Process**
- Business justification
- Fair Market Value Assessment
- DD Questionnaires

**Finalisation of DD Assessment**

Retraining TPI

# Roles and Responsibilities

**Business Sponsor**

- Annual Business Justification
- Annual Fair Market Value Assessment
- Facilitation of TPI Questionnaire Completion
- Training of TPIs
- Annual TPI Certification
- Contract
- Ownership of the Relationship

**HCC Officer**

- Review & Approval
- Review & Escalation of Red Flags
- Submission of Results Metrics
- Training of TPIs
- Facilitation of Due Diligence Process

**Finance Lead**

- Review & Approval of ABJ and FMVA

**Managing Director**

- Review & Approval of Due Diligence

**Regional BP&C Lead**

- Review & Approval of New TPIs
- Lead Regional Working Group
- Training

**Regional Working Group**

- Review Escalated Red Flags & Resolutions
- Approve Resolved Red Flags
- Review & Approve Exemptions
- Provide Guidance & Facilitation

Business owns the actual execution of the due diligence checks and documentation

# TPI DD and red flag management

- What is a ‘red flag’: *A warning signal that requires immediate attention and resolution*
- Needs to escalated to the Regional Working Group (RWG)
- Discuss issue and proposed resolution
- Decision by RWG is final

# Contract Requirements

| FCPA | Right to Audit | Annual Training & Recertification | Termination |
|---|---|---|---|
| a requirement to comply with the U.S. FCPA and other anti-corruption laws | the right of the company to audit relevant books and records related to the services provided to the company | TPI is required to certify its status (any significant changes) and conduct anti-corruption training | the right of the company company to terminate the agreement for any anti-corruption or FCPA violations |

**Additional requirements:**

- Use of appropriate language (clauses as provided by Law Department)
- Contract must be signed by **authorized** representatives of both company and TPI

# Mitigating Risks

- Conduct the appropriate level of due diligence on agents, investors, JV partners, and all other third parties and investigate
  - the prospective third party's qualifications for the position
  - the reputation of the third party and its clientele
  - whether the third party has personal, professional, or familial ties to government personnel or officials (including physicians employed or compensated by public entities)
  - the third party's business associates
  - the nature and scope of any existing "red flags"
- Obtain a written contract, including strong compliance provisions, for each third party
  - Consider including audit rights and indemnification

# Mitigating Risks

- Train all employees and third parties
- Obtain compliance certifications from all employees and third parties
- Ensure that all third-party payments are reasonable, commensurate with the work performed, and legal under local law
- Identify, report, and respond appropriately to all red flags
- Ensure all payments are legitimate and reasonable in amount and manner of payment
- Separate any marketing or sales function from the compliance function

- **Monitor to ensure compliance**