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Wednesday, Apr. 07, 2010

U.S. Cashes In on Corporate Corruption Overseas

By Ken Stier

Why must Daimler AG, the German automaker, pay big fines to the U.S. government because two of its subsidiaries, one in Germany and the other in Russia, made improper payments to government officials of countries other than the U.S., such as China, Egypt and Serbia?

Welcome to the age of the Foreign Corrupt Practices Act (FCPA), a far-reaching bit of American legislation that cracks down on corporate bribery in all its forms and is rattling the cages of corporate chiefs the world over. The Department of Justice (DOJ) has jurisdiction over all related criminal violations under the act, and the Securities and Exchange Commission (SEC) keeps tabs on the civil violations committed by U.S. companies. What's more, the law doesn't just mean the U.S. government is looking for past incidents of corruption; it's also stirring the pot to see who may be corruptible in the future. ([See the top 10 crooked CEOs.](#))

Consider the case of Pat Caldwell. In January 2009, after 27 years in the U.S. Secret Service, Caldwell became head of sales and marketing for Protective Products of America Inc. (PPA), a Florida firm that sells body armor to federal and state agencies.

Just five months later, the U.S. government was selling Caldwell a deal — one he should have refused — to help equip the presidential guard of an African country for about \$15 million. The offer came from two undercover FBI agents posing as the sales broker and representative of an African defense minister, in meetings at Miami's Mandarin Oriental hotel and at Clyde's restaurant in Washington, D.C. The catch: there was a 20% commission tacked onto the real price as a kickback for the two men. ([See the worst business deals of 2009.](#))

Caldwell went for it, the U.S. alleges in a recently unsealed indictment. After \$18,000 was wired to a PPA bank account as a test purchase, the first batch of 50 body-armor plates (from a total order of 3,600) were shipped off — on July 16, the same day Caldwell was promoted to CEO. Caldwell proved to have a very short stint as PPA chief, as the African deal soon blew up in his face. He was arrested in January this year along with 21 executives of other law-enforcement and military-supply companies — most of whom were conveniently gathered at a Las

Vegas trade show — who all allegedly fell for the same false honey pot. Caldwell has pleaded not guilty to the charges.

The raid, in which 150 FBI agents fanned out across the country to execute search warrants, was a dramatic demonstration of the government's new resolve to crack down on violations of the Foreign Corrupt Practices Act, which has largely lain dormant since becoming law in 1977. In fact, it was the first time Washington had used a sting operation to enforce this law — part of what Justice Department officials vow is a "new chapter" in white-collar crime enforcement. "The message is that we are going to bring all the innovations of our organized-crime and drug-war cases to fight against white-collar criminals," Lanny A. Breuer, a senior Justice official, told the American Bar Association recently. ([See the 25 crimes of the century.](#))

The evidence of Washington's determination is a mounting pile of enforcement fines. In 2007, FCPA-related fines — paid to the Justice Department and the SEC to settle civil charges — were \$87 million. Last year this rose to \$627 million and then it doubled to \$1.2 billion in just the first two months of 2010. Now you can also add the \$185 million in civil and criminal penalties that Daimler AG and its subsidiaries have agreed to pay.

And the Justice Department is just getting started. The post-9/11 creation of a new national-security division within Justice freed up more resources for the criminal division and its fraud section. There are now eight full-time FCPA prosecutors supplemented by 54 other prosecutors in the fraud section. The same is true of the FBI, which performs the actual gumshoe investigation; a new Washington field-office unit has 10 agents working exclusively on FCPA. More prosecutors and agents are expected to be added, paid for indirectly by the huge new income stream these fines represent (fines go into the Treasury, not directly back to the DOJ). There are currently about 150 investigations under way, some targeting foreign firms listed on U.S. exchanges, such as the just concluded Daimler AG case.

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Ramped-up FCPA prosecutions were actually started under the Bush Administration and grew out of post-Enron concerns about marketplace integrity, as well as a growing appreciation for how corruption torpedoes growth in developing countries. Even more focused on the link between corruption and underdevelopment, the Obama Administration has sharpened government sticks by forcing forfeiture of corrupt assets and targeting executives, several of whom are now serving prison time.

"This is a huge threat to American firms if they get caught in the crosshairs of enforcement authorities," says Kenneth Kurtz, CEO of the Steele Foundation, a risk-management firm. A recent survey by his firm found that only 10% of companies (with an average income of \$250 million) had adequate compliance in place to protect against illegal sales deals. This inadequate level of preparation is a boon for compliance-service companies and

defense lawyers, and both say companies are in for new headaches and higher costs as they scramble to stay out of the way of the new legal juggernaut. ([See 25 people to blame for the financial crisis.](#))

That's particularly true because of the aggressive application of the law, which some critics say pushes the envelope on barely tested legal theories, and strains for the higher reaches of penalty-fine guidelines. One example: regarding employees of foreign state-owned companies as government officials, which holds them to stricter rules of engagement. That is the basis, in part or whole, for more than half of recent FCPA cases, says Mike Koehler, who worked on the FCPA for a decade at a law firm but now teaches at Butler University.

The government also has tremendous leverage over companies because self-disclosure is seen as the most effective way to mitigate punishment. That creates a veritable gravy train for the government, with cases served up on a silver platter by companies trying to lessen the penalties. "It's an upward spiral of a compliance-enforcement cycle: companies are establishing better compliance systems leading to more detection of wrongdoing, leading to more internal investigations and self-reporting, leading to more enforcement, which then cycles around to even more corporate compliance and investigations," says Paul McNulty, a senior Justice official under Bush who now leads global law firm Baker & McKenzie's FCPA practice. "Meanwhile, the penalties keep getting higher and higher." ([See George W. Bush's biggest economic mistakes.](#))

Another leverage point is that companies can only contest charges in court if there is an indictment. "But what board of directors member, in this post-Arthur Andersen world, is going to allow their company to be indicted? Regardless of whatever the DOJ legal theory is, no matter how tenuous or dubious it is, it is simply easier, more cost-efficient, more practical to [settle]," says Koehler.

The result is that the vast majority of cases result in privately negotiated non- or deferred-prosecution agreements. Justice officials say their legal positions have all been vindicated so far and the flexibility they have to reach agreements aids the department's higher priority of getting compliance — not just imposing fines — and reforming company practices. "We take a broad vision of what our mission is in this area," says Mark Mendelsohn, a key Justice FCPA enforcer.

That broad mandate seems likely to have wide repercussions. One way to view the FCPA is as a kind of extension of the Sarbanes-Oxley Act, which tightened management's liability for inadequate internal controls. The FCPA now extends that exposure to dealings with overseas business partners. The more control management has over those partners, the more the liability. This is forcing companies to choose to provide overseas operations compliance training or put them further at arms length, explains Kurtz, who says one client company recently slashed its subsidiaries to just 11 from 100. ([See which businesses are bucking the recession.](#))

The good news for U.S. companies is that increasingly their overseas competitors are being held to higher standards, reflecting a growing global consensus that corruption is not only unethical, it's bad for business and for economies. That's the reason China and Brazil (less so India and even less so Russia) have been putting muscle

into enforcing their own anticorruption laws, at least in their domestic markets.

If the U.S. really is committed to raising global standards again by leading a new campaign against global corruption, there will undoubtedly be more companies like Daimler AG that will learn the hard way that the rules of the game are really changing.

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