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BRIBERY

Anti-Corruption Enforcement Controls in Government Procurement In Central and Eastern Europe Call for Redoubled Compliance Efforts




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The economies of Central and Eastern Europe[1] (CEE) continue to grow steadily, with significant economic opportunities for investors. With a population of some 185 million people and an anticipated growth rate of about 3.5 percent in 2011, this region remains one of the world's most intriguing emerging markets.

As a part of this positive trend of local and regional development, and to facilitate even more growth, CEE countries are making substantial new investments in their domestic infrastructures, in areas as diverse as transportation systems, telecommunications, utilities, construction of government facilities, defense and security, pharmaceuticals, and supplies of basic goods and services to government institutions. Government procurement is thus on the rise. With this planned infrastructure growth come major economic opportunities

[1] The following countries are usually classified as Central and Eastern Europe: Albania, Austria, Belarus, Bosnia & Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kosovo, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovak Republic, Slovenia, and Ukraine.

 ISSN 1559-3185

for investors from outside the region, including from the United States and other parts of Europe.

However, given serious corruption problems in these emerging markets, doing business with governments and government officials in the CEE carries with it a heightened responsibility for diligence on the part of all potential participants in the markets. All stages of participation in government procurement carry important corruption risks, ranging from the initial tendering process to procurement, selection activities, and—for successful bidders—actually carrying out their responsibilities in performing the work.

Today's enhanced and more rigorous anti-corruption enforcement environment thus has direct and serious consequences for investors in these markets. Potential exposure exists under the U.S. Foreign Corrupt Practices Act, the United Kingdom's Bribery Act 2010 (U.K. Bribery Act), and, importantly, enforcement frameworks developed locally by individual CEE states, including those implemented pursuant to such international authority and guidance as European Union directives, the United Nations Convention against Corruption (UNCAC), the Organisation for Economic Co-operation and Development Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Anti-Bribery Convention), and the Regional Anti-Corruption Initiative.

Corruption Risks In Public Procurement In CEE countries

Public procurement raises corruption risks at every stage of the process. This is true in every procurement environment, but the risks are particularly heightened where public officials seek opportunities to benefit personally from the process. Even in an environment where all concerned in the public and private sectors are aware of enhanced enforcement of anti-corruption laws, corruption opportunities and challenges can arise throughout private sector contact with government officials.

Public contracting processes in the CEE, as in other markets, broadly follow the same general steps:

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(1) Governmental decision to contract: A decision is made by government officials with decisionmaking authority to look outside the government for assistance on a public project.

(2) Decision on the scope of the governmental need: The procurement officials identify technical requirements to determine what exactly will be sought from the private sector.

(3) The structure of the contracting process: The agency officials, generally following a pre-existing regulatory structure, determine how the process will work, with issues including the timeframes for bidding, the stages in the process, the number of bidders, who is eligible, any applicable restrictions or exceptions from normally applicable processes, and what transparent communications systems and opportunities are available between the selecting authority and the bidders.

(4) The decision by the competent governmental authority: Officials select the winning bidder; this may include any conditions or limitations relating to the award, including agents and subcontractors that may have connections to government officials.

(5) The administration of the contract: Further interactions of many kinds between the successful bidder and governmental authorities continue during the course of contract performance, including decisions on the selection of third parties, whether benchmarks are achieved, change orders, payment schedules, licensing, and permitting.

Because officials exercise discretion at every stage of the process, government officials have ample opportunities to seek irregular payments. On the private sector side, temptations similarly abound to shortcut the process or to make it more advantageous for competitors. Once a contract is issued, the temptations do not stop, as contract administration similarly involves numerous interactions between the public and private sectors that can lead to corrupt payments.

Enhanced Enforcement Atmosphere

Anti-corruption controls in the context of CEE public procurement emanate broadly from two directions: (i) enforcement by countries outside the CEE with jurisdiction over those who bid on or win government contracts; and (ii) enforcement by the CEE countries themselves regarding the activities of potential and successful contractors and of their own government officials. These enforcement systems are complementary, and in most circumstances a corrupt act will therefore violate the laws of multiple legal systems. The following describes some key enforcement authorities that are directly relevant to disciplining illicit activities in connection with CEE procurement-related activities.

U.S. Foreign Corrupt Practices Act. The FCPA, enacted in 1977, prohibits making—or offering to make—a corrupt payment to a foreign (i.e., non-U.S.) official for the purpose of obtaining or retaining business for or with, or directing business to, any person. It applies to a broad range of individuals and businesses, including U.S. citizens and resident aliens, businesses organized under U.S. law or having a principal place of business in the United States, and their officers, directors, employees, and agents (regardless of their citizenship). The FCPA also applies to foreign individuals and organizations that take any action in furtherance of such a

  WCR ISSN 1559-3185

corrupt payment while in the United States, as well as third parties that act on behalf of any person or organization covered by the law.

The FCPA also requires issuers on U.S. exchanges, foreign or domestic, to comply not only with the act's anti-bribery requirements but also with its additional provisions on recordkeeping and internal accounting controls. Books and records of covered entities must accurately and fairly reflect transactions (including the purposes of an organization's transactions), and covered entities must devise and maintain an adequate system of internal accounting controls. Many enforcement actions in the United States have been founded on failures related to these additional requirements, which require not a showing of a criminal intent to bribe but instead a failure to account properly for expenditures (e.g., concealing bribes by mislabeling them), or a failure to establish a system of controls that would minimize the risk of bribery from occurring (e.g., a lack of oversight by management of the corrupt activities of subsidiaries).

Johnson & Johnson Settlement. A recent settlement under the FCPA illustrates the significance of vigorous anti-corruption enforcement relating to the CEE. On April 8, 2011, Johnson & Johnson pledged in settlement agreements with the Justice Department, the U.S. Securities and Exchange Commission, and the U.K.'s Serious Fraud Office to pay a total of about $78 million in connection with payments allegedly made by J&J subsidiaries to doctors and hospital administrators in Greece, Poland, and Romania, as well as asserted kickbacks under the U.N.'s Oil-for-Food program in Iraq.[2] The U.S. government alleged that J&J subsidiaries in Greece, Poland, and Romania made payments to government-employed physicians and hospital administrators in exchange for the procurement of J&J products or to reward loyal physicians. J&J agreed to pay approximately $70 million to the U.S. government, and the U.K.'s SFO announced a parallel civil settlement for more than £4.8 million.

J&J's deferred prosecution agreement (DPA) with DOJ committed the company to certain compliance obligations, which are nearly identical to DPAs that have been agreed to by DOJ in settlements with other companies.[3]

Among other things, J&J was required:

> to adopt new or to modify existing internal controls, policies, and procedures in order to ensure that it maintains: (a) a system of internal accounting controls designed to ensure that J&J makes and keeps fair and accurate books, records, and accounts; and (b) a rigorous anti-corruption compliance code, standards, and procedures designed to detect and deter violations of the FCPA and other applicable anticorruption laws.

As the table below reflects, the FCPA compliance obligations accepted by J&J were in keeping with the compliance obligations generally imposed on organizations under the U.S. Sentencing Guidelines, with the obligations imposed on U.S. federal contractors by the Federal Acquisition Regulation, and with the compliance obligations called for by the implementing guidance for the UK Bribery Act (further discussed below).

The U.K. Bribery Act. The U.K. Bribery Act, which came into force July 1, 2011, applies to individuals and businesses, including people ordinarily residing in the U.K. and companies carrying on a business in the U.K., and their activities both inside and outside the U.K. The act prohibits people subject to U.K. jurisdiction from giving someone a financial or other advantage to encourage that person to perform his functions or activities improperly or to reward him for performing his functions or activities. It includes provisions relating to corrupt payments to foreign officials (with provisions analogous in many respects to certain provisions of the FCPA).

[2] 6 WCR 325 (4/22/11).

[3] For a discussion of recent DPAs, including the striking similarities in the language used by DOJ in each case, *see* Arnold & Porter LLP, ''Advisory: Building an Effective Anti-Corruption Compliance Contacts Program: Lessons Learned from the Recent Deferred Prosecution Agreements in Panalpina, Alcatel-Lucent, and Tyson Foods,'' (March 2011), available at: http://www.arnoldporter.com/public_document.cfm?id=17347&key=1H3.

	U.S. Sentencing Guidelines - § 8B2.1	Federal Acquisition Regulation (FAR) 52.203-13	FCPA - Deferred Prosecution Agreement in Johnson & Johnson Case	U.K. Bribery Act - Guidance
1. Standards and procedures	Yes	Yes	Yes	Yes
2. Knowledgeable leadership	Yes	No	Yes	Yes
3. Exclude personnel that present particular risks	Yes	Yes	Yes	Yes
4. Training	Yes	Yes	Yes	Yes
5. Monitor, evaluate, reporting hotline	Yes	Yes	Yes	Yes
6. Incentives and discipline	Yes	Yes	Yes	Yes
7. Adjust program to risk	Yes	Yes	Yes	Yes

The offenses under the U.K. Bribery Act can be committed by individuals and commercial organizations. The act also creates a specific offense for commercial organizations that fail to prevent bribery by people associated with the organization unless the organization can show that it has adequate procedures in place to prevent bribery—in other words, for commercial organizations that do not have effective anti-bribery compliance systems in place.

A commercial organization subject to the U.K. Bribery Act is defined as a body or partnership incorporated or formed in the U.K. regardless of where it carries on a business, or an incorporated body or partnership that carries on a business or part of a business in the U.K. regardless of the place of incorporation or formation. The guidance published by the Ministry of Justice in March 2011 urges commercial organizations to adopt a common-sense approach when deciding whether they are ''carrying on a business'' in the U.K.[4]

In relation to payments to foreign officials, Section 6 of the U.K. Bribery Act states that individuals cannot offer, promise, or give a financial or other advantage to a foreign public official with the intention of influencing the official in the performance of his or her official functions, where the person making the offer, promise, or giving the advantage intends to obtain or retain business or an advantage in the conduct of business by doing so. However, the offense is not committed where the official is permitted or required by the applicable written law to be influenced by the advantage. The U.K. Bribery Act thus has provisions that cover both bribery of foreign officials (and is thus analogous to key aspects of the FCPA) but also covers ''commercial'' bribery that doesn't implicate government officials.

As the table reflects, the U.K. government's implementing guidance under the U.K. Bribery Act, http://www.justice.gov.uk/guidance/making-and-reviewing-the-law/bribery.htm, follows the general standards for compliance systems already adopted in the United States. In fact, companies implementing compliance systems in the CEE may want to review both the commentary by the U.K. government in its implementing guidance under the U.K. Bribery Act and some of the cases that have been resolved in the last six months by U.S. law enforcement authorities through deferred prosecution agreements, because they are similar and often parallel guidance on effective compliance systems.

By understanding and drawing on both U.S. and U.K. models for compliance, firms operating in the CEE will be able to build on emerging international best practices in compliance.

Implementation of UNCAC And the OECD Anti-Corruption Convention

Most of the nations of Europe are parties to two major binding international legal instruments that have been developed in recent years—one that was negotiated under the framework of the United Nations and the other under the framework of the Organisation for Economic Co-operation and Development.

Parties to the UNCAC have undertaken legal obligations to prevent corrupt acts, criminalize acts of corruption, and cooperate internationally on corruption investigations and prosecutions. The UNCAC includes specific provisions relating to public procurement, with requirements of transparency, competition, and objective criteria for selection of bidders. Article 9 requires each state party to ''take the necessary steps to establish appropriate systems of procurement, based on transparency, competition and objective criteria in decisionmaking, that are effective, inter alia, in preventing corruption.'' Parties are required to maintain transparent and effective enforcement system at all steps of the process, ranging from the public distribution of information relating to procurement procedures to regulating personnel responsible for procurement, such as transparency of personal interests relating to particular public procurements, screening procedures, and training requirements. Most nations of the CEE are party to the UNCAC.

The OECD Anti-Bribery Convention, modeled in part after the FCPA, establishes legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides for numerous related measures that make this effective. It focuses on the ''supply side'' of the classic bribery transaction (i.e., forbidding the offering of a bribe to public officials). Unlike UNCAC, it does not contain explicit provisions relating to bribery in connection with procurement, but its prohibitions on illicit payments to foreign officials would apply to any of the interactions with government officials in the procurement or implementation process. Many CEE countries are party to the OECD Anti-Bribery Convention, including Austria, Bulgaria, Czech Republic, Estonia, Hungary, Poland, Slovenia, and Slovak Republic.

EU Public Procurement Directives. The European Union has issued a number of public procurement directives that are directly relevant to procurement controls, including the following:

- Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport, and postal services sectors;
- Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts, and public service contracts;
- Directive 2007/66/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directives 89/665/EEC and 92/13/EEC with regard to improving the effectiveness of review procedures concerning the award of public contracts; and
- Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts, and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC.

These EU public procurement directives are intended to be implemented by the EU member states (which include a growing number of CEE countries) as part of progressive EU legal harmonization. They contain fun-

[4] 6 WCR 305 (4/8/11).

  WCR ISSN 1559-3185

damental principles of procurement processes and transparency.

Of significant interest to any company seeking to bid on business in an EU country is the general preclusion from bidding of those who have been convicted of corrupt activities. Thus, for example, under Article 45 of Directive 2004/18/EC, ''Any candidate or tenderer who has been the subject of a conviction by final judgment of which the contracting authority is aware for [corruption] shall be excluded from participation in a public contract.''

Significant Issues. This broad debarment framework is significant for any company seeking to do business in EU countries. It also, however, leads to a number of important interpretive questions that will be resolved over time:

- The mandatory exclusion relates to one of the criminal offenses listed in the EU public procurement directives, which include corruption as defined in Article 3 of the Council Act of 26 May 1997 and Article 3(1) of Council Joint Action 98/742/JHA. Corruption is defined as ''the deliberate action of whosoever promises or gives, directly or through an intermediary, an advantage of any kind whatsoever to an official for himself or for a third party for him to act or refrain from acting in accordance with his duty or in the exercise of his functions in breach of this official duties.'' The bribing of a government official to influence a public tender procedure, for example, would fairly clearly fall within this requirement. U.K. Justice Secretary Ken Clarke has expressed a view, however, that a violation of Section 7 of the U.K. Bribery Act for a failure to prevent bribery may result in a discretionary, not mandatory, debarment.
- The second requirement is a conviction by final judgment. While the EU public procurement directives do not define ''final judgment,'' the term typically means that a judgment is no longer subject to appeal. We would not anticipate that a deferred prosecution agreement, used frequently to resolve FCPA and other cases involving corruption in U.S. practice, would be considered a ''final judgment'' within the meaning of the EU Public Procurement Directives, since it is not a final judgment but (effectively) a tool to resolve an investigation through commitment and monitoring. In this respect, in the context of the broad anti-corruption investigation of Siemens AG, which was concluded in 2008 with major fines, Siemens was prepared to enter into a DPA but was not prepared to plead guilty to a final charge of bribery.[5]
- Finally, and the area that may need to be most clarified over time, is the requirement for a nexus between the criminal offense and the candidate or tenderer who has been the subject of a conviction by final judgment. Under EU public procurement law, a candidate is a company or a group of companies (i.e., a consortium) that submitted a request to participate; a tenderer is a company or a group of companies that submitted a bid. Although the EU public procurement directives must be implemented into the national legislation of each EU member state, it is likely that variations will exist in implementation regarding the requirement for the mentioned nexus. It may be that for a company subject to a final judgment, this requirement will apply to the entire corporate entity and to all those who represent it, thus including the directors of a company, the partners of a firm, etc.

Unanswered Question. One question left unresolved by the EU public procurement directives is whether a bidder, having been convicted of a covered crime involving corruption, must be allowed to re-enter the public procurement market if the bidder takes remedial measures. Under the EU public procurement directives' language discussed above, in a case where a bidder has been convicted by final judgment of corruption, a contracting authority apparently has no discretion but to exclude that bidder from future tenders.

The question, then, is whether such a mandatory exclusion is also required for companies that have undergone so-called ''self-cleaning'' measures. Several observers have argued that a company that has adopted such self-cleaning measures after being convicted of corruption (by final judgment) should avoid being excluded from public bidding procedures altogether. This approach to self-cleaning is grounded in principles of European law: It is based on the fundamental freedom of movement of services and goods within the EU and on the principle of proportionality (that government should take no action beyond that necessary to achieve a stated goal).

On the other hand, supporters of the ban point out that one of the EU public procurement directives' central goals is to protect integrity and competition in the procurement process. That goal, however, is arguably met if the company in question has taken remedial action to ensure that corruption will not occur in the future.

Ultimately, it will be up to the various national public procurement review authorities in the CEE to interpret the EU public procurement directives and to resolve many of these open questions over time, perhaps through bid protest brought by companies that have been excluded from tender procedures because of corruption in the past.

Local Anti-Corruption Laws and Enforcement. It is beyond the scope of this article to describe in detail the anti-corruption frameworks in the various CEE countries. In general terms, all of these countries have some kind of anti-corruption framework on the books. For instance, Austria, Bulgaria, Croatia, Czech Republic, Romania, Serbia, and Slovakia all have legislation making it a criminal offense to commit public bribery, with potential prison sentences ranging from five to 15 years. Croatia, Romania, and Serbia have particularly strong sanctions against corporate offenses in their legislation, and an entity that commits bribery may be compulsorily liquidated.

The vigor and breadth of enforcement will no doubt be based on the nature of the laws, local resources to pursue investigations and prosecutions, and commitment to anti-corruption by government officials, including whether there is any corruption among those government officials who might have some stake in the outcome of potential enforcement actions. Generally speaking, enforcement action in the CEE has significantly increased in recent years. National prosecutors have been open to using bribery of government officials to bring enforcement action, and this is an upward trend.

[5] 3 WCR 858 (12/19/08).

The Regional Anti-Corruption Initiative. The RAI is a cooperative effort among Albania, Bosnia & Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Montenegro, Serbia, and Romania to enhance commitments and capabilities of governments in the region to address corruption. Activities include encouraging the adoption and implementation by individual member states of international anti-corruption standards such as those contained in the UNCAC and the OECD Anti-Bribery Convention. RAI also promotes and coordinates an ongoing dialogue on anti-corruption issues by organizing conferences on anti-corruption efforts, improving communication on relevant issues among RAI members, and providing technical assistance. It also seeks to have RAI members promote good governance and improve public administration of corruption laws; strengthen relevant national legislation; promote transparency and integrity in business operations; and promote an active civil society and raise public awareness about the problem of corruption.

Conclusion

Public procurement markets in the CEE offer robust opportunities for growth, but they also raise new risks because of pockets of serious corruption. To address this risk, firms moving into the CEE markets should deploy corporate compliance systems designed to detect and deter corruption, and to ensure full cooperation in broader national and international efforts to erase corruption. Those compliance systems should draw upon emerging global best practices and should reflect the converging national, regional and international norms regarding corporate anti-corruption systems. By being aggressive and proactive in addressing the legal risks of corruption, firms will be able to benefit from rapid growth in the CEE economies while reducing the collateral risks of corruption.

WCR ISSN 1559-3185