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LESSONS FROM RECORD PENALTY UNDER FEDERAL ANTI-CORRUPTION LAW

by
Claudius O. Sokenu

In yet another record-setting settlement in the Foreign Corrupt Practices Act (“FCPA”) area, the Securities and Exchange Commission (“SEC” or the “Commission”) and the Department of Justice (“Justice Department”) announced, April 26, 2007, that Baker Hughes Inc. (“BHI”) and Baker Hughes Services International, Inc. (“BHSI”), a wholly-owned subsidiary of BHI (collectively “Baker Hughes”), have agreed to pay \$11 million in criminal penalties, \$23 million in civil disgorgement and prejudgment interest, and \$10 million for violating a 2001 Commission cease-and-desist order prohibiting BHI from future violations of the FCPA.

The total payment of \$44 million by Baker Hughes represents the largest combined penalty ever imposed under the FCPA. The Baker Hughes settlement comes on the heels of the February 6, 2007 settlement in which three Vetco Gray International Limited subsidiaries, Vetco Gray Controls Inc., Vetco Gray Controls Ltd., and Vetco Gray UK Ltd., agreed to pay a combined \$26 million to settle charges that they violated the antibribery provisions of the FCPA. Justice Department Release No. 07-075 (Feb. 6, 2007). The message from the Justice Department and the SEC is loud and clear: According to Assistant Attorney General Alice Fisher, the Justice Department “will continue to hold U.S. companies and their subsidiaries accountable for foreign bribery[,]” and “[t]he record penalties leveled in [the Baker Hughes] case leave no doubt that foreign bribery is bad for business.” Justice Department Release No. 07-296 (Apr. 26, 2007). The Justice Department’s view is that “[b]y enforcing the FCPA, [it is] maintaining the integrity of the U.S. markets and leveling the playing field for those companies that want to play by the rules.” *Id.* For its part, the SEC takes the view that “[c]ompanies like Baker Hughes will be held accountable when they circumvent the rules of fair play and honest competition by making improper payments to win business.” SEC Press Release No. 2007-77 (Apr. 26, 2007).

Setting aside for the moment the philosophical debate about whether the United States should dictate how business is done around the world while ignoring the harsh realities of the environments in which U.S. companies operate around the globe, what is clear from these recent cases is that U.S. companies will continue to pay steep civil and criminal penalties if caught violating the strictures of the FCPA. Additionally, the Baker Hughes and Vetco Gray settlements also illustrate that repeat offenders face an especially daunting task in negotiating a favorable settlement, not the least of which is the real prospect of an injunctive action and criminal prosecution, both of which could have significant collateral consequences on a company’s ability to conduct its business.

Claudius O. Sokenu is a litigation partner in the New York office of Mayer, Brown, Rowe & Maw LLP and a former senior counsel with the Securities and Exchange Commission, Division of Enforcement in Washington, D.C. He was the Commission’s lead counsel in the first Baker Hughes Inc., Securities and Exchange Commission and Department of Justice civil enforcement action that was filed in 2001, *In the Matter of Baker Hughes Inc.*, Exchange Act Release No. 44784 (Sept. 12, 2001). The views expressed here are those of the author and do not necessarily reflect the views of the firm or any of its clients.

The Charges against Baker Hughes. The SEC and the Justice Department allege that, in late September 2000, BHSI acceded to a demand for illicit payments made by officials of Kazakhoil, the state-owned oil company of Kazakhstan. *See SEC v. Baker Hughes Inc.*, No. 07 Civ. 1408 (S.D. Tex. Apr. 26, 2007); DOJ Criminal Information, No. 07 Cr. 129 (S.D. Tex. Apr. 11, 2007). Prior to September 2000, BHI had received unofficial notice that it had prevailed in its bid, tendered through BHSI, to provide a wide range of oil-field drilling and production services for Karachaganak, a large oil and gas field located in Kazakhstan. *Id.* Notwithstanding this notice, a Kazakhoil official demanded that BHI hire a consulting firm located in the Isle of Man to assist its bid on the Karachaganak project and pay that firm a three percent commission on the profits earned by BHI on the Karachaganak project. *Id.* After receiving a threat that refusal to pay would jeopardize BHI's bid for the Karachaganak project and its chances of obtaining future work in Kazakhstan, BHSI agreed to pay a two percent commission to the consulting firm. *Id.* The firm had provided no services in preparing the bid and provided no services to BHI or BHSI at any later point. *Id.* The resulting payments – which were extended between May 2001 and November 2003 – totaled approximately \$4.1 million. BHI and BHSI were also alleged to have improperly characterized these payments as legitimate payments in their respective books and records, even though BHSI knew they were not compensation for legitimate services. *Id.*

The SEC complaint additionally alleges that Baker Hughes and its subsidiaries committed numerous other FCPA violations in Kazakhstan and elsewhere by paying bribes and making other payments to agents without obtaining sufficient assurances that these payments were not being passed to government officials. These allegations include charges that: BHSI and a second BHI subsidiary paid over \$1 million in bribes to Kazakh oil officials in connection with separate transactions; a BHI subsidiary extended over \$11 million in questionable payments to Angolan agents with close ties to government officials; and BHI subsidiaries extended smaller amounts to officials in Nigeria, Indonesia, Uzbekistan, and Russia, while ignoring signs that these payments were intended to be transferred to government officials and failing to conduct the due diligence necessary to ensure that the payments were legitimate.

Lessons Learned. This record settlement was likely driven by several factors. *First*, and perhaps foremost, was the size of the contract and, consequently, the level of profits that Baker Hughes secured through its allegedly unlawful payments. Baker Hughes conceded that it had earned almost \$20 million in profits from its work on the Karachaganak project. BHSI's criminal penalty and BHI's disgorgement was largely derived from this profit calculation. *Second*, the SEC clearly viewed BHI's violation of the cease-and-desist order imposed as a result of past FCPA violations as a sign that steep penalties were appropriate, particularly because the Commission then went on to conclude that BHI's subsequent violations had been "widespread and egregious." The message sent by the \$10 million civil penalty, according to SEC enforcement director Linda Thomsen, was that "recidivists will be punished." SEC Press Release No. 2007-77. Coming hard on the heels of the combined \$26 million fine imposed on three Vetco International Ltd. subsidiaries by the Justice Department in February 2007 – still the record for purely criminal investigations – that message is now unmistakable. *Third*, the record sanctions obtained by the government in this case also can be seen as a consequence of the coordinated civil and criminal investigation by the SEC and Justice Department. This tactic of conducting joint civil and criminal FCPA investigations (which ironically was first used against BHI in 2001) permits the government to exert maximum pressure on companies by simultaneously unleashing all of its investigatory powers, and by placing the full panoply of civil and criminal sanctions on the negotiating table at the same time.

Conclusion. Prosecuting violations of the FCPA is a priority for both the SEC and the Justice Department. What is of concern is that regulators appear to be disinterested in the reality on the ground in the many countries around the globe where paying to get things done is par for the course. More and more cases are brought not for bribes paid to "obtain or retain business," but for routine payments made to get things done. *See, e.g., SEC v. Dow Chemical Company*, SEC Litigation Release No. 20000, Feb. 13, 2007 (charging that employees of fifth-tier foreign subsidiary level made payments to speed approval for sale of pesticide products). Companies are advised to pay as much attention to these small, seemingly innocuous payments – which are often made by low-level employees with little or no management input – as they do to requests for large payments from highly placed government officials when bidding for government projects.