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USING EFFECTIVE CONTRACTS MANAGEMENT TO REDUCE THIRD PARTY FCPA EXPOSURE

By **Andrew Goodman** and **Sailaja Meesaraganda**¹

Anti-corruption enforcement continues to rise. On January 9, 2014, it was announced that Alcoa agreed to pay \$384 million to settle charges under the Foreign Corrupt Practices Act (“FCPA”). This ranks Alcoa as number five on the FCPA Blog list of Top Ten FCPA cases of all time.² And as Forbes noted in September 2013, the Serious Fraud Office, responsible for enforcing the UK Bribery Act, has begun to “hit its stride.”³ Companies are on notice more than ever before to address potential bribery and corruption risk, including the risks associated with third party relationships. This article addresses how companies can leverage a robust contracts management program to reduce third-party risk.

WHAT IS THIRD PARTY RISK AND WHY IS IT IMPORTANT?

There are basically two sources of bribery and corruption risk – internal actors and third parties. In theory, a company can exert firm control over its employees by providing adequate training and monitoring to mitigate risk. Third parties can present the same risks as employees; however, implementing effective controls concerning them can be more difficult. The organization lacks hire/fire power over third party employees and has no insight into corporate records. However, a company can implement controls and mitigate potential risk with whom it decides to do business. The many types of relationships (agents, distributors, freight forwarders resellers, consultants, lawyers, et al) present different risks, and it is important to identify the unique types of risk, and what each means to your organization. One of the most effective (and often neglected) means to managing third-party risk is to address them proactively through your contract management and compliance program. Regulators recognize the value of such programs and have appreciated their successful implementation as part of remediation efforts following an adverse FCPA event.

CRAFT AN APPROPRIATE DUE DILIGENCE PLAN TO IDENTIFY RISK

Performing due diligence on the various third parties with whom you contract is a critical first step in identifying potential corruption and bribery risk. This can be done in several ways. A company may use internal resources, an outside consultant,

or managed legal service provider to acquire and review raw intelligence reports on potential vendors, flag compliance risks, and generate summary reports for the company’s internal compliance team. Where the company perceives greater risk, specialists can perform “boots on the ground” diligence if warranted. Here it is helpful to have an evaluation process in place that will elevate to appropriate individuals, suspect or “red-flagged” contracts and third parties. Potential actions may include (1) reducing the number of third parties (based on criteria such as inactivity for long periods, or performing cost/benefit analyses of continuing the relationships; (2) consider disposition of existing contracts (e.g., modify, terminate or take no action); and (3) establishing the requirements and protocols for adding new third party contracts and integrating the procedure into the company’s contract management and compliance processes.

The ideal (and logical) time for the company to exert necessary controls over third parties to the extent possible is at the time it is considering entering into a new contractual relationship. In an anti-bribery and corruption context, the most important of these controls is of course, strict payment procedures. These include but are not limited to requesting a valid tax invoice, insisting on wire transfer or other non-cash form of payment, requiring documentation from the third party evidencing the relationship, and limiting payment to the actual third party service provider to a bank account in the country in which the third party is providing services on the company’s behalf.

Further, strict internal controls should be considered when entering into contracts with new third parties including the accountability of a business sponsor, a documented business justification, training and a completed FCPA Certification, and the aforementioned risk assessment/due diligence review. The final agreements should include relevant anti-bribery language, and the company should provide additional training on the principles underlying these controls and the potential impact of failing to adhere to them. Not all of these may be required for every third party; they will be a function of the perceived level of risk.



DOCUMENTATION IS KEY TO MANAGING RISK

The next key step to managing risk is to build and maintain contract management workflow policies and procedures that ensure any newly-created agreements or other documentation (such as amendments) are in a well-maintained third party contracts database. Properly implemented, with the requisite training and compliance incentives, this process will disallow unauthorized or undocumented exceptions and ensure the database is robust and complete, providing a reliable and up-to-date record of all contractual relationships. Items to consider include:

- Creating a playbook of well-documented negotiation positions that ensure only approved positions are agreed to;
- Establishing approval matrices for the instances when something non-standard is agreed to;
- Having a process in place for ongoing contract maintenance; and
- Reviewing commercial terms such as commissions or discounts to identify potential issues.

Once this database is established, the company should carry out both periodic and random documentation audits and ongoing monitoring to ensure that future amendments are consistent with approved terms and conditions and that the database is fully serving the purpose for which it was created.

Finally, the company should add to the database documentation for all existing third-party relationships, with several goals in mind:

- Ensure that database contains all documentation associated with a particular relationship;
- Identify missing or incomplete documentation and determine the most likely source of any missing materials; and
- Consider from the perspective of complexity whether a novation would make sense as a way to simplify the contractual relationships.

EFFECTIVE CONTRACTS MANAGEMENT AND COMPLIANCE IN RESPONSE TO AN ADVERSE EVENT

If the company finds itself on the wrong end of an FCPA or other anti-corruption investigation, the response should include a targeted effort to remediate third party risk. As noted above, the first step is to collect existing documentation (orders, emails, agreements, etc.) governing the relationships with third parties, followed by the review and categorization of these documents to identify agreements and determine if mandatory

compliance clauses were present. If these clauses were not present, the company should seek to amend the contracts to include the appropriate anti-bribery provisions. If a valid agreement does not exist, the company will need to draft the necessary agreement.

Another crucial step in identifying FCPA exposure after the fact is performing enhanced due diligence. The cost/benefit analysis mentioned earlier has now shifted as the environment in which the company does business has changed. The goal is now to reduce reputational and sanctions risk, demonstrate that the company takes its obligations seriously, and respond swiftly to any red flags its due diligence raises, up to and including terminating the contract and relationship.

The company may wish to not only coordinate with counsel, but leverage a managed legal services provider or other resource as necessary (think time and money) to create standard and localized templates based on the identified relationship types. The templates can then be regionalized for the local regulatory environment, and maintained in both English and the local language. By following these steps the company not only demonstrates a robust compliance process to a court, regulator or monitor, it can also leverage the remediation effort to develop new and improved approval matrices and negotiation guidelines. This will in turn create a faster, more efficient contracting process adding significant value to the business beyond the required risk mitigation.

CONCLUSION

Companies operating in a cross-border environment face increasing scrutiny from anti-corruption regimes. They can address third-party risk proactively with the creation of a robust contracts management and compliance program. These same principles can also be used to effectively deal with an adverse anti-corruption event.

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² <http://www.fcpablog.com/blog/2014/1/10/alcoa-lands-5th-on-our-top-ten-list.html>

³ <http://www.forbes.com/sites/riskmap/2013/09/19/uk-anti-corruption-efforts-are-getting-serious/>