

TWO RECENT FCPA SETTLEMENTS FOCUS ON CHINA, THIRD-PARTY DUE DILIGENCE, AND EMPLOYEE SCREENING

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Two recent settlements under the Foreign Corrupt Practices Act (“FCPA”) highlight the risks of certain business practices in China, and reinforce the importance of pre-retention screening of employees and third party agents.

AGA Medical Corporation. On June 3, 2008, the DOJ announced that it had entered into a three-year deferred prosecution agreement with AGA Medical, a privately held Minnesota-based manufacturer of cardiac devices. In connection with the agreement, the DOJ filed a Criminal Information in the District of Minnesota, alleging that AGA Medical made payments to physicians in China employed by government hospitals to obtain and retain business. The two-count Criminal Information charges AGA Medical with conspiracy to violate the FCPA and with FCPA anti-bribery violations. AGA Medical agreed to pay a \$2 million criminal fine, and to retain an independent compliance monitor to review improvements to the company’s internal control procedures.

The settlement documents describe two courses of conduct by AGA Medical: (i) alleged improper payments to government officials at the Chinese Patent Office to expedite and approve AGA Medical’s patent applications; and (ii) alleged “kickbacks” and “rewards” to physicians employed by government-owned hospitals to encourage them to purchase AGA Medical products. According to the Statement of Facts accompanying the deferred prosecution agreement, AGA Medical’s sales in China between 1997 and 2005 totaled approximately \$13.5 million.

Faro Technologies Inc. On June 5, 2008, the SEC and DOJ announced settlements with Faro Technologies, a publicly traded software development and manufacturing company headquartered in Florida. Faro Technologies entered into a two-year non-prosecution agreement with the DOJ, covering alleged FCPA violations arising from payments to employees of Chinese state-owned entities to obtain and retain business. Faro Technologies agreed to pay a \$1.1 million criminal penalty, and to retain an independent compliance monitor for the period of the agreement.

Faro Technologies also entered into a civil settlement with the SEC, pursuant to which the company agreed to disgorge approximately \$1.4 million and to pay prejudgment interest of approximately \$439,000. As with the DOJ settlement, the SEC settlement requires Faro Technologies to retain an independent consultant for two years to review its internal controls and compliance procedures.

The settlement documents describe Faro Technologies’ efforts to hire a Country Sales Manager for Faro Shanghai Co., Ltd., a wholly-owned subsidiary of Faro Technologies. Specifically, the SEC and DOJ allege that Faro Technologies’ Asia-Pacific Sales Director recommended hiring a Chinese citizen who had worked for a Faro distributor. During employment negotiations, the individual asked three Faro officers whether he could “do business the Chinese way” at Faro, which the Sales Director allegedly interpreted as giving money and things of value to Chinese customers to obtain and retain contracts. The SEC and DOJ

allege that Faro Technologies determined that these payments would violate Chinese law; nevertheless, the company hired the individual as its Country Sales Manager, and then orally instructed him and the Asia-Pacific Sales Director not to make such payments. According to the settlement documents, the Asia-Pacific Sales Director authorized the Country Sales Manager to make improper payments to government officials on several occasions in 2004 and 2005. The DOJ and SEC further allege that Faro Technologies inaccurately recorded improper payments as “referral fees” in its books and records.

Analysis. The AGA Medical and Faro Technologies settlements highlight the DOJ and SEC’s increased scrutiny of business interactions in China, involving state-owned enterprises. In particular, the AGA Medical settlement reinforces that the government considers state-owned hospitals to be foreign government instrumentalities under the FCPA, and their employees to be “foreign officials.”

Companies with foreign operations should conduct pre-employment screening and due diligence of prospective new hires, particularly in high-risk countries and business lines. One lesson of the allegations in the Faro Technologies settlements is that a prospective employee who asked about doing business “the Chinese way” should not have been hired, or should have been stringently supervised. Best practices further suggest that employees should be required to certify anti-bribery compliance, and that compliance efforts should be considered in employee promotion, compensation, and evaluation processes.

In addition, third party relationships are increasingly under scrutiny by U.S. regulators, who are familiar with specific third parties and business practices throughout the world. When a third party is advancing a company’s interests, the government will frequently seek to attribute the actions of the third party to the company itself. Thorough due diligence should be conducted prior to entering an agreement with any intermediary, agent, distributor, or partner. Third party relationships should be documented and monitored closely, and any suspicious conduct promptly examined.

Finally, the DOJ’s allegations regarding alleged payments by AGA Medical to employees of the Chinese Patent Office to expedite and obtain patent approvals highlight the U.S. government’s continued broad interpretation of the FCPA’s “obtain or retain business” element. In recent years, the DOJ has placed an increased focus on non-sales bribery – such as payments in connection with licenses, customs, and permits. A company’s FCPA compliance program should address benefits and payments in connection with all government relationships, not only those where a government entity is a customer.