FENWICK & WEST LLP

Corporate and Securities Law Update

InVision Non-Prosecution Agreement with DOJ and Proposed Settlement with SEC Demonstrate Importance of Compliance with Foreign Corrupt Practices Act

FEBRUARY 1, 2005

On December 3, 2004, the U.S. Department of Justice entered into a non-prosecution agreement relating to a Foreign Corrupt Practices Act investigation of InVision Technologies, Inc., a publicly traded company based in Newark, California, that manufactures and sells airport security screening devices to detect explosives in passenger baggage.

Fenwick & West LLP represented the Special Investigation Committee of InVision's Board of Directors in connection with the investigation, the company's voluntary disclosure of its findings to the government, and the negotiation of the non-prosecution agreement with the DOJ and the proposed agreement with the SEC.

As we discuss below, the InVision FCPA case:

- highlights how an FCPA violation can impact a company;
- demonstrates the importance of adopting an effective FCPA compliance program in order to avoid these sorts of FCPA violations; and
- illustrates some benefits that may be obtained by companies that are faced with an FCPA violation if they cooperate fully with regulatory authorities in the course of an FCPA investigation.

In addition to the specifics of the InVision case, this update also provides an overview of the FCPA and discusses aspects of an effective FCPA compliance program. While the FCPA has been in effect since 1977, there has recently been more focus on FCPA compliance by the DOJ and the SEC, in part due to the increasing scrutiny on corporate conduct in general following the passage of The Sarbanes-Oxley Act.

The Significance of the InVision Investigation and Non-Prosecution Agreement

Background of the InVision Case. In early 2004, the General Electric Company and InVision announced an agreement for GE to acquire InVision. Prior to completion of the acquisition, questions were raised regarding potential FCPA problems involving InVision. According to the non-prosecution agreement, InVision, through a senior sales executive and a regional sales manager, became aware of information suggesting a "high probability" that InVision's sales agents and/or distributors in Thailand, China and the Philippines intended to use their commissions, mark-ups or other payments from InVision to fund improper payments to foreign officials to secure or retain business for InVision. InVision's former sales executive and former sales manager failed to conduct adequate inquiry regarding this information and thereby allegedly avoided learning the true intentions of InVision's agents and/or distributors.

Following our investigation and InVision's voluntary self disclosure, InVision and the DOJ entered into a non-prosecution agreement in December 2004. Pursuant to the non-prosecution agreement, InVision agreed, among other things, to the following:

- to accept responsibility for the conduct disclosed to the DOJ and the failure to maintain sufficient internal FCPA controls with respect to its foreign sales operations;
- to pay a monetary penalty of $800,000; and
- to perform certain undertakings to ensure its ongoing compliance with the FCPA and its continued cooperation with the DOJ and SEC.

In agreeing not to prosecute InVision, the DOJ emphasized the following points:

- InVision's voluntary disclosure to the DOJ;
- the fact that the voluntary disclosure prevented an improper payment from being made in Thailand;
- InVision's prompt disciplinary action respecting the employees responsible for the conduct at issue;
- InVision's ongoing cooperation; and

- the absence of any prior FCPA-related or other criminal history at InVision.

The resolution of the InVision FCPA matter is noteworthy because it is the first time the DOJ has resolved an FCPA investigation through a non-prosecution agreement.

GE's acquisition of InVision was completed following the execution of the non-prosecution agreement with the DOJ. The DOJ and GE also entered into a related agreement, which provides that GE will implement the conditions of InVision's non-prosecution agreement, and retain and pay for an independent consultant to evaluate and report on GE's integration of InVision into GE's FCPA compliance program.

InVision has also made an offer of settlement to the SEC staff, which, if approved by the SEC, will require InVision to pay a monetary fine, disgorge certain profits from one foreign transaction, and to implement and adhere to an FCPA compliance program.

Significance of the InVision Case. This matter demonstrates the critical importance of having comprehensive internal FCPA controls and an effective FCPA compliance program. In the absence of adequate controls and programs, otherwise routine and legitimate payments, such as commission payments to agents, the terms of product sale agreements to distributors, or virtually any payment to a third party, can become the focus of an anti-bribery investigation. This is especially true in light of the fact that liability under the FCPA can be predicated on a theory of "deliberate ignorance" — that the failure to follow-up on "red flags" can, by itself, be a sufficient basis for establishing liability under the FCPA.

The InVision FCPA matter is also noteworthy because the allegedly improper payments included payments made to foreign officials by a distributor of InVision's products. Unlike a sales representative or a consultant, a distributor generally purchases products from a manufacturer, then resells them to the end user. In a distributor transaction, the manufacturer of the products is not a party to the sale to the end user and is not generally involved in setting the price of the products from the distributor to the end user. As a result, FCPA compliance practices with respect to distributors have generally been less extensive than those involving sales representatives or consultants, where the manufacturer sells the products directly to the end user and pays the sales representative or consultant a commission for assisting with the transaction. However, in light of the InVision case, companies should review their FCPA compliance procedures to evaluate whether they should enhance their scrutiny of their relationships with, and the practices of, their distributors.

In addition, a number of recent proposed acquisitions, including the InVision merger, have been delayed or terminated as a result of potential FCPA problems. This underscores the importance of reviewing FCPA matters in the acquisition context and illustrates some of the adverse effects that FCPA compliance problems can have upon a company. Finally, the InVision FCPA matter also demonstrates the significant leniency that may be accorded to companies that choose to make a voluntary disclosure and fully cooperate with the government's investigation.

Overview of the Foreign Corrupt Practices Act

In general, what does the FCPA require that companies do? The FCPA has three principle components:

- *Anti-bribery provisions*, which prohibit payments, offers of payment or authorization of payments by U.S. persons (including individuals and organizations) to foreign officials for the purpose of obtaining or retaining business.

- *Internal accounting controls provisions*, which require public companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

  - transactions are executed in accordance with management's general and specific authorization;
  - transactions are recorded as necessary to permit preparation of financial statements under GAAP and to maintain accountability for assets;
  - access to assets is permitted only in accordance with management's general or specific authorization; and
  - the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

- *Books and records provisions*, which require public companies to maintain their books and records such that they accurately and fairly reflect the transactions and dispositions of their assets.

A copy of the text of the FCPA is available on the DOJ's website at: http://www.usdoj.gov/criminal/fraud/fcpa/fcpastat.htm.

What sorts of penalties apply to companies if they fail to comply with the FCPA?
Each of the three principle provisions of the FCPA carry both criminal and civil penalties. In many cases, including the InVision case, companies find themselves the target of concurrent criminal actions by the Department of Justice and civil actions by the SEC.

The potential *criminal penalties* for knowing or willful violations of any of the FCPA provisions are severe:

- *Organizations* are subject to a fine of $2 *million* for knowing violations of the anti-bribery provisions, and up to a $25 million fine for willful violations of the internal accounting controls or books and records provisions.

- *Individuals* are subject to a maximum of five years' imprisonment and a $250,000 fine.

Under the Alternative Fines Act, both organizations and individuals are also subject to fines equal to twice the gain (or loss) from the offense. Finally, debarment and other collateral consequences of a conviction under the FCPA can be catastrophic for companies largely dependent on government contracts.

The SEC has equally dramatic remedies available to it, including injunctive relief, substantial civil fines, and the disgorgement of any ill-gotten gains. The SEC is significantly aided in its enforcement efforts by the fact that there is no *mens rea* requirement for civil violations of the FCPA's books and records or internal accounting controls provisions.

What is the scope of the FCPA's anti-bribery provisions?
The scope of the FCPA's anti-bribery provisions is extraordinarily broad. The FCPA makes it unlawful for:

- *any* U.S. individual or organization, including "issuers" and "domestic concerns," or any officer, director, employee or agent of any issuer or domestic concern or any stockholder acting on behalf of any issuer or domestic concern, acting anywhere in the world, as well any non-US persons who act on US soil,

- to "corruptly" offer, pay, promise to pay, or authorize the payment of money or the giving of anything of value,

- to a foreign official, foreign political party, or candidate for foreign political office,

- for the purpose of influencing such official to do any official act or inducing such official to influence a foreign government or any entity thereof, in order to assist the "issuer" or "domestic concern" in retaining or obtaining business.

Recent case law has expanded the scope of the "retaining or obtaining business" prong to include virtually any government action that may be favorable to a company, such as favorable tax treatment or securing any "improper advantage."

In addition to prohibiting direct payments to foreign officials, the FCPA also prohibits payments to third parties (such as agents, consultants, foreign subsidiaries or joint business partners) while "knowing" that the third party will, *directly or indirectly*, make a payment or offer of payment to a foreign official. In practice, this means that a company may be held liable for the acts of its agents — even though the company did not directly make or offer to make any payments to foreign officials — if it knew or authorized the payments. Further, the FCPA also provides that the required knowledge to make out a criminal violation of the FCPA can be established not just by actual, affirmative knowledge of improper payments, but also by merely being aware of a "high probability" that such conduct may have occurred.

The FCPA also imposes obligations on companies with respect to the conduct of their subsidiaries and other entities they own in whole or in part, which can vary based upon the extent of the ownership interest.

What are some of the areas that companies should focus on when evaluating their internal accounting controls over foreign sales?
The SEC has identified five conceptual elements that it will consider when assessing the adequacy of a company's internal accounting controls:

- the company's overall control environment;

- the translation of the broad objectives of internal accounting controls into specific control objectives tailored to the company;

- company-specific control procedures designed to achieve the specific control objectives;

- monitoring of control procedures to determine whether they are functioning as intended; and

- consideration of the benefits and costs of additional or alternative controls.

In evaluating their internal accounting controls over foreign sales, companies should be asking the following types of questions in their reviews:

- Are there written controls and procedures covering access to cash, expense reimbursements, commission payments, and other disbursements?

- Does the company have a written policy on providing gifts and reimbursing travel and entertainment expenses?

- Are transactions accurately recorded in the company's books and records and are they supported by appropriate back-up documents?

- Are there written procedures in place for the evaluation and selection of agents and distributors? Are agents and distributors required to sign an FCPA compliance certification and has the company insisted on audit rights over its agents' books and records?

- Does the company have a published FCPA compliance policy and does it periodically provide its employees, agents and distributors with FCPA training? Are the company's employees and agents required to sign certifications attesting to their training?

- Is the designated compliance officer truly disinterested or does he have a financial stake in the transactions he is meant to be policing?

- Are all of these policies and procedures in writing and subject to verification?

What is covered by the FCPA's books and records provisions?
The FCPA requires companies to make and keep books and records, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the company's assets. The FCPA's books and records provisions apply to every aspect of a company's business activities, both domestic and foreign, and are not limited just to bribes or other corrupt payments. Moreover, there is no materiality requirement under the books and records provisions, thus making even *de minimus* payments or any off-the-books slush fund potentially subject to the FCPA.

In practice, the record keeping provisions are designed to prevent three different improprieties:

- the failure to record illegal transactions;

- the falsification of records to conceal illegal transactions; and

- the creation of records that are quantitatively correct but fail to specify the qualitative aspects of the transactions that might reveal the true purpose of the particular payment. In other words, if a company is obtaining business through commercial bribery, the SEC will take the position that the company's records are inaccurate unless payments are labeled "bribes to secure business."

Adopting an Effective FCPA Compliance Program

Who should consider adopting an FCPA compliance program?
All U.S. companies that conduct business overseas, regardless of their size or whether they are publicly traded or privately held, should implement comprehensive FCPA internal controls, including FCPA compliance and training programs.

What should an FCPA compliance program include?
A company's FCPA compliance program should be tailored to its particular circumstances. As a result, FCPA compliance programs will vary from company to company. In most cases, an FCPA compliance program will be part of a company's broader compliance and ethics program, which should be structured to comply with recently revised U.S. sentencing guidelines. We recently distributed a Corporate and Securities Law Update regarding compliance and ethics programs, which can be accessed at http://www.fenwick.com/docstore/publications/Corporate/SEC/Corp_Sec_11-16-04.pdf.

In general, an effective FCPA compliance program should include the following:

- Established "tone at the top" that emphasizes the importance of ethical conduct and legal compliance.

- Established standards and procedures to prevent and detect potential violations of the FCPA, including the

adoption of a corporate ethics policy that explicitly prohibits conduct that violates the FCPA.

- Oversight by the Board of Directors and senior management of the content and operation of the company's FCPA compliance program.
- A designated member of senior management to act as the company's Compliance Officer, with overall responsibility for the FCPA compliance program.
- Adequate resources for the implementation of the program.
- Ongoing monitoring and risk assessment to confirm the program is being followed and is effective.
- Periodic reporting regarding the efficacy of the program to the Board of Directors and senior management.
- Periodic training for officers, employees, agents, consultants, joint venture partners, and distributors concerning the requirements of the FCPA.
- Appropriate disciplinary mechanisms for violations or failure to detect violations of company policy or the law.
- Incentives for compliance and an established system for anonymous and confidential reporting of suspected violations without fear of retribution.
- Documented procedures to ensure that the company forms business relationships only with reputable agents, consultants, joint venture partners, and distributors.
- Contractual provisions in agreements with agents, consultants, joint venture partners, and distributors, explaining and requiring adherence to the FCPA.
- Internal accounting controls governing access to cash, travel and entertainment expenses, and other disbursements, as well as controls over any exceptions to established commission rates or price schedules.
- Procedures to ensure that, if criminal conduct is detected, reasonable steps will be taken to respond appropriately to prevent it from recurring, including modification of the program as appropriate.
- Procedures to enable the company to exercise due diligence in order to exclude from management those persons who the company knew or should have known had engaged in illegal conduct or other conduct inconsistent with the program.

It is critically important that documentation exist for each aspect of the company's FCPA controls, including written policies and procedures, formalized reporting responsibilities within the organization, and written descriptions of specific compliance controls and procedures, as well as documentation relating to the testing of the adequacy of those controls and procedures. Indeed, without such documentation or other evidentiary proof, a company is without the means to demonstrate to the Department of Justice or to the SEC the adequacy, or even the existence, of its compliance program.

What are the benefits of an effective FCPA compliance program?

Establishing an effective FCPA compliance program in accordance with the U.S. Sentencing Guidelines can provide significant benefits. First, such a compliance program may detect and prevent potential violations of the FCPA before they occur. In addition, in the event of a violation of the FCPA, the existence of an effective FCPA compliance program is an important factor used by both the Department of Justice and the SEC in deciding whether to prosecute. Finally, in the event of a prosecution and conviction, the existence of an effective FCPA compliance program can significantly reduce the punishment the company would otherwise receive.

For further information on the FCPA or how to implement an effective FCPA compliance program, please contact any member of your Fenwick & West LLP team, Brad Lewis (blewis@fenwick.com), Susan Muck (smuck@fenwick.com), Donald Searles (dsearles@fenwick.com), or David Bell (dbell@fenwick.com), each of whom worked on the InVision matter and assisted in the preparation of this update.