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FCPA and Other Anti-Corruption Concerns Facing Sovereign Wealth Funds

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Sovereign wealth funds wield a staggering amount of financial influence. Indeed, according to at least one report, the total aggregate amount of assets under management by state-owned investment funds is approximately $4.8 trillion.[2] Given all the money at issue, U.S. prosecutors have expressed a clear concern about the risk of corruption in dealings with these funds. Indeed, both the U.S. Department of Justice ("DOJ") and the U.S. Securities and Exchange Commission ("SEC") have indicated an interest in examining transactions involving sovereign wealth funds for possible violations of the U.S. Foreign Corrupt Practices Act ("FCPA").

More specifically, in 2008, Steven Tyrrell, the then Chair of the DOJ's Fraud Section, noted that the "boom of sovereign wealth funds is an area at the top of the Justice Department's hit list." Then in January 2011, as has been widely reported, the SEC initiated an inquiry requesting documents from several entities relating to their dealings with sovereign wealth funds.

In the wake of these public expressions of the U.S. government's interest in this area, there has been considerable discussion regarding FCPA exposure of companies doing business with sovereign wealth funds; however, there has been little discussion of the exposure faced by the sovereign wealth funds themselves. This article will address the potential liability that sovereign wealth funds face under three of the most significant antibribery laws: the U.S. FCPA, the U.K. Bribery Act, and the People's Republic of China's ("PRC") Antibribery Laws.

I. The U.S. Foreign Corrupt Practices Act

The FCPA makes it illegal for United States citizens, residents, issuers,[3] and businesses (and their employees and agents) to bribe foreign officials in order to obtain or retain business.[4]

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[2] *See* Chart, "Recent Sovereign Wealth Fund Market Size by Quarter," Sovereign Wealth Fund Institute, http://www.swfinstitute.org/fund-rankings.

[3] Even foreign companies trading on U.S. exchanges (*i.e*., those who have a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act") or who have to file periodic reports under Section 15(s) of the Exchange Act) are considered U.S. issuers under the FCPA. 15 U.S.C. § 78(c)(a)(8).

15 U.S.C. §§ 78dd. The statute defines the term "foreign official" to mean "any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of [such an entity]." 15 U.S.C. §§ 78dd-2(h)(2)(A).[5]

Although the FCPA does not define the term "instrumentality," the DOJ has taken an expansive view of the term and interpreted it to include state-owned entities.[6] In *US v. Carson*, the court stated that the issue of whether an entity constitutes a government instrumentality is dependant on several factors, none of which is dispositive. The factors include:

- The foreign state's characterization of the entity and its employees;
- The foreign state's degree of control over the entity;
- The purpose of the entity's activities;
- The entity's obligations and privileges under the foreign state's law, including whether the entity exercises exclusive or controlling power to administer its designated functions;
- The circumstances surrounding the entity's creation; and
- The foreign state's extent of ownership of the entity, including the level of financial support by the state (*e.g.*, subsidies, special tax treatment, and loans).

Carson, 2011 WL 5101701, at *3-4; *see also Aguilar*, 783 F. Supp.2d at 1115 (citing similar non-exclusive list of characteristics belonging to government agencies and departments). Given the structure and purpose of most sovereign wealth funds, their employees are likely to be considered foreign officials for the purposes of the FCPA. As a result, the DOJ and the SEC are likely to take the position that individuals and entities who bribe employees of sovereign wealth funds are in violation of the FCPA.[7]

Because the FCPA does not prohibit receipt of bribes, however, employees of sovereign wealth funds who receive bribes are unlikely to be held liable for violations of the FCPA. See 15 U.S.C. §§ 78dd-2(h)(2)(A). Indeed, in *United States v. Castle*, the court dismissed an indictment against a Canadian foreign official for conspiracy to violate the FCPA. *Id.* at 832. In doing so, the court expressly found that the FCPA "does not criminalize the receipt of a bribe by a foreign official." 925 F.2d 831, 833 (5th Cir. 1991). Citing "overwhelming evidence of a Congressional intent to exempt foreign officials from prosecution for receiving bribes," the court reasoned that

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[4] Foreign individuals and foreign companies that do not trade on U.S. exchanges can also violate the FCPA if they cause an act in furtherance of a corrupt payment within the United States. 15 U.S.C. §§ 78dd-1(g).

[5] In addition to antibribery provisions, the FCPA also has accounting provisions that require U.S. issuers to make and keep books and records that accurately and fairly reflect the issuer's transactions and to maintain a system of adequate internal accounting controls. 15 U.S.C. § 78m(b).

[6] *See US v. Carson*, 09–00077–JVS, 2011 WL 5101701, at *3-4 (C.D. Cal. May 18, 2011); *U.S. v. Aguilar*, 783 F. Supp.2d 1108, 1115 (C.D. Cal. 2011).

[7] Noting the reality that bribes are made to individuals within the government who have influence over commercial transactions, the FCPA prohibits bribes made to government officials. Payments to the government entities themselves are not prohibited. As a result, any payments made directly to a sovereign wealth fund would not violate the statute.

it would be "absurd" to apply the general conspiracy statute to obviate this exemption. *Id.* at 835. Even given some of the aggressive theories of liability that the SEC and DOJ have been pursuing in this area, it is therefore unlikely they could successfully pursue direct or indirect (*e.g.*, aiding and abetting, conspiracy) FCPA charges against sovereign wealth funds or their employees for the receipt of a bribe.

That said, there remains the possibility that the DOJ could proceed under other statutes for conduct ancillary to the bribe. For example, in January 2010, the DOJ charged Juthamas Siriwan, a senior official at the Tourism Authority of Thailand with money laundering and conspiracy to commit money laundering in violation of 18 U.S.C. §§ 1956(a)(2)(A) and (h). The charges arose from bribes allegedly paid to her in violation of the FCPA. In addition, sovereign wealth funds and their employees could be liable for prosecution in their own countries. As the *Castle* court pointed out, many foreign nations already prohibit the receipt of a bribe by a foreign official. 925 F.2d at 835.

Even if it is unlikely that the SEC or DOJ would pursue a sovereign wealth fund or its employee for receipt of a bribe, sovereign wealth funds must still take steps to ensure that there is no corruption of its employees. Even the mere allegation of bribery at a sovereign wealth fund can thrust the fund and its employees into a government investigation that would subject the sovereign wealth fund to intrusive requests for information, documents, and testimony. Such requests can prove distracting to the normal conduct of business and place sovereign wealth funds in the delicate position of having to decide between cooperating with U.S. government prosecutors (who, depending upon which country's sovereign wealth fund is involved, may have a difficult time quickly getting the requested materials without cooperation) and refusing to turn over the information (thereby reinforcing negative stereotypes of sovereign wealth funds as being veiled in secrecy and insensitive to the concerns of U.S. government regulators).

In addition, the press attendant to a bribery allegation would inflict severe reputational damage to the sovereign wealth fund at a time when sovereign wealth funds are seeking to reassure the global public as to their integrity. Indeed, in the explanation and commentary to the "Santiago Principles" set forth by the International Working Group of the Sovereign Wealth Funds ("IWG"), such reputational risk was identified as one of the main risks that sovereign wealth funds face in their operations: "Reputational risk is the potential that negative publicity regarding an SWF's business practices, whether true or untrue, may cause a decline in investment returns, costly litigation, or loss of counterparties, or impair the home country government's international standing." Sovereign Wealth Funds, Generally Accepted Principles and Practices, IWG (October 2008) (hereinafter "Santiago Principles"), at pg. 23. In short, even if they are unlikely to lead to liability under the FCPA, allegations of bribery subject sovereign wealth funds to unnecessary reputational risk.

Conversely, sovereign wealth funds can improve their relationship with foreign regulators by taking affirmative steps to prevent bribery of its employees. Such steps would include among other things, adopting and implementing a comprehensive compliance program addressing the issue. Such steps would be consistent with Santiago Principle 13, which states that "[p]rofessional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff." As the explanation and commentary to this principle makes clear,

> To the extent applicable, the governing body(ies) should require establishment of a code of conduct for all members of the governing body(ies), management, and staff, *including compliance programs.* Furthermore, members of the governing body(ies), management, and staff should be subject to conflicts of interest guidelines, and rules. These codes, guidelines, and rules are critical to ensuring a high level of integrity and professionalism.

Santiago Principles, at pg. 18.

In addition to the foregoing, sovereign wealth funds should be cognizant of FCPA concerns when they acquire or take a predominant ownership position in a company. Depending on the sovereign wealth fund's level of involvement in company's business, and subject to considerations of sovereign immunity discussed below, the DOJ or the SEC (if the company is a U.S. issuer) may seek to hold the sovereign wealth fund liable if the company has committed an FCPA violation, even if that violation occurred before the acquisition. Even if the company is not a U.S. company or issuer, DOJ could seek to hold the sovereign wealth liable if the company or someone acting on its behalf has violated the FCPA *while in the United States. See* 15 U.S.C. §§ 78dd-2(h)(2)(A).

Sovereign Immunity in the United States

The Foreign Sovereign Immunities Act ("FSIA"), 28 U.S.C. § 1602 was enacted to codify the doctrine of sovereign immunity in the United States. It provides that "a foreign state shall be immune from the jurisdiction of the courts of the United States" except as provided in the act. *Id.,* § 1602. The FSIA defines a "foreign state" to include "a political subdivision" or "an agency or instrumentality" of a foreign state. *Id.,* § 1603. As the U.S. Supreme Court has recently held, however, the FSIA does not grant immunity to government officials working on behalf of a foreign state. *Samantar v. Yousuf,* 130 S. Ct. 2278, 2292 (2010).

The FSIA also sets forth a "commercial" exception, which provides that a foreign state is not immune from suit in any case

> (1) in which the action is based upon a commercial activity carried on in the United States by the foreign state;
>
> (2) or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere;
>
> (3) or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

Id., § 1605(a)(2). The U.S. Supreme Court has held that "when a foreign government acts, not as a regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are commercial within the meaning of the FSIA." *Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607, 614 (1992).

Given the analysis above, an employee of a sovereign wealth fund could not claim immunity under the FSIA. The sovereign wealth fund itself would likely be considered an agency or instrumentality of a foreign state, but its activities would likely trigger the commercial exception to immunity if the conduct had a sufficient United States nexus.

II. **The U.K. Bribery Act**

The UK overhauled its antiquated corruption statutes with the Bribery Act 2010 ("Bribery Act"), which came into force on July 1, 2011. The Bribery Act prohibits the act of giving, promising or offering a bribe, but also the act of requesting, agreeing to receive or accepting a bribe. It also creates a separate offense of bribery of a foreign public official in order to obtain or retain business or an advantage in the conduct of business.[8] The Bribery Act also creates a corporate strict liability offence of failing to prevent bribery on behalf of a "relevant commercial organisation."

The Bribery Act covers any violative conduct that occurs in whole or in part in the U.K. Where the alleged conduct occurs wholly outside the U.K., the Bribery Act covers U.K. businesses and citizens and people ordinarily resident in the U.K. Thus, while sovereign wealth funds and their employees would be liable for any bribes given or received in the U.K., most sovereign wealth funds and their employees that are not U.K. citizens or residents would not be subject to the Bribery Act for conduct outside the U.K.

The corporate "failure to prevent" offense may, however, present an exception. This offense covers any "relevant commercial organisation" formed anywhere in the world which "carries on business or part of a business" in any part of the U.K. It exposes such companies to liability for any act of bribery committed on its behalf anywhere in the world.

A sovereign wealth fund would likely be considered a "relevant commercial organization" and subject to the offense if it is "incorporated" or a "partnership."[9] Some sovereign wealth funds would appear to fall clearly within this definition. For example, the China Investment Corporation ("CIC") is incorporated under Chinese Company Law and constitutes a wholly state-owned company. On the other hand, funds with structures that do not have the attributes associated with traditional English corporations might be able to argue that they fall outside the definition of a "relevant commercial organization."

To be held liable under the "failure to prevent" offense, a corporate body must also be carrying on a business or part of a business in the U.K. While one might assume that most sovereign wealth funds carry on business in the U.K. by virtue of their investment activities, there is as yet no case law interpreting the phrase. According to Ministry of Justice guidance, the

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[8] With respect to this offense, the Guidance to the Bribery Act defines a "foreign public official" as a person who holds a legislative, administrative or judicial position whether elected or appointed. It also includes those "exercising a public function" which can be problematic in the context of state-owned enterprises, where the distinctions between the private and public functions of employees and agents can become blurred. Broadly speaking, e more senior the employee or the closer the connection with the State the more likely he or she is to be considereda "foreign public official" under the U.K. Bribery Act.

[9] A limited partnership or equivalent is a "partnership" for these purposes (and a limited liability partnership is "incorporated").

mere purchase of U.K.-listed shares or U.K. companies or financial products from outside the U.K. is not necessarily a "demonstrable business presence" in the U.K. The exposure of sovereign wealth funds that do not base any operations in the U.K. again depends on the exact nature of the fund and/or its investments. Further, Ministry of Justice guidance also states that a mere ownership interest even in a 100% a subsidiary will not, of itself, mean that the parent "carries on business" in the U.K. if the subsidiary acts independently of its parent. However, a private equity-style investment, where the fund takes an active management role in a U.K. portfolio company may qualify as carrying on business where very many passive minority holdings would not.

If a sovereign wealth fund is a "relevant commercial organization," it may be found guilty of failure to prevent bribery if anyone performing services on the fund's behalf bribes any person (*i.e.,* not only foreign public officials) for the benefit of the fund. The fund's only defense is if it can show that it had in place "adequate procedures" to prevent bribery. The Ministry of Justice guidance indicates that such procedures should meet six principles:

(a) A clear policy that bribery and corruption are unacceptable in the business and implementing procedures proportionate to the attendant bribery risks;
(b) Top-level management commitment to and engagement with the policy and procedures;
(c) Assessment of the nature and extent of the bribery risks in the business;
(d) Proper due diligence in respect of persons who perform services for the organisation;
(e) Effective communication of, and training on, the anti-corruption policies and procedures of the company to its internal and external representatives; and
(f) Regular monitoring and review.

Proceeds of Crime Act 2002

There is a further potential exposure for a SWF in the U.K. which presents what might be seen as an easier route for the prosecuting authorities. Where the authorities are not convinced they have sufficient evidence to prove a bribery offense, they may choose to allege a money-laundering offense under the Proceeds of Crime Act 2002, ("POCA"), in a manner similar to the US approach in the *Siriwan* case referred to above. Broadly, any dealing with property, such as the proceeds of a contract, that one knows or suspects to be the proceeds of crime is a money-laundering offense.[10] Thus where, for example, an SWF suspects a bribe was paid or offered to win a contract, there is likely to be the risk of a substantive money-laundering offense - and there does not need to be a prosecution in respect of the substantive unlawful conduct in order to proceed under POCA. In order, in such a situation, to avail itself of a statutory defense to money laundering, the SWF may need to make a report to the U.K. authorities[11]. Currently such disclosures are made to the Serious Organised Crime Agency ("SOCA"). SOCA shares information from such reports with the Serious Fraud Office, which conducts overseas

[10] See Proceeds of Crime Act 2002 Chapter 29, §§ 327 (Concealing), 328 (Arrangements), and 329 (Acquisition, use and possession).

[11] That is, an "authorised disclosure" as defined in Proceeds of Crime Act 2002 s.338 seeking consent under the Proceeds of Crime Act 2002 §§327(2)(a), s.328(2)(a), and s.329(2)(a).

corruption investigations, and the City of London Police, which investigates UK domestic corruption.

State Immunity Under U.K. Law

Under the Diplomatic Privileges Act of 1964, a state, its arms of government, and heads of state and diplomats enjoy immunity. While there is no case law on the point, a sovereign wealth fund is unlikely to be considered a state for these purposes and would likely not be granted immunity. English courts would look to the principles of the United Nations Convention on Jurisdictional Immunities of States and their Property, to which the U.K. is a signatory, although it is not yet in force. The convention defines "State" as including "agents or instrumentalities of the State or other entities, to the extent that they are entitled to perform and are actually performing acts in the exercise of the sovereign authority of the State" and "representatives of the State acting in that capacity." Article 1(b)(iii)(iv). As in the United States, there is an exception to state immunity for acts which are "commercial transactions." *See* State Immunity Act 1978.[12] Given the commercial nature of sovereign wealth funds, it would be unlikely to enjoy state immunity.

III. PRC Antibribery Laws

In February 2011, the PRC promulgated Article 164 of the PRC Criminal Laws, which has since been referred to as "China's FCPA." It prohibits giving property "for the purpose of seeking illegitimate commercial benefit, . . . to any foreign public official or official of an international public organization." However, on its face, the new law does not prohibit the receipt of the bribe by foreign officials. Thus, sovereign wealth funds and their employees are unlikely to face prosecution under the PRC Antibribery Laws for the receipt of bribes.

Sovereign wealth funds and their employees could theoretically face prosecution for bribing PRC state officials under Article 389 of the PRC Criminal Law, which prohibits the giving of money or property to PRC state officials[13] to obtain unjustified benefits (such as the opportunity to acquire equity in PRC entities). Theoretically, regardless of whether the criminal acts occur inside or outside of PRC borders, the PRC Criminal Law applies[14]. However, typically, China only attempts to assert jurisdiction where it is confident of its actual ability to do

[12] State Immunity Act 1978 Chapter 33, section 3.

[13] According to Article 93 of the PRC Criminal Law, the term "state officials" refer to all personnel of state organs/agencies. In addition, the personnel engaging in public service in state-owned corporations, enterprises, institutions, and people's organizations, the personnel who are assigned by state organs/agencies, state-owned corporations, enterprises, and institutions to engage in public service in non state-owned corporations, enterprises, institutions, and social organization, and other personnel engaging in public services according to relevant laws, are to be treated as "state officials".

[14] According to Article 8 of the PRC Criminal Law, the Criminal Law may be applicable to foreigners outside PRC territory who commit crimes against the PRC state or against PRC citizens, provided that according to the PRC Criminal Law a minimum sentence for such crimes is not less than a three-year fixed term of imprisonment (e.g., Article 389 of the PRC Criminal Law may be applicable here), or such crimes would not be punished according the laws of the place(s) where they were committed.

so, such as where assets are located within the PRC or the would-be defendants are within PRC boarders.

In addition, it bears noting that cases prosecuted under the two above-mentioned statutes are rare and given the prosecutorial priorities of PRC regulators, there would be little likelihood of enforcement against foreign sovereign wealth funds or their employees even if they violated the statutes. The primary concern for PRC regulators is the impact that the receipt of bribes by PRC officials has on the credibility of the State and particularly the Chinese Communist Party (a substantial percentage of State officials are also Party members). Thus, prosecutions initiated by the CCP's Party Discipline apparatus and brought under Article 385, which prohibits PRC state officials from taking bribes, are more common.

It appears clear that the CIC and its employees would be subject to prosecution for receipt of bribes under PRC Criminal laws. However, PRC regulators have declined to state how they would treat foreign sovereign wealth funds engaged in the giving or receiving bribes. Given that the PRC regulations appear most concerned with governing the conduct of PRC officials, sovereign wealth funds (other than the CIC) and their employees are unlikely to be prosecuted for giving or receiving bribes under these regulations.

Sovereign Immunity under PRC Law

On the issue of sovereign immunity for state agencies, PRC law lacks statutory guidance. Although in 2005 the PRC government has signed the *United Nations Convention on Jurisdictional Immunities of States and Their Property*, the Convention has not yet been ratified via PRC legislation. However, a 2011 decision by the Hong Kong Court of Final Appeal in the case of *FG Hemisphere Associates v. Democratic Republic of Congo* (FACV Nos. 5, 6 & 7 of 2010) ("FG Hemisphere") implies that China takes the position that states enjoy absolute sovereign immunity. The court decided in *FG Hemisphere* that, because the PRC (including Hong Kong) is a "jurisdiction that recognizes absolute immunity absent exclusion," a Hong Kong court must consistently apply that position. *FG Hemisphere* indicates that the PRC recognizes absolute sovereign immunity unless the relevant party waives such rights expressly.

Under PRC laws, foreign individuals who are employed by sovereign wealth funds are also subject to relevant criminal laws and thus might be prosecuted for their criminal offenses if their actions constituting such offense were linked to China. An exception exists for diplomats or those who otherwise enjoy diplomatic immunities[15]. If a foreign diplomat engaged in bribery activities in China which otherwise would be deemed a criminal offense, such matter would be resolved through diplomatic channels rather than normal criminal prosecution procedures in

[15] The definitional scope of a "diplomat" under PRC law is somewhat general for purposes of diplomatic immunity. According to relevant PRC laws, diplomats enjoying diplomatic immunities from criminal prosecution include ambassadors, consulates and other staff with diplomatic rank working in the embassies and consulates, as well as their spouses and children who live with them. In addition, heads of foreign states or governments, ministers of foreign affairs, and other officials with similar positions who visit China are also considered diplomats for diplomatic immunity purposes. Therefore, unless SWF employees fall into the above category of "diplomats", they will not enjoy the diplomatic immunity from criminal prosecution under PRC law.

China. Conversely, foreign individuals who do not enjoy diplomatic immunities may be punished for their bribery activities in China under PRC laws.

IV. Conclusion

With some exceptions, sovereign wealth funds and their employees are generally unlikely to be charged with violations of the FCPA, the Bribery Act, or PRC Antibribery Laws. Among other things, the FCPA does not prohibit the receipt of bribes, the Bribery Act is primarily focused on conduct within the U.K., and the PRC is more concerned with bribery of its own officials than those from other countries. The legal risks attendant to pursuing alternative theories of liability (however creative), the political considerations attendant to suing a sovereign wealth fund, and the opportunity to pursue more fruitful investigations elsewhere all counsel against bringing actions against sovereign wealth funds or their employees under these particular anti-corruption laws. That said, even the specter of a government investigation would cause considerable distraction to a sovereign wealth fund and serve to harm its reputation around the world in the very countries that it is trying to reassure as to its integrity, transparency, and intentions. As a result, even though the risk of liability under anti-corruption laws is relatively slight, sovereign wealth funds need to protect themselves against the considerable harm that would nonetheless flow from bribery allegations. They need to make sure that they have thoroughly vetted their compliance policies and procedures, effectively implemented these policies and procedures, and conducted risk assessments to identify and address the areas most susceptible to corruption.