

What's in a Name Under the FCPA

What is in a name? The terms agent, reseller and distributor are sometimes used interchangeably in the business world. However in the legal world they usually have distinct definitions. An agent can be generally defined as is a person who is authorized to act on behalf of another to create a legal relationship with a Third Party. An agent can also be a person who makes introductions and generally facilitates relationships between the seller of goods or services and end-using buyer. Such an agent usually receives some type of percentage of the final sale as his commission. An in-country national agent is often required in most Middle East and Far East countries. A reseller can be generally defined as a company or individual that sells goods to an end-using buyer. A reseller does not take title and thereby own the goods; the reseller is usually a conduit from the seller to the end-using buyer. A reseller usually receives a flat commission for his services, usually between 5-10% of the final purchase price. This format is often used in the software and hardware industries. A distributor can be generally defined as a company or individual which purchases a product from an original equipment manufacturer (OEM) and then independently sells that product to an end user. A distributor takes title, physical possession and owns the products. The distributor then sells the product again to an end-using purchaser. The distributor usually receives the product at some discount from the OEM and then is free to set his price at any amount above what he paid for the product. A distributor is often used by the US manufacturing industry to act as a sales force outside the US.

The landscape of the Foreign Corrupt Practices Act (FCPA) is littered with cases involving both agents and resellers are they are the most clearly acting as representatives of the companies whose goods or services they sell for in foreign countries. However many US businesses believe that the legal differences between agents/resellers and distributors insulate them from FCPA liability should the conduct of the distributor violate the Act. They believe that as the distributor takes title and physical possession of the product, the legal risk of ownership has shifted to the distributor. If the goods are damaged or destroyed, the loss will be the distributor's not the US business which manufactured the product. Under this same analysis, many US companies believe that the FCPA risk has also shifted from the US company to the foreign distributor. However such belief is sorely miss-placed.

As almost everyone knows, the FCPA prohibits payments to foreign officials to obtain or retain business or secure an improper business advantage. But many US companies view distributors as different from other types of sales representatives such as company sales representatives, agents, resellers or even joint venture partners, for the purposes of FCPA liability. However the Department of Justice (DOJ) takes the position that a US company's FCPA responsibilities extend to the conduct of a wide range of third parties, including the aforementioned company sales representatives, agents, resellers, joint venture partners but also distributors. No U.S. company can ignore signs that its distributors may be violating the FCPA. Company management cannot engage in

conscious avoidance to the activities of a distributor that the company has put into a business position favorable to engaging in FCPA violations. Court interpretation of the FCPA has held that it is applicable where conduct violative of the Act is used to “to obtain or retain business or secure an improper business advantage” which can cover almost any kind of advantage, including indirect monetary advantage even as nebulous as reputational advantage.

This scenario played out in China from 1997 to 2005 through AGA Medical Corporation. The Minnesota-based firm manufactured products used to treat congenital heart defects. To boost its China sales, AGA worked through its Chinese distributor. AGA sold products at a discounted rate to its Chinese distributor. This distributor then took some of the difference between his price from the equipment manufacturer AGA and the price he sold the equipment to Chinese hospitals to and paid corrupt payments to Chinese doctors to have them direct their government-owned hospitals to purchase AGA’s products. Its sales in China for the period were about \$13.5 million. The Chinese distributor was found to have paid bribes in China of at least \$460,000 to doctors in government-owned hospitals and patent-office officials. In 2008, AGA agreed to pay a \$2 million criminal penalty and enter into a deferred prosecution agreement with the Department of Justice to settle Foreign Corrupt Practices Act violations.

The same game was played by a Volvo subsidiary, Volvo Construction Equipment International ("VCEI") when it used a Tunisian distributor to facilitate additional sales of its products to Iraq. VCEI reduced its prices to enable the distributor to make the illegal payments based on bogus after-sales service fees. Volvo's 2008 settlement with the SEC included an agreement permanently enjoining it from future violations of Sections, ordering it to disgorge \$7,299,208 in profits plus \$1,303,441 in pre-judgment interest, and to pay a civil penalty of \$4,000,000. In addition to this fine imposed by the SEC, Volvo also paid a \$7,000,000 penalty pursuant to a deferred prosecution agreement with the DOJ.

So what is in a name? Do we simply look to Shakespeare and his immortal words, “What's in a name? That which we call a rose; By any other name would smell as sweet.” Unfortunately I do not think the answer is quite so ethereal. It is more down to earth. If it walks like a duck and quacks like a duck, it probably is a duck. If you have a distributor, it must be subjected to the same FCPA scrutiny and management as an agent, reseller or joint venture partner.

* * *

This publication contains general information only and is based on the experiences and research of the author. The author is not, by means of this publication, rendering business, legal advice, or other professional advice or services. This publication is not a substitute for such legal advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking

any action that may affect your business, you should consult a qualified legal advisor. The author, his affiliates, and related entities shall not be responsible for any loss sustained by any person or entity that relies on this publication. The author can be reached at tfox@tfoxlaw.com.

© Thomas R. Fox, 2010