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Chevron Pays \$30 Million To Settle Foreign Corrupt Practices Act Charges In Oil For Food Case

On November 14, 2007, the Securities and Exchange Commission (“SEC”) filed a settled Foreign Corrupt Practices Act (“FCPA”) civil complaint (“Complaint”) against Chevron Corporation (“Chevron”) in the Southern District of New York arising from Chevron’s role in making \$20 million in improper kickbacks paid in connection with the U.N.-administered Oil for Food Program during Saddam Hussein’s reign. Chevron consented to entry of a final judgment that, among other things, ordered the company to disgorge \$25 million in profits, pay a \$3 million civil penalty and pay the Office of Foreign Asset Controls of the U.S. Department of Treasury a penalty of \$2 million (the “Chevron Settlement”).¹ Chevron also is permanently enjoined from committing violations of the FCPA’s books and records and internal controls provisions.

The Chevron Settlement serves as an important warning about the expanded reach of the FCPA, as it illustrates the risk of U.S. civil (and potentially criminal) enforcement of the FCPA’s books and records and internal controls provisions regardless of whether there is any evidence of a prosecutable corrupt payment. Publicly-traded companies that participate in markets where underlying transactions may have involved corrupt payments must be vigilant against such an approach even if they have not violated the FCPA’s anti-bribery provisions.

The SEC charges stemmed from Chevron allegedly buying Iraqi crude oil from third parties at prices that effectively allowed those third parties to pass through to Chevron illegal surcharges those third parties had paid. The Complaint did not charge Chevron with a violation of the FCPA’s anti-bribery provisions; indeed, whether Chevron’s conduct would have independently violated the anti-bribery provisions of the FCPA was irrelevant to the SEC’s charges, which instead were predicated on Chevron’s alleged failure (a) to properly characterize the illicit nature of the payments it made to those third parties in its books and records, and (b) to institute sufficient internal accounting controls to detect and prevent those illicit payments. At the center of the SEC’s charges was an alleged failure by Chevron’s management to take an active role in oversight and implementation of the company’s policy against paying illegal surcharges.

The Alleged Oil for Food “Kickback” Scheme

The Iraq Oil for Food Program was implemented by the United Nations (“U.N.”) to provide humanitarian relief to the Iraqi people during the time that Iraq was subject to U.S. and international trade sanctions. In response to Saddam Hussein’s invasion of Kuwait, the U.N. passed Resolution 661, which prohibited member nations from trading in any Iraqi commodities or products. On April 14, 1995, the U.N. Security Council adopted Resolution

¹ For more information, see the SEC’s Release 2007-230 (available at <http://www.sec.gov/news/press/2007/2007-230.htm>), Litigation Release No. 20363 (available at <http://www.sec.gov/litigation/litreleases/2007/lr20363.htm>), and the complaint (available at <http://www.sec.gov/litigation/complaint/2007/comp20363.pdf>).

986, which authorized the Government of Iraq to sell oil on the condition that the proceeds were to be deposited into escrow and utilized solely to purchase designated humanitarian goods for the benefit of the Iraqi people. In May 1996, the Government of Iraq entered into a written Memorandum of Understanding to implement Resolution 986.²

The U.N. established a formal program to oversee the implementation of Resolution 986, which came to be known as the Oil for Food Program. Under it, Iraqi government officials had the authority to select the companies and individuals which received the rights to purchase Iraqi oil at a certain price. These selections were commonly known as “allocations.” After a company entered into a contract with Iraq’s State Oil Marketing Organization (“SOMO”) to purchase oil, the contract had to be approved by the U.N.; the purchaser of crude oil was required to pay the full contract price through a letter of credit issued by its bank to the escrow account. No direct or indirect payments to Iraq or Iraqi officials were permitted under the program.³

The Complaint alleges that between 2000 and 2003, SOMO officials conditioned allocations on the purchasers’ agreement to pay kickbacks in the form of “surcharges” on each barrel of oil sold. If a company refused to pay the surcharge, it did not receive an allocation. SOMO officials allegedly directed companies to make these surcharge payments to bank accounts under their control, primarily in Jordan and Lebanon. In order to maintain the economic viability of the scheme, SOMO allegedly combined below-market oil prices with surcharges ranging from \$0.10-\$0.50 per barrel, which allowed purchasers to afford the kickback payments while maintaining a sufficient profit margin. In October 2001, the U.N. attempted to eliminate surcharges by imposing “retroactive pricing,” which made it less profitable for buyers to pay surcharges.⁴

2 See generally United Nations Office of the Iraq Programme, Oil-for-Food, “About the Programme,” available at <http://www.un.org/Depts/oip/background/index.html>; United Nations Security Council Resolution 986, available at <http://daccess-ods.un.org/TMP/6267565.html>; Memorandum of understanding between the Secretariat of the United Nations and the Government of Iraq on the implementation of Security Council resolution 986 (1995), available at <http://daccess-ods.un.org/TMP/7294939.html>.

3 *Id.*

4 Complaint at ¶¶ 13-17.

Chevron’s Alleged Violations of the FCPA

According to the SEC, from April 17, 2001 through May 6, 2002, Chevron, through its traders, purchased approximately 78 million barrels of crude oil from Iraq pursuant to 36 different contracts with such third-party suppliers.⁵ The Complaint alleges that included in the premiums paid by Chevron to third-party suppliers in connection with these purchases were approximately \$20 million in illegal surcharge payments. Notably, at least one Chevron trader “responsible for a large portion of Chevron’s purchases” allegedly expressly factored the cost of surcharge payments into price negotiations with the suppliers.⁶

The SEC alleged that Chevron was told about the surcharge demands as early as December 2000.⁷ Indeed, in January 2001, Chevron implemented a company-wide policy prohibiting the payment of surcharges. As written, the policy was more than just a nominal prohibition—Chevron required its traders to obtain “prior written approval for all proposed Iraqi oil purchases from Chevron’s Director of Global Crude Trading,” and “charged management with reviewing each proposed Iraqi oil deal to ensure that there was no reason to believe that a surcharge had been or would be paid.”⁸ As part of the process of reviewing proposed Iraqi oil purchases, Chevron’s management “was to consider, among other things, the identity, experience, and reputation of the third party, as well as whether the proposed pricing basis or margin deviated from historical practice.” According to the SEC, Chevron’s policy further required that any third-party supplier “certify that no illegal payments had been or would be made in connection with its acquisition of crude oil from Iraq.”⁹

According to the SEC’s allegations, Chevron’s policy was not followed and thus did not stop Chevron from making illicit payments that included payments to third parties to cover the illegal surcharges. This, in the SEC’s view, made Chevron’s books and records inaccurate and internal controls inadequate, and the SEC charged Chevron with a violation of the FCPA’s internal controls and books and records provisions.

5 *Id.* at ¶ 18.

6 *Id.* at ¶ 19.

7 *Id.* at ¶ 16.

8 *Id.* at ¶ 20.

9 *Id.* at ¶ 21.

With respect to internal controls, the SEC alleged that, notwithstanding the written policy, the fact that the premiums paid by Chevron included the illegal surcharges meant that Chevron failed to “devise and maintain a system of internal accounting controls to detect and prevent such illicit payments,” as required by the FCPA. Specifically, the SEC alleged that Chevron missed several “red flags” which should have raised concern regarding potential FCPA liability in connection with Chevron’s purchases of Iraqi oil. Among other things, the SEC alleged that:

- Chevron’s premiums paid to third parties rose sharply when Iraq began demanding surcharges and “remained inflated” until the surcharge policy ended, and despite “the obvious increase in premiums,” Chevron’s management “routinely approved the Iraqi oil purchases proposed by Chevron’s traders”;¹⁰
- A third-party supplier stated that the trader with whom he dealt, as well as the “trader’s bosses,” “always knew about the illegal surcharge demands” and that the Chevron trader asked the supplier to “persuade Iraq to reduce the amount of its surcharges”;¹¹
- An email from a Chevron employee to a Chevron trader discussed the overall premium to be paid to a third-party supplier and discussed the third party’s “purchase cost from SOMO,” a reference the SEC alleged “show[ed] the trader was aware of SOMO’s kickback costs.”¹²

In addition, the SEC alleged that Chevron conducted no due diligence on its contract partners, instead relying solely on a certification “that Chevron officials knew or should have known was ineffective.”¹³ In one example, Chevron management approved two transactions with a third-party supplier that had no assets, no real business operations and no experience in the oil industry.¹⁴ The SEC further alleged that Chevron management abdicated its responsibilities by relying entirely “on its trader’s representations” regarding the identity, experience and reputation of third-party sellers.¹⁵

¹⁰ *Id.* at ¶¶ 24-25.

¹¹ *Id.* at ¶ 26.

¹² *Id.* at ¶ 27.

¹³ *Id.* at ¶ 29.

¹⁴ *Id.* at ¶ 23.

¹⁵ *Id.* at ¶ 22.

With respect to the books and records count, the SEC’s allegation was simple, straightforward and serves as a strong warning of the reach of the FCPA’s books and records provisions: Chevron allegedly violated the FCPA by failing to record the payments at issue as “illegal surcharges”—“characterizing them instead simply as premiums.”¹⁶ According to the SEC, this “characterization” constituted an FCPA violation because Chevron failed to “accurately record these payments in its books, records, and accounts.”¹⁷

The Take-Away

The SEC and Department of Justice continue to demonstrate a reinvigorated commitment to FCPA enforcement. The Chevron Settlement is but the latest illustration that U.S. companies conducting business overseas would be well advised to reassess their exposure and readiness to defend their practices. In particular, this case demonstrates the critical importance to U.S. companies involved in business abroad of:

- performing adequate due diligence into all foreign business partners, agents, representatives and transactions;
- following up on any “red flags” that come to light;
- implementing robust and effective anti-corruption policies and training for employees, agents and representatives involved in conducting business in foreign countries; and
- providing management with an active role in enforcing such robust anti-corruption policies and reviewing activities conducted in foreign countries.

K&L Gates continues to monitor developments relating to the FCPA and other laws and regulations affecting U.S. companies doing business abroad and stands ready to assist clients on these matters.

¹⁶ *Id.* at ¶ 30.

¹⁷ *Id.*

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