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Oil & Gas Alert

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customs and international
trade controls



Leading practices for reducing FCPA risk in your global logistics operations

In this issue, we address anti-bribery compliance in the supply chain, a topic of significant regulatory enforcement recently for oil, gas and oil field service companies. The authors – a former international trade counsel for a very large oil field service company and a CPA with extensive experience reviewing and creating internal controls for energy and manufacturing companies – share their views on leading practices companies are using to help comply with US and foreign anti-bribery laws while maintaining a predictable supply chain.

Introduction

The 2007 Vetco International Ltd. (Vetco) \$26 million fine for alleged bribes paid by its freight forwarder to Nigerian customs officials¹ spawned a new awareness that Foreign Corrupt Practices Act (FCPA) violations could arise during customs clearance activities. Many companies historically view the customs clearance process as a low-risk process often left unchecked or outsourced to others.

The Vetco case led to oil field service companies initiating and disclosing customs-related FCPA investigations in their Securities and Exchange Commission (SEC) filings, as well as certain premier oil and gas and oil field service companies receiving Department of Justice (DOJ) requests for information regarding certain freight forwarding operations. That same year, the United States Court of Appeals for the Fifth Circuit upheld the criminal conviction of former-corporate officers for bribes paid to Haitian customs officials, making clear that that bribes paid to customs officials were criminally cognizable under the FCPA.

Recent events have increased these risks. In July 2009, the SEC filed a settled enforcement action which sought to hold the CEO and CFO of a US parent company civilly responsible for alleged bribes paid by the customs broker of a foreign subsidiary to customs officials in Brazil-based on a theory that they failed to properly supervise.² And in August 2009, Robert Khuzami, the SEC's Director of the Division of Enforcement, announced plans to create a special SEC unit focusing exclusively on FCPA enforcement.³

¹See the DOJ press release at http://www.usdoj.gov/opa/pr/2007/February/07_crm_075.html.

²SEC v. *Nature's Sunshine Products, Inc., Douglas Faggioli and Craig D. Huff*, Case No. 09CV672 (D. Utah, Filed July 31, 2009); <http://www.sec.gov/litigation/litreleases/2009/lr21162.htm>.

³*Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement*, Robert Khuzami, Director, Division of Enforcement, U.S. Securities and Exchange Commission (August 5, 2009); <http://www.sec.gov/news/speech/2009/spch080509rk.htm>.

At the same time, companies are facing operational pressures caused by delays in customs clearance. Delays occurring during the customs clearance process can translate into material costs; corrupt officials know this and have been known to use delays, seizures and penalties as opportunities for extortion.

This Hot Topic explores how some companies are addressing heightened FCPA risks and operational pressures caused by foreign customs clearance.

Commercial sales representatives and customs brokers pose different FCPA risks.

Revise existing FCPA compliance tools to reflect different risks posed by customs clearance

Many companies have long-established policies and procedures designed to reduce risk of FCPA violations. These tools are used to govern the internal sales function, but also focus heavily on commercial sales representatives and other entities that may be engaged in representative services.

Such common tools include:

- ▶ “Due diligence” background examinations before hiring entities engaged in potential sales or other representative services
- ▶ Offshore payment restrictions
- ▶ Cash payment restrictions
- ▶ Petty cash account restrictions
- ▶ Other accounting controls
- ▶ Internal audits
- ▶ Accounts payable screening
- ▶ Meals, gifts and entertainment policies

At most companies, these tools were created to minimize FCPA risks posed by internal sales efforts, commercial sales agents/representatives or by consultants assisting with the bidding process, but they may fail to adequately address foreign customs clearance risks. The bribery risks posed by commercial sales agents or bidding consultants are entirely different than the bribery risks posed by freight forwarders and customs brokers. As a consequence, tools written to address sales, commercial sales agents and bidding representatives are generally not effective in reducing the logistics bribery risk.

Bribery by commercial sales or bidding representatives typically involves financially meaningful payments, close relationships between the representative and government actor and scenarios where there should not be any payments between the representative and the government official. Therefore, at most companies, existing anti-bribery tools focus on relationships and money trails. For example, policies may prevent payment to the representative in cash. They may prevent offshore payments to representatives. They may require audit rights over the books and records of the representative, with the ability to specifically track whether significant monies are unaccounted or were paid to suspect entities.

They may require complex background checks into the nature of the services supplied by the representative, and their connections with government officials. All of these tools are fairly meaningless in reducing bribery risk in logistics operations (except in situations where a commercial sales representative is also performing logistics functions and is, therefore, already subject to extensive scrutiny).

Bribery by freight forwarders or customs brokers typically involves comparatively smaller payments, situations where there is only a transitory relationship between the representative and the government official and occurs in a context where there are a number of plausible reasons why a number of payments may be made to various parties. It is much more difficult to track than large payments to obtain business or operator rights.

For example, if a customs broker paid a \$500 bribe to release goods seized by customs:

- ▶ Would audit rights over the general books and records of the freight forwarder be likely to reveal the bribe? No, because the payment would likely be hidden by the numerous other payments associated with each shipping transaction by any number of shippers. It would be very difficult to track payments to government actors, let alone ascribe them to the import files of any particular importer. Moreover, most freight forwarders would not grant access to their books and records.
- ▶ Would analysis of the relationship between the customs broker and government officials reveal the bribe? No, because the bribe is fairly transactional in nature; it is not based on any special relationship.

Methods to identify and prevent bribery risk for commercial sales or bidding representatives do not work well to identify and prevent bribery risk for freight forwarders and customs brokers. There are, of course, different tools that apply to spotting and reducing bribery risk in logistics operations.

Leading practice. Companies that have anti-bribery procedures that are general in nature should reassess them to see if they are effective for logistics and customs clearance.

Establish customs compliance procedures managing shipments from origin through delivery

Bribe requests in an import country are often caused by paperwork errors created in the export country. For example, an invoice created in Houston may cause a critical shipment to be detained when clearing customs in Brazil.

Customs declarations in the receiving country are generally prepared based on commercial invoices, packing lists, certificates of origin, bills of lading and other documents created in the exporting country. If a bad description or the wrong customs tariff classification or an inaccurate price is placed on the invoice, then it is possible that the customs officials in the receiving country will seize or detain the merchandise or initiate penalty demands or assess additional duties. Seizure or penalties also may occur where the documents meet industry norms, but do not meet special requirements of the importing country. In many countries where the energy industry operates, any kind of customs compliance issue may lead to bribe solicitations by customs officials.

Key to preventing customs problems during import is to have and follow proper procedures during export.

Nearly all oil-bearing nations pose heightened corruption risks. Transparency International tracks perceived corruption levels of each nation in its Corruption Perceptions Index. It assigns numerical scores, and also provides a global chart summarizing the scores; any country shaded orange or red is perceived to have corruption problems. Transparency International's scoring and map are viewable on its website, at http://www.transparency.org/policy_research/surveys_indices/cpi. Most nations are red; oil bearing nations and developing countries are particularly likely to have problems.

The best way to minimize bribe solicitations when importing is to make sure that the customs paperwork is accurate, complete and satisfies local import laws. And the best time to do this is **prior** to export. Once a shipment has been seized, your only lawful recourse may be to pursue administrative or judicial remedies that take time – and time can delay your project, or your customer's project if they are waiting on you to deliver the detained merchandise. This further elevates the risk of an unlawful act occurring.

To minimize bribery risk, you should establish policies and procedures that lessen customs compliance risk *in advance of* shipment. You should have well documented shipping procedures that guide export logistics – step by step – in how to create a shipment that complies with the import laws of the receiving country. Personnel should be appropriately and adequately trained in understanding the risks involved and the importance of adhering to the procedures.

This should include: (1) customs compliance manuals that explain the laws of the receiving country and, more importantly, (2) destination-based shipping procedures which guide export operations on what must be done to meet the laws of the receiving country. Properly constructed, shipping procedures can also lessen export control, economic sanctions and anti-boycott while addressing customs compliance and anti-bribery compliance.

Leading practice. Create destination-based customs policies and procedures.

**More logistics vendors
means less control.**

Reduce the quantity of logistics vendors

The actions of freight forwarders and customs brokers can lead to FCPA exposure. SEC and DOJ enforcement actions that arose in a customs clearance context include resolutions with Vetco Gray, American Rice, Inc. and other companies. A number of energy sector companies have announced internal investigations in connection with customs entries, and it is believed that at the time of this writing the DOJ has upward of 20 investigations stemming from alleged freight forwarder conduct in certain countries.

Customs brokers typically file a customs declaration with a government *on behalf of* an importer. From a customs perspective, the customs broker is performing a representative service on the importer's behalf. In fact, in some locations they are known as "customs agents" and are perceived as agents of the principal. Enforcement officials may attempt to impute the actions of customs brokers – or knowledge of such actions – to companies in a variety of ways.

A leading practice to reduce risk caused by freight forwarders and customs brokers is to minimize the number used and manage them properly (as described below). Each separate vendor is a separate process, and is a separate opportunity to have a defective process.

Each separate process drains the internal resources spent policing anti-bribery efforts (e.g., management, diligence and auditing). Reducing the number of freight forwarders and customs brokers reduces risk and decreases internal compliance costs. It may also lead to operational cost savings, through volume discounts and a more predictable and transparent supply chain.

Leading practice. Consider re-examining your supply chain and reducing the number of freight forwarders and customs brokers serving you.

Align with logistics vendors that have their own compliance programs

Recently, a large oil field service company performed a comprehensive analysis of global logistics providers. It examined both operational and compliance aspects. As part of this process, it asked its logistics vendors to discuss their customs compliance, export control compliance, economic sanctions compliance, anti-boycott compliance and anti-bribery compliance policies, procedures and organizations. The surprising result? Many logistics companies did not have internal anti-bribery or trade control (e.g., export control, economic sanctions) procedures. Companies that intend their freight forwarders and customs brokers to help them comply with trade laws should align with logistics vendors that can demonstrate compliance programs in these areas.

Leading practice. Align with freight forwarders and customs brokers that have their own anti-bribery and trade compliance programs.

Inform your logistics vendors about your expectations

Does your freight forwarder know your anti-bribery policies? Will they give you the information you need to ensure that your books and records are accurate? If they make a mistake, do you have documents in your files memorializing communication of your expectations to protect you?

Leading practice. Shippers should consider:

- ▶ Communicating compliance expectations as part of any due diligence or vendor selection process
- ▶ Institutionalizing compliance expectations as part of vendor contracts
- ▶ Providing periodic reminders
- ▶ Asking vendors to communicate these expectations to their employees and subcontractors

Forwarders and brokers should have their own compliance programs.

Have a formal system for communicating your requirements to your vendors – and for them to communicate requirements to their own employees and subcontractors.

An effective logistics function aids compliance.

Establish an effective logistics organization

It is difficult to manage logistics anti-bribery risk without a competent logistics organization. Anti-bribery compliance for your logistics operations requires consistent adherence to procedures, proper management of freight forwarders and customs brokers and an ability to spot warning signs. These tasks will be complicated by an unstructured environment, particularly where shipping is handled by personnel for whom logistics is only one of their many roles. While the ideal logistics organization must match the needs of operations and will therefore vary from one company to the next, for some companies a coordinated, integrated supply chain or logistics organization comprised of logistics professionals may be the right answer.

Leading practice. Establish a logistics organization appropriate to your company's operational needs and compliance risks.

High-risk countries may require special logistics management.

Consider expatriates and manager change-outs in high-risk countries

As companies begin to focus on their logistics operations, they would be well-served to carefully consider who is managing their logistics processes in high-risk countries. While there is no "best" answer, in some cases instituting rotation of employees between countries or hiring expatriates may be helpful. Rotation helps employees keep a fresh perspective, and reinforces awareness that their actions will be visible to their co-rotators and successors. Expatriates may help avoid "groupthink" in countries where cultural norms tolerate corruption.

Leading practice. Consider expatriates and rotators for logistics management in high-risk countries.

Forwarder and customs broker invoice review is essential.

Review freight forwarder and customs broker invoices for red flags

Companies that pay freight forwarder or customs broker invoices without review expose themselves to risk. Descriptions for ambiguous services such as "customs intervention," "special processing," "expedited treatment" and the like may describe wholly lawful services or may instead be a euphemism for facilitation payments or other bribes paid to customs officials by the forwarder or broker. Companies do not want to find themselves in a position where they have paid for a particular "service" for years only to learn that they have been reimbursing customs bribes.

As leading practices, companies should strongly consider:

- ▶ Establishing special invoice review protocols for customs broker and freight forwarder invoices

- ▶ Requiring invoice reviewers to read each invoice line item and to be aware of what described services entail before they authorize payment
- ▶ Requiring invoice reviewers to know the language for the invoices they review

Audit and train logistics operations

While most oil and gas companies offer FCPA training and have internal audit programs addressing anticorruption, leading companies supplement their programs with content for specific roles. For example, an FCPA compliance audit that examines financial controls and sales practices in a foreign country may be broadened to examine logistics operations. Or a general FCPA compliance training program may be targeted to different groups, such as financial controllers, operations managers, sales and logistics. Auditing and training programs should also include customs compliance content, based on a theory that customs compliance is an effective way of reducing FCPA risk.

Leading practice. Consider appropriate customization of anti-bribery training and audit programs to include logistics; consider customs compliance training and auditing.

Retain local customs professionals

Understanding the local customs laws of where you do business is an essential part of planning and compliance. There may be times when your local customs broker approaches you about using “expedited” customs clearance programs. Is it a legitimate program, or a euphemism for bribes? Are “fees” paid to use the program going to the government – or to a customs official? You will not know unless you have in-country customs advice. Local customs planning can also help you lawfully lessen customs duties and avoid supply chain delays.

Leading practice. Have access to in-country customs consultants or counsel.

Revise auditing and training programs to reflect logistics anti-bribery compliance needs.

Know local customs laws and have local customs resources.



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