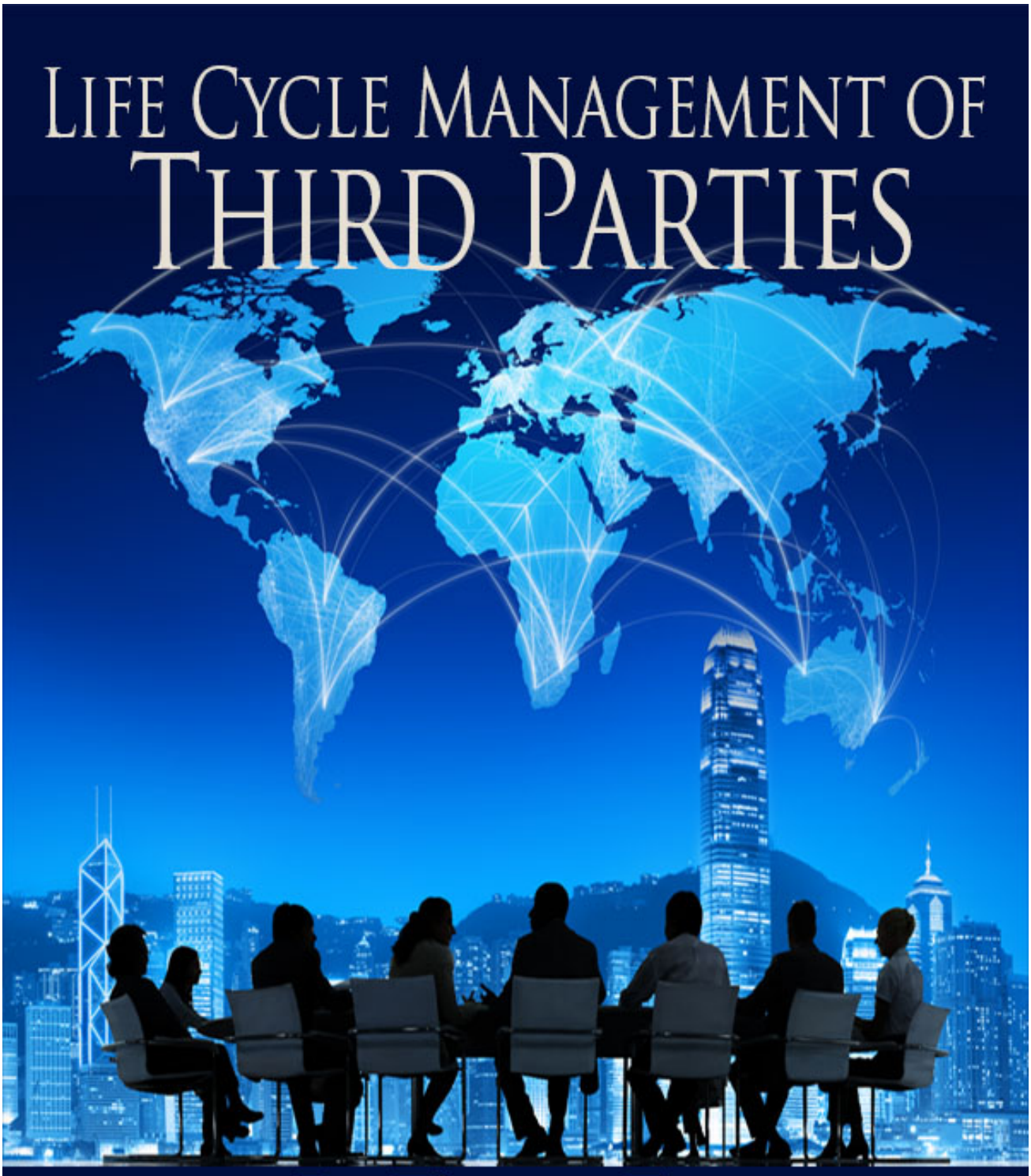
Life Cycle Management of Third Parties



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The Life Cycle of Third-Party Management

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I recently interviewed Marie Patterson, Vice President of Marketing at Hiperos, for my podcast, the FCPA Compliance and Ethics Report, on the subject of the life cycle in the management of third parties as facilitated through the Hiperos software solution. During the interview, Marie explained the process in such a clear and concise manner that I was inspired to try and duplicate her elucidation in a more traditional legal/compliance analysis. Therefore this article will provide a framework to think through, "The Life Cycle of Third Party Management."

Why is such as task important for your company? In a whitepaper entitled "Third Party Essentials: A Reputation/Liability Checkup When Using Third Parties Globally," authors Marjorie Doyle and Diana Lutz posit that in most foreign business partner relationships, your company will be held responsible for the actions of third parties working for and with your company.

The new global expectation is *you know who they are, you have vetted them and you are in control of the activities for which you hired them.* They further believe that third-party management is even more important when anti-corruption and anti-bribery laws, such as the Foreign Corrupt Practices Act (FCPA), UK Bribery Act or other OECD-based legislation, are applicable. They note, "gone are the days when organizations could wash their hands of liability or damage to reputation from outsourced work due to ethics and compliance failure."

Further, it is generally recognized that third parties present the greatest risk under the FCPA. But for the Department Of Justice (DOJ), Securities and Exchange Commission (SEC), UK Serious Fraud Office (SFO) or other anti-corruption or anti-bribery regulator, the ultimate question for a compliance officer is simply *does my system work?* Questions about effectiveness, therefore, get to that core issue of whether all the compliance activities actually make the business less vulnerable to corruption risk. One thing that the DOJ and SEC have made clear in both FCPA enforcement actions and their jointly released FCPA Guidance is that a well-reasoned, thought-out and documented compliance regime will receive considerable weight in any review. Therefore, based upon the need for a systemic process to outline and think through the management of third parties, I break down the life cycle of third-party management into five steps:

1. Business Justification and Business Sponsor
2. Questionnaire to the Third Party
3. Due Diligence
4. The Contract
5. Management of the Relationship

I will review each of these steps and provide specific guidance on how you should develop, implement and execute them.

Step 1: Business Justification and Business Sponsor

It really seems common sense to me that you should have a business justification to hire or use a third party. If that third party is in the sales chain of your international business, it is important to understand why you need to have a particular third party represent your company. This concept is enshrined in the FCPA Guidance, which says "companies should have an understanding of the business rationale for including the third party in the transaction. Among other things, the company should understand the role of and need for the third party and ensure that the contract terms specifically describe the services to be performed."

The Internal Revenue Service (IRS) also considers a business justification to be an important part of any best practices anti-corruption compliance regime. Clarissa Balmaseda, a special agent in charge of IRS criminal investigation, speaking at the 2013 ACI Boot Camp in Houston, said that a lack of business justification is a red flag and a possible indicator of corruption. With the DOJ, SEC and IRS all noting the importance of a business justification, it is clear that this is something you should incorporate into your compliance program.

But the business justification also provides your company the opportunity to help weave compliance into the fabric of your everyday operations. This is done by requiring the employee who prepares the business justification to be the Business Sponsor of that third party. The Business Sponsor can provide the most direct means of communication to the third party and can be the point of contact for compliance issues.

Tyco International takes this approach in its seven-step process for third-party qualification. Tyco breaks the first step into two parts, which include:

1. **Business Sponsor** – Identify a business sponsor or primary contact for the third party within your company. This requires not only business unit buy-in, but also business unit accountability for the business relationship. As Scott Moritz, a partner at Navigant and one of the architects of the Tyco Process says, "this puts the onus on each stakeholder."
2. **Business Justification** – The business unit must articulate a commercial reason to initiate or continue to work with the third party. You need to determine how this third party will fit into your company's value chain and whether they will become a strategic partner or only be involved in a one-off transaction.

Further, at the same conference where IRS Agent Balmaseda spoke, another Chief Compliance Officer (CCO) of a major energy service company detailed his thoughts on his company's 12-point evaluation process for reviewing, assessing, then contracting with and managing foreign business partners. In the second step, which he entitled "Competence of foreign business partner," he detailed a two-part analysis for his company. "It includes a review of the qualifications of the candidate for subject matter expertise and the resources

to perform the services for which they are being considered. However, it also in includes an identification of the representative's expected activities for your company. "

He also added that under his company's step called "Business justification for use of agent and reasonableness of compensation," "you should begin the entire process by requiring the relevant business unit which desires to obtain the services of any foreign business partner to provide you with a business justification including current opportunities in territory, how the candidate was identified and why no currently existing foreign business relationships can provide the requested services. Your next inquiry should focus on the terms of the engagement, including the commission rate, the term of the agreement, what territory may be covered by the agreement and if such relationship will be exclusive."

So what should go into your Business Justification? First and foremost, you should craft a document that works for both you as the compliance practitioner and the business folks in your company. There are some basic concepts that I think are important, but you may want to modify my suggestions based on your own experiences.

You need the name and contact information for both the Business Sponsor and the proposed third party. You need to inquire into how the Business Sponsor came to know about the third party, because it is red flag when a customer or government representative points you towards a specific third party. You should inquire into what services the third party will perform for your company, the length of time those services will be provided and the compensation rate for the third party. You will also need an explanation of why this particular third party should be used as opposed to an existing or other third party. All of this information should be documented and signed by the Business Sponsor.

Remember, the purpose of the Business Justification is to document the adequacy of the business case to retain a third party. The Business Justification should be included in the compliance review file assembled on every third party at the time of initial certification and again if the third-party relationship is renewed. As explained by the Tom Fox Mantra for FCPA compliance, this means document, document, document.

Step 2: Questionnaire to the Third Party

The second step involves a questionnaire, a term mentioned several times in the FCPA Guidance. It is generally recognized as one of the tools that a company should complete in its investigation to better understand with whom it does business. I believe that this requirement is not only a key step, but also a mandatory step for any third party that desires to do work with your company. I tell clients that if a third party does not want to fill out the questionnaire or will not fill it out completely, that you should not walk but *run* away from doing business with them.

In the 2011 UK Ministry of Justice's (MOJ) discussion of six principles of an adequate procedures compliance program, the MOJ said the following about the questionnaire: "this means that both the business person who desires the relationship and the foreign business representative commit certain designated information in writing prior to beginning the due diligence process." Indeed, the use of a questionnaire was one of the key findings of Kroll's "*2012 FCPA Benchmark Report.*" As reported in the FCPA Blog in a post entitled "Compliance Officers Troubled By Third-Party Risk:"

> "71 percent require third parties to complete a disclosure listing affiliations with foreign officials (65 percent verify that third parties adhere to the company's code of ethics and 73 percent confirm that each third party is free from sanctions pertaining to compliance with anti-bribery regulation)."

One of the key requirements of any successful anti-corruption compliance program is that a company must make an initial assessment of a proposed third-party relationship. The size of a company does not matter, as small businesses can face quite significant risks and will need more extensive procedures than other businesses facing limited risks. The level of risk that companies face will also vary with the type and nature of the third parties with which it has business relationships.

For example, a company that properly assesses that there is no risk of bribery on the part of one of its associated persons will, accordingly, require nothing in the way of procedures to prevent bribery in the context of that relationship. By the same token, the bribery risks associated with reliance on a third-party agent representing a company in negotiations with foreign public officials may be assessed as significant and, accordingly, requires much more in the way of procedures to mitigate those risks. Businesses are likely to need to select procedures to cover a broad range of risks, but any consideration by a court in an individual case regarding the adequacy of procedures is likely necessarily to focus on procedures designed to prevent bribery on the part of the person committing the offense.

So what should you ask for in your questionnaire? Randy Corey, Executive Vice President (EVP) and Global Compliance Officer at Edelmen Inc. said in a presentation at Compliance Week 2012 entitled "3rd Party Due Diligence Best Practices in Establishing an Effective Anti-Corruption Program," that his company has developed a five-step approach in evaluating and managing their third parties. In step three they ask, w*hat do you need to*

know? Initially, Corley said that the scope of review depends on risk assessment – high risk, medium risk or low risk. This risk ranking will determine the level of information collected and due diligence performed. The key element of this step is data collection. The initial step is to have the third party complete an application, which should include requests for information on background and experience, scope of services to be provided, relevant experience, a list of actual and beneficial owners, references and compliance expertise.

Below are areas I believe you should explore when questioning a proposed third party:

- **Ownership structure**: Describe whether the proposed third party is a government or state-owned entity and the nature of its relationship(s) with local, regional and governmental bodies. Are any members of the business partner related by blood to governmental officials?
- **Financial qualifications**: Describe the financial stability of, and all capital to be provided by, the proposed third party. You should obtain financial records, audited for three to five years if possible. Obtain the name and contact information for their banking relationship.
- **Personnel**: Determine whether the proposed agent will be providing personnel, and particularly whether any of the employees are government officials. Make sure that you obtain the names and titles of those who will provide services to your company.
- **Physical facilities**: Describe what physical facilities will be used by the third party for your work. Be sure to obtain the physical address.
- **References**: Obtain names and contact information for at least three business references that can provide information on the business ethics and commercial reliability of the proposed third party.
- **PEP**s: Determine whether any of the owners, beneficial owners, officers or directors are politically exposed persons (PEPs).
- **UBO**s: It is imperative that you obtain the identity of the ultimate beneficial owner (UBO).
- **Compliance regime**: Does the proposed third party have an anti-corruption/anti-bribery program in place? Do they have a code of conduct? Obtain copies of all relevant documents and training materials.
- **FCPA training and awareness**: Has the proposed third party received FCPA training? Are they TRACE certified or certified by some other recognizable entity?

One thing to keep in mind is that you will likely have pushback from your business team in making many of the inquiries listed above. However, my experience is that most proposed agents that have done business with U.S. or UK companies have already gone through this process. Indeed, they understand that by providing this information on a timely basis, they can set themselves apart as more attractive to U.S. businesses.

The questionnaire fills several key roles in your overall management of third parties. Obviously it provides key information that you need to know about who you are doing business with and whether they have the capabilities to fulfill your commercial needs. Just as importantly is what is

said if the questionnaire is not completed or is only partially completed. Namely, a the lack of awareness of the FCPA, UK Bribery Act or anti-corruption/anti-bribery programs generally. Lastly, the information provided (or not provided) in the questionnaire will assist you in determining what level of due diligence to perform.

Step 3: Due Diligence

Most companies fully understand the need to comply with the FCPA regarding third parties, as they represent the greatest risks for an FCPA violation. Also, most companies are not created out of new cloth, but are ongoing enterprises with a fully up-and-running business in place. They need to bring resources to bear to comply with the FCPA while continuing to do business. This can be particularly true in the area of performing due diligence on third parties. Many companies understand the need for a robust due diligence program to investigate third parties, but have struggled with how to create an inventory to define the basis of risk of each foreign business partner and thereby perform the requisite due diligence required under the FCPA.

Getting your arms around due diligence can sometimes seem bewildering for the compliance practitioner. However, the information that you should have developed in Steps 1 and 2 of the life cycle of third-party management should provide you with the initial information to consider the level of due diligence you should perform.

Jay Martin, CCO at Baker Hughes, often emphasizes that a company needs to evaluate and address its risks regarding third parties. This means that an appropriate level of due diligence may vary depending on the risks arising from the particular relationship. So, for example, the appropriate level of due diligence required by a company when contracting for the performance of information technology services may be low, to reflect low risks of bribery on its behalf. Conversely, a business entering into the international energy market and selecting an intermediary to assist in establishing a business in such markets will typically require a much higher level of due diligence to mitigate the risks of bribery on its behalf.

Our British compliance cousins are, of course, subject to the UK Bribery Act. In principle four of an adequate procedures compliance program, the UK Ministry of Justice (MOJ) stated, "The commercial organization applies due diligence procedures, taking a proportionate and risk-based approach, in respect of persons who perform or will perform services for or on behalf of the organization, in order to mitigate identified bribery risks." The purpose of principle four is to encourage businesses to put in place due diligence procedures that adequately inform the application of proportionate measures designed to prevent persons associated with a company from bribing on their behalf. The MOJ recognized that due diligence procedures act both as a procedure for anti-bribery risk assessment and as a risk mitigation technique. The MOJ said that due diligence is so important that "the role of due diligence in bribery risk mitigation justifies its inclusion here as a principle in its own right."

Carol Switzer, writing in Compliance Week, related that you should initially categorize your third parties into high-, moderate- and low-risk groups. Based on which risk category the third party falls into, you can design specific due diligence. She defined low-risk screening as "trusted data source search and risk screening such as the aforementioned World Compliance," moderate-risk screening as "enhanced evaluation to include in-country public

records…and research into corporate relationships," and high-risk screening as basically a "deep dive assessment" where there is an audit/review of third-party controls and financial records, in-country interviews and investigations "leveraging local data sources."

A three-step approach was also discussed favorably in Opinion Release 10-02. In this Opinion Release, the DOJ discussed the due diligence that the requesting entity performed. "First, it [the requestor] conducted an initial screening of six potential grant recipients by obtaining publicly available information and information from third-party sources…Second, the Eurasian Subsidiary undertook further due diligence on the remaining three potential grant recipients. This due diligence was designed to learn about each organization's ownership, management structure and operations; it involved requesting and reviewing key operating and assessment documents for each organization, as well as conducting interviews with representatives of each MFI to ask questions about each organization's relationships with the government and to elicit information about potential corruption risk. As a third round of due diligence, the Eurasian Subsidiary undertook targeted due diligence on the remaining potential grant recipient, the Local MFI. This diligence was designed to identify any ties to specific government officials, determine whether the organization had faced any criminal prosecutions or investigations and assess the organization's reputation for integrity."

Based on the wisdom of the aforementioned compliance experts, Opinion Release 10-02 and others, I have broken due diligence down into three stages: Level I, Level II and Level III. A very good description of the three levels of due diligence was presented by Candace Tal in a guest post in the blog "*Deep Level Due Diligence: What You Need to Know."*

Level I

Level I due diligence typically consists of checking individual names and company names through several hundred global watch lists comprised of anti-money laundering, anti-bribery and sanctions lists, coupled with other financial corruption and criminal databases. These global lists create a useful first-level screening tool to detect potential red flags for corrupt activities. It is also a very inexpensive first step in compliance from an investigative viewpoint. Tal believes that this basic Level I due diligence is extremely important for companies to complement their compliance policies and procedures, demonstrating a broad intent to actively comply with international regulatory requirements.

Level II

Level II due diligence involves supplementing these global watch lists with a deeper screening of international media, typically the major newspapers and periodicals from all countries plus detailed Internet searches. Such inquiries will often reveal other forms of corruption-related information and may expose undisclosed or hidden information about the company, the third party's key executives and associated parties. I believe that Level II should also include an in-country database search regarding the third party. Some of the other types of information that you should consider obtaining are country of domicile and

international government records, use of in-country sources to provide assessments of the third party and a check for international derogatory electronic and physical media. You should perform searches on the third party in both English and foreign-language repositories in its country of domicile. If you are in a specific industry using technical specialists, you should also obtain information from sector-specific sources.

Level III

This level is the deep dive. It will require an in-country "boots-on-the-ground" investigation. I agree with Tal that a Level III due diligence investigation is designed to supply your company "with a comprehensive analysis of all available public records data supplemented with detailed field intelligence to identify known and, more importantly, unknown conditions. Seasoned investigators who know the local language and are familiar with local politics bring an extra layer of depth assessment to an in country investigation." Further, the "direction of the work and analyzing the resulting data is often critical to a successful outcome and key to understanding the results … from a technical perspective and understanding what the results mean in plain English. Investigative reports should include actionable recommendations based on clearly defined assumptions or preferably well-developed factual data points."

But more than simply an investigation of the company – critically including a site visit and coupled with on-site interviews – Tal says that some other things you investigate should include "an in-depth background check of key executives or principal players. These are not routine employment-type background checks, which are simply designed to confirm existing information, but rather executive due diligence checks designed to investigate hidden, secret or undisclosed information about that individual." Tal believes that such "reputational information, involvement in other businesses, direct or indirect involvement in other law suits, history of litigious and other lifestyle behaviors … can adversely affect your business and public perceptions of impropriety, should they be disclosed publically."

Further, you may need to engage a foreign law firm to investigate the third party in its home country to determine the third party's compliance with its home country's laws, licensing requirements and regulations. Lastly and perhaps most importantly, you should use the "deep dive" due diligence to look the proposed third party in the eye and get a firm idea of its cooperation and attitude toward compliance, as one of the most important inquiries is not legal in nature, but based upon the response and cooperation of the third party. More than simply trying to determine if the third party objected to any portion of the due diligence process or whether they objected to the scope, coverage or purpose of the FCPA, you can use a Level III to determine if the third party is willing to stand up under the FCPA and if are you willing to partner with the third party.

The Risk Advisory Group has put together a handy chart of its Level I, II and III approaches to integrity and due diligence. I have found it useful in explaining the different scopes and focuses of the various levels of due diligence.

Level	Issues Addressed	Scope of Investigation
I	• That the company exists • Identities of directors and shareholders • Whether such persons are on regulators' watch lists • Signs that such persons are government officials • Obvious signs of financial difficulty • Signs of involvement in litigation • Media reports linking the company to corruption	• Company registration and status • Registered address • Regulators' watch lists • Credit checks • Bankruptcy/liquidation proceedings • Review accounts and auditors comments • Litigation search • Negative media search
II	As above, with the following additions: • Public profile integrity checks • Signs of official investigations and/or sanctions from regulatory authorities • Other anti-corruption red flags	As above, with the following additions: • Review and summary of all media and internet references • Review and summary of relevant corporate records and litigation filings, including local archives • Analysis and cross-referencing of all findings
III	As above, with the following additions: • But seeking fuller answers to any questions raised by drawing on a wider range of intelligence sources and/or addressing specific issues of potential concern already identified	As above, with the following additions: • Inquiries via local sources • Inquiries via industry experts • Inquiries via Western agencies such as embassies or trade promotion bodies • Inquires via sources close to local regulatory agencies

As you can see, there are many different approaches to the specifics of due diligence. Having learned some of the approaches of other experts in the field, I hope that you can craft the relevant portions into your program. The Level I, II and III trichotomy appears to have the greatest favor and is one approach you should be able to implement in a straightforward manner. However, as Jay Martin constantly says, you need to assess your company's risk and manage that risk. So if you need to perform additional due diligence to answer questions or clear red flags, you should do so. And do not forget to document, document, document all your due diligence.

Step 4: The Contract

Before we get to the contracting stage, a word about what to do with Steps 1-3: you cannot simply obtain the information detailed in these first three steps; you must evaluate the information and show that you have used it in your process. If it is incomplete, it must be completed. If red flags have appeared, you must be clear them or demonstrate how you will manage the risks identified. In others words, you must document, document, document that you have read, synthesized and evaluated the information garnered in Steps 1-3. As the DOJ and SEC continually remind us, a compliance program must be a living, evolving system and not simply a "check-the-box" exercise.

After you have completed Steps 1-3 and then evaluated and documented your evaluation, you are ready to move onto to Step 4, the contract. Obviously any commercial relationship should be governed by the terms and conditions of a written contract. Clearly your commercial terms should be set out in the contract. In the area of commercial terms, the FCPA Guidance intones, "additional considerations include payment terms and how those payment terms compare to typical terms in that industry and country, as well as the timing of the third party's introduction to the business." This means that you need to understand what the rate of commission is and whether it is reasonable for the services delivered. If the rate is too high, this could be an indicator of corruption, as high commission rates can create a pool of money to be used to pay bribes. If your company uses a distributor model in its sales side, then it needs to review the discount rates it provides to its distributors to ascertain that the discount rate is warranted.

At a presentation by Flora Francis and Andrew Baird of GE Oil & Gas at the 2014 SCCE Utility and Energy Conference on GE's third-party risk management, they described the process by which GE reviews the risks around each third party with which it does business. Initially, both speakers made clear that GE's program was the company's response to its assessed risks. Further, the compliance program has evolved, not only as the company's risks have evolved, but also as the company has determined what works and does not work. Within the realm of third parties, the pertinent question from compliance to the business unit would be *What is your go-to-market strategy and how will your use of third parties assist you in carrying out that strategy?* Some of the factors the speakers cited could include your company's market coverage strategy, product segmentation, pricing and margin expectation, an added capability which your company may not possess such as technology, and finally local legal requirements for a third party.

Some of the factors GE considers when evaluating a third party include the following:

- **Business Model**: Do we need third parties to reach our customers or can we build the organization ourselves?
- **In-house Capabilities**: Do we already have the organization in place to handle these capabilities?
- **Overlap**: Do we already have a third party in the region/country that can handle our needs?

- **Volume of Business**: How much business will this third party bring to the company?
- **Compliance Risk**: Where is the third party located? Will they interact with government officials? Do they have the same commitment to compliance?
- **Regulatory Environment**: Is it simple or strict? What are the chances of regulatory violations?
- **Reputation**: What is the third party's reputation in the market?

GE takes this information and then break downs the risks down into low risk and high risk. A low risk receives a limited review and analysis, while a high risk receives an escalated review and analysis consisting of compliance, legal, business leadership and finance reviews.

But more than simply the level of review, I was interested in the "risk score drivers" that GE has developed. The speakers emphasized that these drivers have been developed over time through the company's internal analysis and processes. Nevertheless, I found them to be a very useful way to think about third-party risk. The risk score drivers listed were:

- Country channel where the third party is located in or where it sells into
- Experience by the third party with the sales channel
- Type of third party involved (agent, reseller, distributor)
- Standard v. non-standard commission rate
- Will any sub-third-party relationships be involved?
- Will the third party sell to a government entity or instrumentality?
- Do any of the third party's principals, officers or agents work for a foreign government, state-owned enterprise or political party?
- Was the third party mandated by customer or the end user?
- What is the third party's contract duration?
- Is the third party involved in more than one project?
- Does the third party have any historical compliance issues?
- What is the percent of sales with products or services?
- What is GE's annual revenue with the third party?

GE compliance then takes these scoring factors and puts them into an evaluation matrix when determining the amount of risk involved and whether or not the company should move forward with a proposed third party.

In addition to the above analysis from the compliance perspective, you should incorporate compliance terms and conditions into your contracts with third parties. I would suggest that you begin with some type of compliance terms and conditions template, which can be used as a starting point for your negotiations. The advantages of such a template are several; they include: (1) the contract language is tested against real events, (2) the

contract language assists the company in managing its compliance risks, (3) the contract language fits into a series of related contracts, (4) the contract language is straightforward to administer and (5) the contract language helps to manage the expectations of both contracting parties regarding anti-bribery and anti-corruption.

What are the compliance terms and conditions you should include in your commercial contracts with third parties? In the Panalpina Deferred Prosecution Agreement (DPA), Attachment C, Section 12 is found the following language:

"Where necessary and appropriate, Panalpina will include standard provisions in agreements, contracts and renewals thereof with all agents and business partners that are reasonably calculated to prevent violations of the anticorruption laws, which may, depending upon the circumstances, include: (a) anticorruption representations and undertakings relating to compliance with the anticorruption laws, (b) rights to conduct audits of the books and records of the agent or business partner to ensure compliance with the foregoing and (c) rights to terminate an agent or business partner as a result of any breach of anti-corruption laws, and regulations or representations and undertakings related to such matters."

In the Johnson & Johnson (J&J) DPA, the same language as used in the Panalpina DPA is found in Attachment C, entitled "Corporate Compliance Program." However, in Attachment D, entitled "Enhanced Compliance Obligations," the following language is found:

"Contracts with such third parties are to include appropriate FCPA compliance terms and conditions including; (i) representatives and undertakings of the third party to compliance, (ii) right to audit and (iii) right to terminate."

Mary Jones, in an article entitled Panalpina's 'World Wide Web,'" suggested the following language be present in your compliance terms and conditions:

- Payment mechanisms that comply with … the FCPA (Foreign Corrupt Practices Act), the UKBA (UK Bribery Act) and other applicable anti-corruption and/or anti-bribery laws during the term of such contract
- The counterparty's obligation to maintain accurate books and records in compliance with the company's policy and compliance manual
- The counterparty's obligation to certify on an annual basis that: (i) counterparty has not made, offered or promised any payment or gift of money or anything of value, directly or indirectly, to any government official (or any other person or entity if the UK Bribery Act applies) for the purpose of obtaining or retaining business or getting any improper business advantage and (ii) counterparty has not engaged in any conduct or behavior prohibited by the code of conduct, anti-corruption policy and compliance manual and other applicable anti-corruption and/or anti-bribery law
- The company's right to audit the counterparty's books and records, including, without limitation, any documentation relating to the counterparty's interaction with any governmental entity (or any entity if the UK Bribery Act applies) on behalf

of the company and the counterparty's obligation to cooperate fully with any such audit

- Remedies (including termination rights) for the failure of the counterparty to comply with the terms of the contract, the code of conduct, the anti-corruption policy and compliance manual and other applicable anti-corruption and/or anti-bribery law during the term of such contract.

Based on guidance from the foregoing experts and the research I have engaged in, I believe that compliance terms and conditions should be stated directly in the document, whether such document is a simple agency or consulting agreement or a joint venture (JV) with several formation documents. The compliance terms and conditions should include representations that in all undertakings, the third party will make no payments of money, or anything of value, nor will such be offered, promised or paid, directly or indirectly, to any foreign officials, political parties, party officials, candidates for public or political party office, to influence the acts of such officials, political parties, party officials or candidates in their official capacity, to induce them to use their influence with a government to obtain or retain business or gain an improper advantage in connection with any business venture or contract in which the company is a participant.

In addition to the above affirmative statements regarding conduct, a commercial contract with a third party should have the following compliance terms and conditions in it:

- **Indemnification:** Full indemnification for any FCPA violation, including all costs for the underlying investigation.
- **Cooperation:** Require full cooperation with any ethics and compliance investigation, specifically including the review of foreign business partner emails and bank accounts relating to your company's use of the foreign business partner.
- **Material Breach of Contract:** Any FCPA violation is made a material breach of contract, with no notice and no opportunity to cure. Further, such a finding will be the grounds for immediate cessation of all payments.
- **No Sub-Vendors (without approval):** The foreign business partner must agree that it will not hire an agent, subcontractor or consultant without the company's prior written consent (to be based on adequate due diligence).
- **Audit Rights:** An additional key element of a contract between a U.S. company and a foreign business partner should include the retention of audit rights. These audit rights must exceed the simple audit rights associated with the financial relationship between the parties and must allow a full review of all FCPA-related compliance procedures such as those for meeting with foreign governmental officials and compliance-related training.
- **Acknowledgment:** The foreign business partner should specifically acknowledge the applicability of the FCPA to the business relationship as well as any country or regional anti-corruption or anti-bribery laws applying to either the foreign business partner or business relationship.

- **Ongoing Training:** Require that the top management of the foreign business partner and all persons performing services on your behalf receive FCPA compliance training.
- **Annual Certification:** Require an annual certification stating that the foreign business partner has not engaged in any conduct that violates the FCPA or any applicable laws, nor is it aware of any such conduct.
- **Re-qualification:** Require that the foreign business partner re-qualify as a business partner at a regular interval of no greater than every three years.

Many will exclaim, *What an order, I can't go through with it!* By this they mean that they do not believe that they will be able to get the third party to agree to such compliance terms and conditions. I have found that while it may not be easy, it is relatively simply to get a third party to agree to these, or similar, terms and conditions. One approach to take is that the terms are not negotiable. When faced with such a position on non-commercial terms, many third parties will not fight such a position. There is some flexibility, but the DOJ will require the minimum terms and conditions that it has suggested in the various Attachment Cs to the DPAs I have discussed. But the best position I have found is that if a third party agrees with these terms and conditions, they can then use that as a market differentiator from other third parties who have not gone through the life cycle management of a third party.

Step 5: Management of the Relationship

I often say that after you complete Steps 1-4 in the life cycle management of a third party, the real work begins, and that work is found in Step 5, the management of the relationship. While the work done in Steps 1-4 is absolutely critical, if you do not manage the relationship, it can all go downhill very quickly and you might find yourself with a potential FCPA or UK Bribery Act violation. There are several different ways that you should manage your post-contract relationship. What follows are some of the tools you can use to help make sure that all the work you have done in Steps 1-4 will not be for naught and that you will have a compliant anti-corruption relationship with your third party going forward.

Managing third-party relationships is an area that continues to give companies trouble and heartburn. The *"2013 Anti-Bribery and Corruption Benchmarking Report - A joint effort between Kroll and Compliance Week*" found that many companies are still struggling with ongoing anti-corruption monitoring and training for their third parties. Regarding training, 47 percent of the respondents said that they conduct no anti-corruption training with their third parties at all. The efforts companies do take to educate and monitor third parties are somewhat pro forma. More than 70 percent require certification from their third parties that they have completed anti-corruption training, 43 percent require in-person training and another 40 percent require online training. Large companies require training considerably more often than smaller ones, although when looking at all the common training methods, 100 percent of respondents say their company uses at least one method, if not more.

While the FCPA Guidance itself only provides that "companies should undertake some form of ongoing monitoring of third-party relationships," Diana Lutz, writing in the whitepaper by The Steele Foundation entitled "Global anti-corruption and anti-bribery program best practices," said:

"As an additional means of prevention and detection of wrongdoing, an experienced compliance and audit team must be actively engaged in home office and field activities to ensure that financial controls and policy provisions are routinely complied with and that remedial measures for violations or gaps are tracked, implemented and rechecked."

Another noted commentator has discussed techniques to provide this management and oversight of any third-party relationship. Carol Switzer, President of the Open Compliance and Ethics Group (OCEG), writing in the Compliance Week magazine, set out a five-step process for managing corruption risks, which I have adapted for third parties.

1. **Screen:** Monitor third-party records against trusted data sources for red flags.
2. **Identify:** Establish helplines and other open channels for reporting issues and asking compliance-related questions by third parties.
3. **Investigate:** Use appropriately qualified investigative teams to obtain and assess information about suspected violations.

4. **Analyze:** Evaluate data to determine "concerns and potential problems" by using data analytics, tools and reporting.
5. **Audit:** Finally, your company should have regular internal audit reviews and inspections of the third party's anti-corruption program, including testing and assessment of internal controls to determine if enhancement or modification is necessary.

Based upon the foregoing and other commentators, I believe there are several different roles in a company that play a function in the ongoing monitoring of the third party. While there is overlap, I believe that each role fulfills a critical function in any best practices compliance program.

Relationship Manager

There should be a relationship manager for every third party with which the company does business through the sales chain. The relationship manager should be a business unit employee who is responsible for monitoring, maintaining and continuously evaluating the relationship between your company and the third party. Some of the duties of the relationship manager may include:

- Point of contact with the third party for all compliance issues
- Maintaining periodic contact with the third party
- Meeting annually with the third party to review its satisfaction of all company compliance obligations
- Submitting annual reports to the company's oversight committee summarizing services provided by the third party
- Assisting the company's oversight committee with any issues with respect to the third party

Compliance Professional

Just as a company needs a subject matter expert (SME) in anti-bribery compliance to be able to work with the business folks and answer the usual questions that come up in the day-to-day routine of doing business internationally, third parties also need such access. A third party may not be large enough to have its own compliance staff, so I advocate the company providing such a dedicated resource to third parties. I do not believe that this will create a conflict of interest or that there are other legal impediments to providing such services. They can also include anti-corruption training for the third party, either through on-site or remote mechanisms. The compliance practitioner should work closely with the relationship manager to provide advice, training and communications to the third party.

Oversight Committee

I advocate that a company should have an oversight committee review all documents relating the full panoply of a third party's relationship with the company. It can be a formal structure or some other type of group, but the key is to have the senior management put a "second set of eyes" on any third parties who might represent a company on the sales side. In addition to the basic concept of process validation of your management of third parties, as third parties are recognized as the highest risk in FCPA or Bribery Act compliance, this is a manner to deliver additional management of that risk.

After the commercial relationship has begun, the oversight committee should monitor the third-party relationship on no less than an annual basis. This annual audit should include a review of remedial due diligence investigations and evaluation of any new or supplement risk associated with any negative information discovered from a review of financial audit reports on the third party. The oversight committee should review any reports of any material breach of contract including any breach of the requirements of the company code of ethics and compliance. In addition to the above remedial review, the oversight committee should review all payments requested by the third party to ensure such payment is within the company guidelines and is warranted by the contractual relationship with the third party. Lastly, the oversight committee should review any request to provide the third party any type of non-monetary compensation and, as appropriate, approve such requests.

Audit

A key tool in managing the relationship with a third party post-contract is auditing the relationship. I hope that you will have secured audit rights, as that is an important clause in any compliance terms and conditions. Your audit should be a systematic, independent and documented process for obtaining evidence and evaluating it objectively to determine the extent to which your compliance terms and conditions are followed. Noted fraud examiner expert Tracy Coenen described the process as one to (1) capture the data, (2) analyze the data and (3) report on the data, which is also appropriate for a compliance audit. As a baseline, I would suggest that any audit of a third party include, at a minimum, a review of the following:

- The effectiveness of existing compliance programs and codes of conduct
- The origin and legitimacy of any funds paid to the company
- Books, records and accounts, or those of any of its subsidiaries, joint ventures or affiliates, related to work performed for, or services or equipment provided to, the company
- All disbursements made for or on behalf of the company
- All funds received from the company in connection with work performed for, or services or equipment provided to, the company.

If you want to engage in a deeper dive, you might consider evaluation of some of the following areas:

- Review contracts with third parties to confirm that the appropriate FCPA compliance terms and conditions are in place.
- Determine that actual due diligence took place on the third party.
- Review the FCPA compliance training program, both for substance and attendance records.
- Does the third party have a hotline or any other reporting mechanism for allegations of compliance violations? If so, how are such reports maintained? Review any reports of compliance violations or issues that arose through anonymous reporting, hotline or any other reporting mechanism.
- Does the third party have written employee discipline procedures? If so, have any employees been disciplined for any compliance violations? If yes, review all relevant files relating to any such violations to determine the process used and the outcome reached.
- Review employee expense reports for employees in high-risk positions or high-risk countries.
- Test for gifts, travel and entertainment that were provided to or for foreign governmental officials.
- Review the overall structure of the third party's compliance program. If the company has a designated compliance officer, to whom and how does that compliance officer report? How is the third party's compliance program designed to identify risks, and what has been the result of any so identified?
- Review a sample of employee commission payments and determine if they follow the internal policy and procedure of the third party.
- With regard to any petty cash activity in foreign locations, review a sample of activity and apply analytical procedures and testing. Analyze the general ledger for high-risk transactions and cash advances and apply analytical procedures and testing.

In addition to monitoring and overseeing your third parties, you should periodically review the health of your third-party management program. Once again I turn to Diana Lutz and her colleague Marjorie Doyle, and their whitepaper entitled "Third Party Essentials: A Reputation/Liability Checkup When Using Third Parties Globally," in which they gave a checklist to test companies on their relationships with their third parties:

1. Do you have a list or database of all your third parties and their information?
2. Have you done a risk assessment of your third parties and prioritized them by level of risk?
3. Do you have a due diligence process for the selection of third parties, based on the risk assessment?

4. Once the risk categories have been determined, create a written due diligence process.
5. Once the third party has been selected based on the due diligence process, do you have a contract with the third party stating all the expectations?
6. Is there someone in your organization who is responsible for the management of each of your third parties?
7. What are “red flags” regarding a third party?

Perhaps now you will understand why I say that after you prepare the business justification; send out, receive back and evaluate the questionnaire; set the appropriate level of due diligence; and evaluate the due diligence and execute a contract with appropriate compliance terms and conditions, the real work begins, as you have to manage the third-party relationship.

Some Final Thoughts

I often cite Paul McNulty, former United States Deputy Attorney General, who talks about the three areas of inquiry he would assess regarding an FCPA enforcement action – what I call "McNulty's Maxims:"

- Maxim No. 1: *What did you do to stay out of trouble*?
- Maxim No. 2: *What did you do to prevent the issue?*
- Maxim No. 3: *What did you do when you found out about it?*

He also continually reminds listeners that a key component to compliance is documenting overall compliance efforts. Fellow partner at Baker & McKenzie and former federal prosecutor Stephen Martin believes that one key indicator of a best practices compliance program is the ability of a company to respond to an inquiry by a regulator. Martin points out that to do so, a company must document what it does for its compliance efforts on an ongoing basis. However, more critical than simply the ability to document the results of your company's compliance efforts is the ability of a company to quickly and efficiently respond to a prosecutor's request for information.

McNulty's Maxims and the regulators eyes lead me to continually give my mantra of FCPA compliance: document, document, document. Each of the steps you take in the management of your third parties must be documented. Not only must they be documented, but they must stored and managed in such a manner that you can retrieve them with relative ease. At one company where I worked previously, when the assignment was initially given to the in-house counsel, similar to the one that started this discussion, it took the company more than six months to come up with a spreadsheet to simply list the third-party representatives in the sales chain. At another firm, it took almost one month to get a computer-generated list of the vendors in the supply chain. The days of such delays are long gone, so you have to be organized in your documentation and have the ability to retrieve data in a reasonable timeframe.

The management of third parties is absolutely critical in any best practices compliance program. As you sit at your desk pondering whether this assignment given to you by the CCO is a career-ending dead end, you should take heart; there is clear and substantive guidance out there for you to draw upon.

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