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# Foreign Corrupt Practices Act Due Diligence and Voluntary Disclosure

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*The anti-bribery provisions of the Foreign Corrupt Practices Act can affect a wide range of companies and proposed transactions. Here, the authors review the rules and potential penalties of this act and offer due diligence recommendations.*

**D**uring the past two years, the Foreign Corrupt Practices Act of 1977 (FCPA)<sup>1</sup> has been responsible for the termination or substantial delay of at least two major corporate acquisitions: Lockheed Martin Corp.'s proposed acquisition of Titan Corporation and General Electric Co.'s acquisition of InVision Technologies, Inc. In both of these acquisitions, it was discovered through pre-acquisition due diligence that the acquiree companies had engaged in possible violations of the FCPA, and voluntary disclosures were made to the Securities and Exchange Commission (SEC) and Department of Justice (DOJ), the two U.S. government agencies responsible for enforcing the FCPA. In the end, both Titan Corporation and InVision Technologies, Inc. were required to pay substantial civil and criminal penalties and, in the case of Lockheed Martin Corp.'s proposed acquisition of Titan Corporation, the acquisition was terminated.

In light of these developments, all U.S. companies — not just those anticipating engaging in corporate mergers or acquisitions — should re-evaluate and, if necessary, strengthen their FCPA compliance efforts. Historically, the FCPA has been criticized as being ineffective in deterring U.S. companies from engaging in overseas bribery, primarily because of the paucity of criminal prosecutions made under the FCPA since its enactment. However, the SEC and the DOJ have expanded the enforcement of the FCPA and recently

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have obtained record-high civil and criminal penalties against companies and individuals for FCPA violations. In addition, the SEC and DOJ are now conducting seamless investigations of FCPA violations using their joint resources. It is now common practice for an SEC enforcement action and a DOJ prosecution to be announced simultaneously. Numerous publicly traded companies recently have disclosed in their SEC filings that they are under investigation by both the SEC and the DOJ for potential FCPA violations.

## **INTRODUCTION TO THE FCPA**

### **The FCPA's Anti-Bribery Provisions**

The anti-bribery provisions of the FCPA make it unlawful for any “issuer,” “domestic concern,” officer, director, employee or agent of an issuer or domestic concern, or any shareholder acting on behalf of an issuer or domestic concern, to corruptly offer, pay, promise to pay or authorize the payment of money or any other thing of value to any “foreign official” for purposes of influencing any act or decision of such foreign official in his or her official capacity, inducing such foreign official to do or omit to do any act in violation of his or her lawful duty, securing any improper advantage, or inducing such foreign official to use his or her influence with a foreign government or instrumentality thereof to persuade any act or decision of such government or instrumentality, in order to obtain or retain business for or with, or direct business to, any person.<sup>2</sup>

The term “issuer” is defined to include any entity (whether American or foreign) that has a class of securities registered pursuant to Section 13 of the Securities Exchange Act of 1934 (Exchange Act) or that is required to file periodic reports with the SEC pursuant to Section 15(b) of the Exchange Act.<sup>3</sup> The term “domestic concern” is defined to include (1) any individual who is a citizen, national or resident of the United States, or (2) any corporation, partnership, association, joint-stock company, business trust, unincorporated organization or sole proprietorship that has its principal place of business in the United States or that is organized under the laws of the United States.<sup>4</sup> The term “foreign official” is defined to mean any officer or employee of a foreign government or any department, agency or instrumentality thereof, or any person acting in an official capacity for or on behalf of any such government, department, agency or instrumentality.<sup>5</sup>

The DOJ and SEC have failed to provide clear guidance on the types of individuals they will consider to be foreign officials for purposes of FCPA. An examination of prosecutions and enforcement actions brought against U.S. companies for violations of the FCPA does, however, provide some indication of the types of individuals who may be determined by the DOJ and the SEC to be foreign officials. Among the individuals who have been determined to be foreign officials for the purposes of FCPA are:

- ◆ the president, the prime minister and the oil minister of Kazakhstan;<sup>6</sup>
- ◆ officials of the National Petroleum Investment Management Service of Nigeria;<sup>7</sup>
- ◆ engineers employed by the state oil company in Angola;<sup>8</sup>
- ◆ a captain in the Niger Air Force;<sup>9</sup>
- ◆ customs officials in Haiti<sup>10</sup> and Colombia;<sup>11</sup>
- ◆ officials of the State Oil Company of Azerbaijan;<sup>12</sup>
- ◆ an Indonesian tax official;<sup>13</sup>
- ◆ airport officials in China, the Phillipines and Thailand;<sup>14</sup>
- ◆ a member of the Nicaraguan legislature;<sup>15</sup>
- ◆ a senior official of the Indonesian Ministry of Environment;<sup>16</sup>
- ◆ the director of a regional health fund in Poland;<sup>17</sup>
- ◆ physicians and laboratory employees at government-owned hospitals in China<sup>18</sup> and in Taiwan, Mexico, Luxembourg and France;<sup>19</sup> and
- ◆ officials of a government-owned bank in Argentina.<sup>20</sup>

Based on a review of the above prosecutions and enforcement actions, it is apparent that the DOJ and SEC have deemed a wide range of individuals to be foreign officials for the purposes of the FCPA, ranging from heads of state to relatively low-level government officials and employees, such as customs officials in Haiti and Colombia, laboratory employees in government-owned hospitals in China, and state oil company engineers in Angola.

### **The FCPA's Accounting Provisions**

The FCPA's accounting provisions require issuers to make and keep books, records and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer, and to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

- ♦ transactions are executed in accordance with management's general or specific authorization;
- ♦ transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for such assets;
- ♦ access to assets is permitted only in accordance with management's general or specific authorization; and
- ♦ the recorded accountability for assets is compared with the existing assets at reasonable intervals, and appropriate action is taken with respect to any differences.<sup>21</sup>

The FCPA's accounting provisions also require issuers to require their wholly owned foreign subsidiaries to implement effective internal controls and make and keep accurate books, records and accounts.

### **Penalties for Violations of the FCPA**

Violations of the FCPA's anti-bribery provisions may result in criminal fines of up to \$2 million for entities and criminal fines up to \$250,000 and/or imprisonment for up to five years for individuals.<sup>22</sup> If the violation results in pecuniary gain or loss for any person, an alternative statutory maximum fine equal to the greater of twice the gross gain or loss is authorized.<sup>23</sup> For violations of the FCPA's accounting provisions, the SEC may issue a cease and desist order, order an accounting or disgorgement and/or impose civil penalties of up to \$500,000 for entities and \$100,000 for individuals.<sup>24</sup> "Willful" violations of the FCPA's accounting provisions may result in criminal fines of up to \$25 million for entities and criminal fines up to \$5 million and/or imprisonment for up to 20 years for individuals.<sup>25</sup>

## **THE IMPORTANCE OF PRE-ACQUISITION FCPA DUE DILIGENCE**

### **Lockheed Martin Corp.'s Proposed Acquisition of Titan Corporation**

In September 2003, Lockheed Martin Corp. (Lockheed) announced its intention to acquire Titan Corporation (Titan), a California-based defense contractor, for approximately \$1.8 billion. Per the acquisition agreement entered into between Lockheed and Titan, the acquisition was to be completed no later than March 2004. As part of Lockheed's routine pre-acquisi-

tion due diligence into Titan, however, it was discovered that Titan had engaged in various potential violations of the FCPA. In February 2004 — one month prior to the anticipated closing of the acquisition — Lockheed and Titan jointly filed voluntary disclosures with the SEC and DOJ. Pending investigations by the SEC and DOJ into Titan's violations of the FCPA, Lockheed and Titan entered into an amended acquisition agreement that provided that, as a condition to the closing of the acquisition, Titan either (1) obtain written confirmation that the DOJ considered its investigation resolved and did not intend to pursue any claims against Titan, or (2) enter into a plea agreement with the DOJ and complete the sentencing process. The amended acquisition agreement provided that if the acquisition was not completed by June 25, 2004, either Lockheed or Titan could terminate the agreement. On June 26, 2004, Lockheed announced that it had terminated its acquisition agreement with Titan.

On March 1, 2005, Titan pleaded guilty to two felony counts of violating the FCPA's anti-bribery and accounting provisions and to one felony count of filing a false tax return.<sup>26</sup> As part of Titan's plea agreement, Titan agreed to pay \$13 million in criminal fines and, separately, \$15.5 million in disgorgement and prejudgment interest to settle a parallel civil case brought by the SEC. In addition, the plea agreement required Titan to retain an independent consultant to review Titan's FCPA compliance policies and procedures and to draft a report documenting its findings and recommendations for Titan's board of directors and the SEC. Titan was required to provide the consultant with access to its files, books, records, personnel and agents and to adopt and implement the consultant's recommendations within 90 days of receiving the consultant's report. To ensure the independence of the consultant, Titan does not have the authority to terminate the consultant without the prior written approval of the SEC and is required to compensate the consultant, and persons engaged to assist the consultant, at its reasonable and customary rates.

The Titan case is significant because it illustrates the DOJ's and the SEC's commitment to enforcing aggressively the FCPA. Titan's combined civil and criminal penalty of \$28.5 million is the largest penalty ever imposed for a violation of the FCPA. The size of the penalty sends a clear signal to U.S. companies that they will be held accountable both criminally and civilly for their corrupt dealings in foreign countries.

On June 3, 2005, L-3 Communication Corporation (L-3), a New York

City-based defense contractor, announced that it had agreed to acquire Titan for approximately \$2.65 billion.

### **General Electric Co.'s Acquisition of InVision Technologies, Inc.**

In March 2004, General Electric Co. (GE) announced its intention to acquire InVision Technologies, Inc. (InVision), a California-based manufacturer of explosives detection systems, for approximately \$900 million. As part of GE's routine pre-acquisition due diligence into InVision, however, it was discovered that InVision had engaged in various potential violations of the FCPA. In July 2004, InVision and GE voluntarily disclosed to the DOJ and SEC the results of an internal investigation into InVision's potential violations of the FCPA. Further investigation by the DOJ and SEC revealed that InVision employees were aware of a high probability that InVision's agents and distributors in Thailand, China and the Philippines had made improper payments to foreign officials in connection with sales of InVision products in those countries.

GE delayed its acquisition of InVision pending investigations by the DOJ and SEC into InVision's violations of the FCPA. On Dec. 6, 2004, InVision entered into a nonprosecution agreement with the DOJ<sup>27</sup> and, separately, GE entered into a letter agreement with the DOJ under which the DOJ agreed not to take action against GE subsequent to GE's acquisition of InVision, subject to numerous conditions.

In exchange for the DOJ's agreement not to prosecute, InVision agreed to: (1) accept responsibility for its misconduct; (2) pay a criminal penalty of \$800,000; (3) fully and affirmatively disclose to the DOJ and the SEC any additional suspected violations of the FCPA; and (4) continue to cooperate with the DOJ and the SEC in their investigations.<sup>28</sup> As part of its letter agreement with the DOJ, GE agreed to: (1) integrate InVision into GE's FCPA compliance program and retain an independent consultant acceptable to the DOJ to evaluate the efficacy of GE's effort in that regard; (2) cause the full performance by InVision of its obligations under the non-prosecution agreement; and (3) continue to cooperate with the DOJ and the SEC in their investigations.<sup>29</sup>

On Feb. 14, 2005, after GE's acquisition of InVision and renaming of InVision to GE InVision, Inc. (GE InVision), the SEC issued a cease and desist order against GE InVision requiring GE and GE InVision to: (1) incor-

porate GE InVision into GE's FCPA compliance program and retain an independent consultant acceptable to the SEC and DOJ to evaluate the efficacy of GE's efforts in that regard; and (2) pay disgorgement of \$589,000 plus pre-judgment interest of \$28,703.57, for a total amount of \$617,703.57.<sup>30</sup>

### **FCPA Due Diligence Recommendations**

The FCPA imposes no legal duty on U.S. companies to perform due diligence with respect to their proposed acquisitions. In light of the substantial civil and criminal penalties that may be imposed for violations of the FCPA, however, even after an acquisition has been completed (as seen in the InVision matter), it is highly advisable that U.S. companies perform FCPA due diligence with respect to their proposed acquisitions.

In both the Titan and InVision matters, the acquiring companies discovered through pre-acquisition due diligence that the proposed acquirees had engaged in potential violations of the FCPA. As a result of their pre-acquisition due diligence, the acquiring companies were able to analyze fully the risks of their proposed acquisitions and avoid substantial liability under the FCPA.

Although the type and scope of FCPA due diligence that should be completed prior to an acquisition will vary from acquisition to acquisition, depending on the particular risks involved, most pre-acquisition FCPA due diligence contains the following elements:

- ❑ Determination of the risk that the target company has engaged in violations of the FCPA, based on the target company's line of business and the countries where the target company is located or does business. Companies with a higher risk of FCPA violations may include the following:
  - ◆ Companies engaged in cash-intensive lines of business.
  - ◆ Companies with large numbers of government contracts or other government business.
  - ◆ Companies located or operating in countries with high levels of official corruption. One useful source of information is Transparency International's *Corruption Perceptions Index*.<sup>31</sup>
- ❑ Review of the effectiveness of the target company's FCPA compliance program and policies and procedures for marketing- and entertainment-related expenditures.

- ❑ Interviews with employees of the target company and other knowledgeable individuals regarding rumors of unethical or suspicious conduct by the target company, its employees, or its agents, consultants or representatives.
- ❑ Review of the target company's books, records and accounts to determine whether such books, records and accounts accurately and fairly reflect all transactions and expenditures by the target company.
- ❑ Enhanced review of all contracts between the target company and any foreign government, foreign government controlled entity, foreign government employee or foreign political candidate.
- ❑ Enhanced review of all contracts between the target company and any foreign agent, consultant or representative of the target company.
- ❑ Enhanced review of any "red flags" indicating that violations of the FCPA may have occurred. Possible "red flags" include:
  - ◆ Rumors of improper payments or other unethical business practices by the target company, its employees, or its agents, consultants or representatives.
  - ◆ Unusually large or frequent payments in cash.
  - ◆ Unusually large or frequent political contributions.
  - ◆ Unusually large bonuses, commissions, etc., paid by the target company to its foreign agents, consultants or representatives.
  - ◆ Inaccurate or poorly maintained books, records or accounts.
  - ◆ Unexplained or poorly documented expenses on travel and entertainment expense reports.
  - ◆ Any discussions or references to "special arrangements" (or some similar language) with a foreign government entity or official.
  - ◆ An employee, agent, consultant or representative of the target company who refuses to agree in writing to comply with the FCPA or refuses to confirm that he or she has complied fully with the FCPA in the past.

## **VOLUNTARY DISCLOSURE OF FCPA VIOLATIONS**

In both the Titan and InVision acquisitions, voluntary disclosures were filed with the SEC and DOJ prior to the closing of the acquisition. The purpose

of these voluntary disclosures was to provide notice to the SEC and DOJ of potential violations of the FCPA and to avail the parties of potential mitigation of civil and criminal liability. As seen by the amount of penalties paid by Titan (\$28.5 million total) and InVision (\$1.4 million total), voluntary disclosure of an FCPA violation does not guarantee mitigation of civil and criminal penalties. Furthermore, the SEC and DOJ may give greater weight to voluntary disclosure in some cases (such as in InVision) than in other cases (such as is Titan).

Nonetheless, there has been a dramatic increase in the number of U.S. companies that have publicly disclosed their actual or suspected violations of the FCPA in their filings with the SEC or in press releases to investors and the general public. An even larger number of U.S. companies have privately disclosed their actual or suspected violations of the FCPA to the DOJ and SEC.

Although the FCPA does not mandate disclosure of violations, voluntary disclosure of an FCPA violation to the DOJ and/or SEC, as appropriate, may enable a company to either avoid prosecution or obtain partial mitigation of civil and criminal penalties. It may be advisable for a U.S. company to disclose the violation voluntarily to the DOJ and/or SEC, particularly when the risk of an involuntary disclosure of an FCPA violation is high, whether through a press report or a whistle-blower (either internal or external). If a company has violated the FCPA's anti-bribery provisions (enforced by the DOJ) and the FCPA's accounting provisions (enforced by the SEC), the company should make separate voluntary disclosures to both the DOJ and the SEC. Although the DOJ and SEC may share information and cooperate in their investigations, the DOJ and SEC generally will initiate separate investigations and may decide differently on whether to prosecute or initiate an enforcement action against the company.

On Jan. 20, 2003, the DOJ issued the Principles of Federal Prosecution of Business Organizations, also known as the "Thompson Memorandum,"<sup>32</sup> which sets forth the factors to be considered by the DOJ when determining whether to prosecute a company for a violation of federal law. The most important factor that will be considered by the DOJ is "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation." If the DOJ proceeds with a prosecution of a company for an FCPA violation, the fact that the U.S. company voluntarily disclosed the violation and cooperated with

the DOJ may entitle the U.S. company to partial mitigation of criminal penalties. Pursuant to the Federal Sentencing Guidelines, in order to qualify for mitigation of criminal penalties, the U.S. company's voluntary disclosure and cooperation must be both timely and thorough and may require a waiver of the attorney-client and work product privileges.

On Oct. 23, 2001, the SEC issued a Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, also known as the "Seaboard Report,"<sup>233</sup> which indicated that the SEC will consider a number of factors, including voluntary disclosure, cooperation with the SEC, the existence of compliance procedures, and other mitigating factors, when determining whether to initiate an enforcement action or civil proceedings against a company for a violation of the federal securities laws and regulations.

A voluntary disclosure of an FCPA violation, whether to the DOJ or SEC, should be prompt and timely. A "prompt" disclosure of an FCPA violation must be made to the DOJ and/or SEC, as appropriate, as soon as possible after the company discovers the violation and completes an internal investigation. A "timely" disclosure of an FCPA violation must be made prior to the DOJ or SEC becoming aware of the violation through some other source, such as a press report, a competitor or a whistle-blower. If the DOJ or SEC are aware of an FCPA violation prior to receiving a voluntary disclosure, the company making the voluntary disclosure is entitled to little or no benefit for making the voluntary disclosure.

The DOJ and SEC will likely require a company making a voluntary disclosure of an FCPA violation to waive the attorney-client and work product privileges. The company will be required to disclose to the DOJ and SEC all documents and communications related to the underlying FCPA violation and the company's internal investigation of the violation.

The potential benefits of a voluntary disclosure of an FCPA violation should be weighed against the costs of voluntary disclosure, including the expense and resources required to cooperate with a government investigation, the scope of civil and criminal penalties that could be imposed despite the voluntary disclosure, the risk and expense of private litigation resulting from the voluntary disclosure, and the public relations and business consequences, both in the U.S. and overseas, of the voluntary disclosure.

## NOTES

- 1 Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (amended 1988 and 1998), codified at 15 U.S.C. §§ 78m - 78ff.
- 2 15 U.S.C. §§ 78dd-1(a), 78dd-2(a).
- 3 15 U.S.C. § 78m(b)(2).
- 4 15 U.S.C. § 78dd-2(h)(1).
- 5 15 U.S.C. § 78dd-1(a).
- 6 *U.S. v. Giffen*, 2004 U.S. Dist. LEXIS 12194 (S.D.N.Y. 2004)
- 7 *SEC v. ABB, Ltd.*, SEC Lit. Rel. No. 18755 (July 6, 2004).
- 8 *Id.*
- 9 *U.S. v. Liebo*, 923 F.2d 1308 (8th Cir. 1991).
- 10 *U.S. v. Kay*, 359 F.3d 738 (5th Cir. 2004).
- 11 *SEC v. Chiquita Brands International*, SEC Lit. Rel. No. 17169 (Oct. 3, 2001).
- 12 *U.S. v. Bodmer*, 342 F. Suppl.2d.176 (S.D.N.Y. 2004).
- 13 *In the Matter of Baker Hughes, Inc.*, SEC Admin. Proc. Rel. No. 34-44784 (Sept. 12, 2001).
- 14 *In the Matter of GE InVision, Inc.*, SEC Admin. Proc. Rel. No. 34-511 (Feb. 14, 2005).
- 15 *In the Matter of BellSouth Corporation*, SEC Admin. Proc. Rel. No. 34-45279 (Jan. 15, 2002).
- 16 *SEC v. Monsanto*, SEC Lit. Rel. No. 19023 (Jan. 6, 2005).
- 17 *In the Matter of Schering-Plough Corporation*, SEC Admin. Proc. Rel. No. 34-49838 (June 9, 2004).
- 18 *SEC v. Diagnostic Products Corporation*, SEC Admin. Proc. Rel. No. 34-51724 (May 20, 2005).
- 19 *SEC v. Syncor International Corporation*, SEC Lit. Rel. No. 17887 (Dec. 10, 2002).
- 20 *SEC v. Internation Business Machines Corporation*, SEC Lit. Rel. No. 16839 (Dec. 21, 2000).
- 21 15 U.S.C. § 78m(2).
- 22 15 U.S.C. § 78dd-3(e).
- 23 18 U.S.C. § 3571(d).
- 24 15 U.S.C. §§ 78u-2, 78u-3.
- 25 15 U.S.C. § 78u.
- 26 See Office of the United States Attorney, Southern District of California, "News Release," available at <http://www.usdoj.gov/usao/cas/pr/cas50301.1.pdf> (March 1, 2005); Titan Corporation, Litigation Release No. 19,107 (March 1, 2005).
- 27 See U.S. Department of Justice, "InVision Technologies, Inc. Enters into Agreement with the United States," available at [http://www.usdoj.gov/opa/pr/2004/December/04\\_crm\\_780.htm](http://www.usdoj.gov/opa/pr/2004/December/04_crm_780.htm) (Dec. 6, 2004).
- 28 *Id.*
- 29 *Id.*
- 30 *In the Matter of GE InVision, Inc.* (formerly known as InVision Technologies, Inc.), Exchange Act Release No. 51,199 (Feb. 14, 2005).
- 31 The most recent version of Transparency International's Corruption Perceptions Index is available at <http://www.transparency.org/cpi/2004/cpi2004.en.html#cp2004>.
- 32 Available at [http://www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm).
- 33 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44,969 (Oct. 23, 2001).