

September 19, 2018

## United Technologies Hit with \$13.9 Million Fine for Making Illicit Payments

On September 12, 2018, the United Technologies Corporation (“UTC”) reached a \$13.9 million resolution with the U.S. Securities and Exchange Commission (“SEC”) over allegations that it violated the anti-bribery, books and records, and internal accounting controls provisions of the Foreign Corrupt Practices Act (“FCPA”). The SEC credited UTC for making self-disclosure to and cooperating with the enforcement authorities, as well as undertaking a series of remedial efforts. The SEC resolution comes after the Department of Justice (“DOJ”) notified UTC that it had decided to close its investigation on March 7, 2018, again illustrating that the SEC may still impose a civil penalty where the DOJ declines a matter and the company pays full disgorgement of ill-gotten gains.

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While the DOJ declination itself and the moderate SEC civil penalty highlight the U.S. enforcement authorities’ efforts to credit companies that engaged in self-disclosure, the UTC resolution is also notable for the SEC’s continued aggressive interpretation of the internal controls provision of the FCPA and the expansion of scope from the initial investigation.

### Liability for Foreign Subsidiaries’ Conduct

The SEC’s order against UTC alleges that from approximately 2009 through 2015, UTC, through its joint venture International Aero Engines (“IAE”), its subsidiary Otis Elevator Company (“Otis”), and its operating division Pratt & Whitney (“Pratt”), made unlawful payments to foreign officials in China, Azerbaijan, and other countries. As a result, UTC obtained a benefit of over \$9 million, and failed to accurately and fairly record the transactions in its books and records. The SEC further found that UTC failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances of the accuracy of the related transactions records.

It is worth noting that the SEC order only cites misconduct pertaining to UTC’s subsidiaries, and did little to establish that UTC itself participated in any of those violations by, for instance, approving the at-issue transactions. It is also worth highlighting that UTC had a number of relevant controls in place; the SEC essentially faulted UTC for failing to prevent bad acts of its foreign subsidiaries despite the fact that UTC had fairly extensive policies and procedures in place. This continues to reflect the SEC’s broad interpretation of the scope of a parent company’s liability stemming from the misconduct of its subsidiaries, such as its resolutions with PTC, SciClone, Alcoa, and Bio-Rad.

### Compliance Failures in China

According to the SEC order, as early as 2006, IAE, acting under the recommendation of a Pratt executive to hire an inexperienced third-party sales agent to “increase IAE’s market share in China,” entered into a sales representative agreement with the agent. Pratt and IAE reportedly performed little due diligence on the agent. Beginning in May 2006, IAE entered into a sales representative agreement and series of amendments with the agent providing a success fee commission of between 1.75 and 4% of sales to Chinese airlines. From 2009 to 2013, IAE allegedly paid approximately \$55 million in commissions to the agent. The SEC order specifically noted that in 2009, the sales agent, after receiving a \$2 million commission advance from IAE, emailed IAE proprietary and confidential

information regarding a state-owned Chinese airline's tender. Notably, the \$2 million advance was purportedly for an office expansion without any proper documentation to verify the purpose. The SEC order states that responsible officers at IAE subsequently revised their bid without advising the legal department of UTC, disregarding the high probability that the agent may have used the commission advance to make improper payments to airline employees in order to obtain confidential information.

In addition to this incident, the agent also allegedly requested advance payments to sponsor a golf event for Chinese officials. Afterwards, responsible officers at IAE toned down the description of the event, including calling it a "conference" and avoiding mentioning "gifts," in order to obtain approval from the legal department. The SEC order states that the IAE employees were aware that the sales agent gave expensive gifts to Chinese airline executives, such as iPads and luggage, at the golf event but took no action and did not report it to their legal department.

The SEC order also found that a sales supervisor of Otis China agreed to give a kickback payment to a Chinese bank official responsible for an elevator procurement project. The Otis China supervisor allegedly arranged for an approved distributor to bid for the contract to accomplish the kickback scheme, and the distributor subsequently won the bid. The SEC order identified several suspicious facts about the distributor: first, the supervisor justified using the distributor by falsely asserting that "the bank insisted on terms that were not acceptable to Otis China"; second, no one at Otis China questioned the business justification for the use of the distributor, especially whether the cost differential between a direct sale and a sale involving a distributor allowed enough spread for a kickback; third, the distributor inserted an unauthorized distributor into the project using a fake chop. UTC learned of the conduct after the sales supervisor was later convicted by Chinese authorities of bribery.

### **Compliance Failures in Azerbaijan**

UTC's use of suspicious third parties extended to its Azerbaijan business. According to the SEC order, from approximately 2012 to 2014, Otis engaged in various schemes to sell Otis elevator equipment to Liftremont, a municipal entity in Baku, Azerbaijan, that was responsible for procuring and maintaining the elevators in Baku's public housing. In March 2012, with the knowledge of Otis Russia's high-level officers, Otis Russia reportedly used two sham subcontractors to make payments to Liftremont officials in connection with making a direct sale of elevator equipment. The SEC noted that Otis Russia did not perform any due diligence on the subcontractors, but still paid them an amount representing nearly 44% of the total contract value without appropriate documentation. Further, between February 2013 and December 2014, Otis Russia allegedly involved four intermediaries to act as conduits to make improper payments at the direction of a Liftremont senior official in order to secure nine contracts from Liftremont. Again, no due diligence was performed on the intermediaries, and none of the intermediaries appeared to have local experience in Azerbaijan or reliable qualifications in either import/export or the elevator industry.

The SEC also alleged that Otis Russia allowed a Liftremont senior official to use Otis Russia's signature stamps to falsify documents. Otis Russia also allegedly executed a distributorship contract with Liftremont despite the fact that Liftremont was the government entity responsible for the selection of the supplier for Baku municipal and government projects.

The SEC faulted Otis's legal, finance, and business employees for failure to prevent these improper transactions.

### **Other Compliance Failures**

Lastly, the SEC order found that UTC funded leisure travel and entertainment for foreign officials from several countries, including China, Kuwait, South Korea, Pakistan, Thailand, and Indonesia. UTC employees frequently circumvented the requirement to have their legal department review and approve leisure travel and entertainment by submitting travel for foreign officials without disclosing its true purposes. Additionally, UTC businesses also provided excessive leisure travel and entertainment in conjunction with legitimate business travel. Between 2009 and

2015, UTC recorded over \$134,000 in improper travel and entertainment for foreign officials in the company's books and records as legitimate business expenses.

### Takeaways

Despite the frequency and severity of these behaviors, the DOJ decided to close its investigation of UTC, and the SEC only imposed a moderate civil penalty on the company. These results again highlight the U.S. enforcement authorities' efforts to credit companies that engaged in self-disclosure, substantial cooperation, and significant remedial efforts to rectify their problems. In the SEC order, the SEC specifically considered UTC's efforts such as timely providing facts developed during its internal investigation, terminating employees and third parties responsible for the misconduct, and enhancing its internal accounting controls. The SEC also credited UTC for strengthening its global compliance infrastructure (including enhancing its policies and procedures regarding travel, the due diligence process, and the use of third parties), creating positions to address potential risks, and increasing training of employees on anti-bribery issues.

This settlement also showcased a salient scope creep during the investigations. In late 2013 and early 2014, after learning of potentially improper behaviors by its employees, UTC self-disclosed to the DOJ, SEC, and the Serious Fraud Office of the United Kingdom the status of an internal investigation regarding a non-employee sales representative for the sales of jet engines and aftermarket services in China. Whereas the initial disclosure pertained to a single investigation in China, the final resolution touched upon the business operations of multiple UTC subsidiaries in Azerbaijan, Kuwait, South Korea, Pakistan, Thailand and Indonesia.

As noted above, despite UTC's lack of participation in these schemes, the SEC nonetheless imposed liability on the parent company for the compliance failures of its subsidiaries. This order again demonstrates that multi-national companies are postured in a challenging spot because they are expected to navigate a patchwork of inconsistent implementations of controls across jurisdictions and alleviate the widespread disarray. Parent companies should therefore be vigilant in implementing and assessing their internal controls at the foreign subsidiary level.

If you have any questions, please contact your usual Ropes & Gray advisor.