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The unspoken dilemma

The RBA and Leighton Holdings both had lawyers clear their business activities, and those activities are now alleged to be corrupt, writes **Patrick Durkin**.

There is a little-noticed similarity in the scandals over foreign bribery now tormenting two pillars of the Australian business world. Both the Reserve Bank of Australia and construction firm **Leighton Holdings** are paying the price for their involvement in paying bribes to win business in developing countries.

But the less obvious common thread is that both Leighton and the RBA had called in highly paid lawyers to investigate rumours of kickbacks prior to the scandals becoming public, but the advisers apparently waved them through.

It was only much later that police were called in to investigate.

Certainly it can be hard to detect corrupt practices in distant chaotic countries even from inside a company, but both cases raise serious questions about why the forensic probity investigators missed the scams and whether directors have taken their reports as a reason to close the case.

One close observer of the current scandals, likens the interrelationship between companies and probity investigators, to the conflict faced by ratings agencies sensationally exposed during the global financial crisis.

"Why would the law and accounting firms want to devour their own meal ticket?", the observer says.

The RBA called in Freehills in 2007 when a whistleblower sounded the alarm about the methods of its subsidiary Note Printing Australia selling bank notes to Asia. But it wasn't until revelations in Fairfax newspapers in 2009 that the police were called in.

Leighton asked accountants PwC to investigate its alleged payments to win construction contracts, and once again PwC said all was fine. It was almost two years later that another investigation by law firm Allens, into an unrelated matter, uncovered problems.

Even probity investigators admit they face a challenge doing their job.

"Your job is to be fearless in giving advice to your client but that can sometimes be difficult," Minter Ellison bribery expert **Ross Freeman** admits, carefully choosing his words about the highly sensitive and usually unspoken dilemma.

The worst scenario is to be pressured by others in the firm about jeopardising a long-term client relationship that provides a steady stream of fees for the firm.

The problem is exacerbated because lawyers are not required to rotate a client to retain their independence. Even for accountants, a five-year rotation is limited to the relevant partner rather than the firm.

A number of US law firms specialise in providing independent reviews but demand "no fetter" to their investigations.

Freeman tells his clients that "I will tell you who I want to see, I will report to the board, I

won't take direction from the CEO or anyone else and I will call for documents so that I do not feel compromised ... That is still not common."

Lawyers questioned about the apparent conflict say they are often only retained to examine limited information. But the defence only seems to reinforce the suspicion that companies don't want to know the full truth and their well-paid advisers do not always demand it.

"Companies are often quite scared to lift up the rock because they fear what they might find," says Mini VandePol, a corruption expert at Baker & McKenzie.

Worse, the reports can usually never be completely scrutinised because of legal professional privilege or confidentiality.

The Freehills report into bribery allegations at NPA, completed in 2007, has never been released, but Victorian Greens MP **Adam Bandt** read a section of the report during a parliamentary inquiry into the RBA that appears to play down the concerns.

"At its highest the Freehills report says, 'We have heard an allegation that it might have been made improperly to a third party, perhaps of a prohibited category. We do not know. It is equally possible that it was paid to a relative or a creditor. 50/50, equally possible.'

Then, on the basis of that, they go on to conclude at the bottom of the page, 'We have not seen any direct evidence that there has been any payment or other benefit provided to a foreign public official.'"

Since the scandal has been exposed, Reserve Bank governor **Glenn Stevens** has repeatedly used the Freehills report to claim that the bank's chiefs did all that they could.

"It was not proposed by Freehills or anyone else at that time that, having been through a process that concluded there was no evidence of a breach of the law, the next step should be to approach the police," Stevens has said.

He maintains that allowing Freehills to assess the NPA bribery allegations "represented a proper, independent and rigorous process", despite never calling in the Australian Federal Police to investigate.

It should be said that the RBA was not alone. **BHP** in 2007 also called in Freehills to decide whether the police needed to be called in after its dealings with **Saddam Hussein's** Iraq attracted attention in the **AWB** oil-for-food inquiry. The AWB inquiry found the so-called BHP Tigris deals were suspicious, but made no formal findings of impropriety.

Freehills then told BHP there was no reason to call in the cops.

Leighton Holdings had asked law firm Allens to examine claims of failing to disclose \$907 million of write-downs to the market after the corporate regulator launched an investigation. Instead, Allens stumbled on a "smoking gun" - the notebook of recently departed Leighton boss **David Stewart** in

All square

Top 20 FCPA* settlements (\$US)

Siemens (2008)	\$800m
KBR-Halliburton (2009)	\$579m
BAE (2010)	\$400m
Total (2013)	\$398m
ENI S.p.A (2010)	\$365m
Technip S.A (2010)	\$338m
JGC Corporation (2011)	\$219m
Daimler AG (2010)	\$185m
Alcatel-Lucent (2010)	\$137m
Deutsch-Magyar Telekom (2011)	\$95m
Panalpina (2010)	\$82m
Johnson&Johnson (2011)	\$70m
Pfizer-Wyeth (2012)	\$60m
ABB (2010)	\$58m
Pride International (2010)	\$56m
Marubeni Corporation (2012)	\$54m
Baker Hughes (2007)	\$44m
Willbros (2008)	\$32m
Chevron (2007)	\$30m
Titan Corporation (2005)	\$29m

*Foreign Corrupt Practices Act SOURCE: BAKER&MCKENZIE

which he details that long-time CEO **Wal King** had approved a \$50 million to \$60 million payment to a third party to win a \$750 million contract in Iraq.

Allens' discovery was eventually referred to the police. But what is striking is that PwC had been called in and reviewed allegations almost two years earlier but was unable to corroborate the allegation of illicit payments.

The PwC review was followed by a third review by law firm Herbert Geer, which identified serious concerns but still did not demand that Leighton call in police.

The confidential Herbert Geer review of Project Eclipse [a huge \$US70 million oil-and-gas-pipe-laying vessel used in Indonesia and Iraq] bribery allegations obtained by Fairfax Media, concluded that PwC's audit was hopelessly flawed.

"The fact that... the external PwC investigation did not give rise to a recommendation that Mr Hodge's [project manager **Gavin Hodge**] employment be terminated for gross misconduct or, at the very least, that he be disciplined for his misconduct, again, beggars belief," the confidential document reveals.

Hodge allegedly stole \$500,000 worth of steel from Leighton to build a barge for Indian company Adani in a black market racket. Rather than being sacked, Mr Hodge was given a bonus and thanked for his work by a Leighton executive who knew of his alleged corruption, **Russell Waugh**.

Herbert Geer said the PwC investigation was "inadequate in scope, execution and management follow-through".

But despite its findings that there was "prima facie evidence of fraudulent activity", they recommended that the board hold yet another inquiry, rather than call in police.

"We recommend that any group established to oversee the Further Investigation be seen to be balanced in its make-up and sufficiently detached from the day-to-day conduct of any investigation to ensure that the results of the investigation are seen to be independent and unbiased."

Sadly, the failure to question the limited role of advisers must fall squarely on the shoulders

of the corporate watchdog. The chairman of the Australian Securities and Investments Commission, **Greg Medcraft**, promised that holding "financial gatekeepers", including lawyer and accountants, to account would be the hallmark of his legacy. So far the reality has not matched the rhetoric.

"They are a cornerstone; I am going to focus very heavily on that area," Medcraft said soon after taking up his post.

The scrutiny comes on top of the serious gap already exposed between ASIC and the AFP on bribery issues.

ASIC claimed last week that they could not investigate the bribery matters until they had received a referral from the police. But the police have limited resources to investigate and by the time the matter comes to ASIC, the six-year limit for enforcement action has often expired.

"There is no reason that ASIC and the AFP shouldn't be co-operating on an investigation or that two investigations are being run in parallel," Freeman says.

In the case of Leighton, ASIC were already investigating the company for failed disclosure and had access to sensitive information from inside the company. The failure of the two agencies to share their resources suggests a serious breakdown in law enforcement.

Moreover, in many cases it might be easier for ASIC to bring civil charges for breach of directors duties than for bribery.

Certainly, in the case of the AWB Iraq kick-backs scandal no criminal charges were ever laid, but ASIC successfully brought civil charges against two senior AWB officials. All of this suggests regulators and politicians need to look at tougher laws and better enforcement.

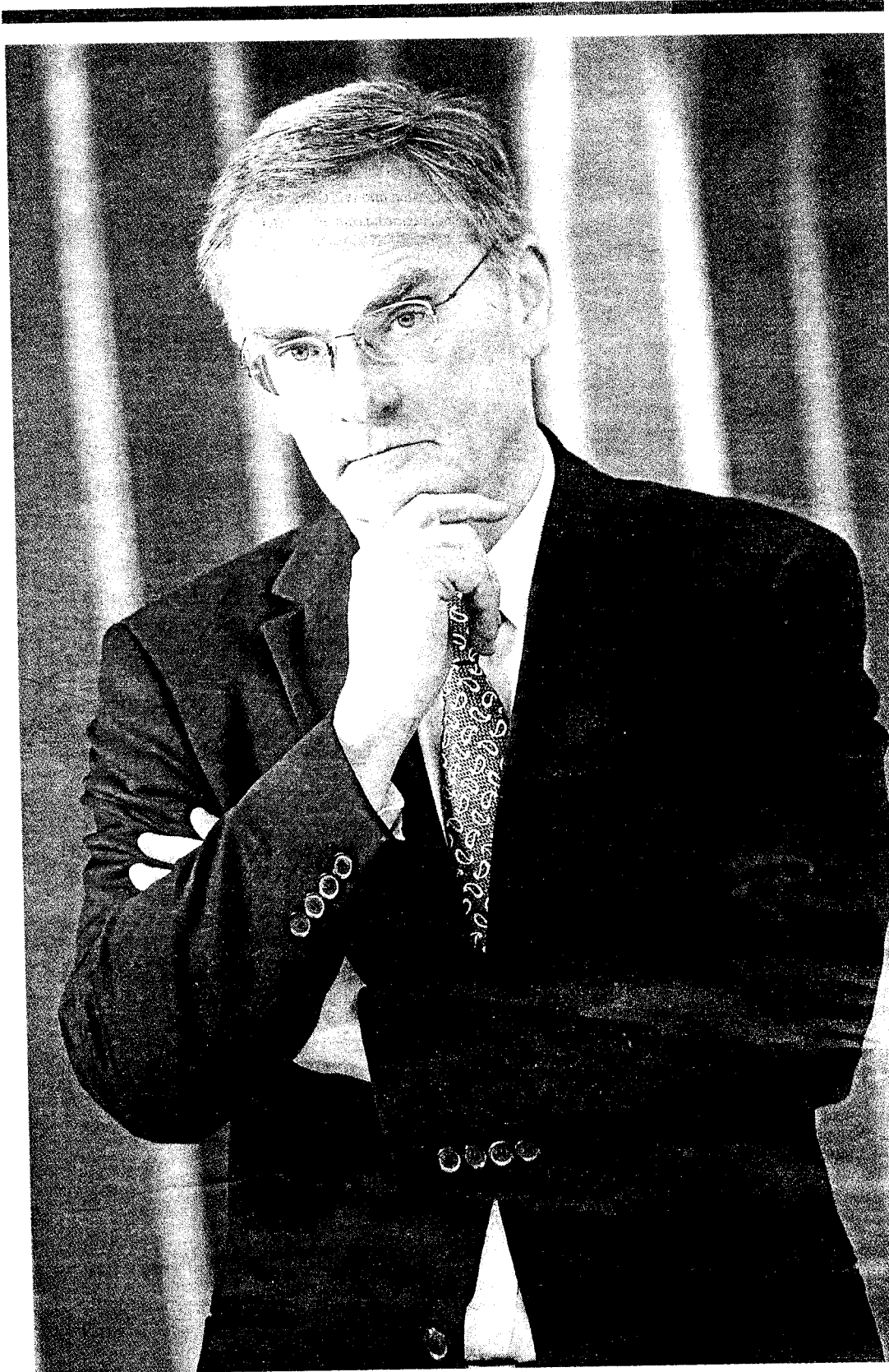
Experts say the bribery laws in Britain and the US are stronger, but they have also been much better policed. The US regulator collected \$1.8 billion in fines in 2010 and Britain has a dedicated and effective bribery regulator, an approach now being called for in Australia.

"The reason the US is more active in enforcement is that the [Department of Justice] and [Securities Enforcement Commission] demand that the company conducts an investigation and present the evidence to the regulator; the regulator then decides what penalty is paid for the transgression... The companies are shamed into co-operating and seldom fight it out in court," Baker & McKenzie's VandePol says.

Finally, Australia's whistleblower laws desperately need to be strengthened. Shockingly, the current protections only apply to public sector employees, VandePol says.

"Having a strong whistleblower policy is one of the 'must haves' as far as the US DOJ and SEC are concerned, as it helps companies know what is really happening and builds confidence in employees to know that they can speak up without repercussions."

Greg Medcraft, ASIC chairman, promised to hold financial gatekeepers to account. So far the reality has not quite matched his rhetoric.
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