Volume 60, Issue 5 Page 1447

Stanford Law Review

FCPA PROSECUTIONS: LIABILITY TREND TO WATCH

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INTRODUCTION

When it comes to compliance with the Foreign Corrupt Practices Act (FCPA), multinational companies that adopt a "don't ask, don't tell" policy may come to regret their hands-off approach. Compliance with the FCPA's laws against bribing foreign officials has recently come under increased scrutiny by the Securities and Exchange Commission (SEC), the United States Department of Justice (DOJ), and the plaintiffs' bar. At the same time, jurisdictions outside of the United States have also exhibited a renewed interest in enforcing their own FCPA-like laws.

For individual officers and directors, the environment is equally challenging. Of particular concern may be an emerging focus by the SEC to hold individual officers personally liable for failing to implement proper internal controls designed to prevent FCPA violations.

In this environment, directors and officers should gauge FCPA-related

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risks and put in place procedures and internal controls designed to mitigate these risks. To achieve these ends, officers and directors can help their companies, and themselves, by asking searching questions to assure themselves that the company is following the dual tracks of preventative training and proactive monitoring.

I. FOREIGN CORRUPT PRACTICES ACT

The Foreign Corrupt Practices Act was first passed in 1977 and is part of the Securities Exchange Act of 1934, as amended.[1] The FCPA fundamentally stands for the proposition that—notwithstanding local customs or business pressures to the contrary—U.S. businesses and persons should not bribe foreign officials or foreign political parties.

Broadly written, the FCPA's provisions include both anti-bribery provisions and accounting provisions. The anti-bribery provisions prohibit public companies from using bribes to secure an "improper advantage."[2] Moreover, the FCPA is designed to prevent companies from hiding behind local agents. The FCPA prohibits giving any person something of value "while knowing that all or a portion of such money or thing of value will be offered" for a bribe.[3] Although there are some exceptions to these broad prohibitions—such as if the payment in question is legal in the foreign jurisdiction involved—these exceptions are narrowly tailored, and it is risky to rely on these exceptions.

In addition to the anti-bribery provisions, the FCPA also has "books and records" and internal control requirements that obligate companies to maintain internal controls that will result in their books and records accurately reflecting all transactions.[4] This is to stop companies from maintaining off-the-books slush funds and turning a blind eye to them.

The penalties for violations of the FCPA can be significant. Under the FCPA, any person who is an "officer, director, employee or agent" of a company in violation of the FCPA—if that violation is willful—may be faced with a penalty of up to five years in jail and $100,000.[5] The SEC has the ability to impose even larger civil fines.

II. THE CURRENT ENVIRONMENT

Navigating the current enforcement environment is a tricky proposition for

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1. *See* Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§ 78dd-1 to -3 (2000)).
2. *Id.* § 30A(a), 15 U.S.C. § 78dd-1(a)(1) (2000).
3. *Id.* § 30A(a)(3), 15 U.S.C. § 78dd-1(a)(3) (2000).
4. *Id.* § 13(b), 15 U.S.C. § 78m (2000).
5. 15 U.S.C. § 78dd-2(g)(2) (2000).

companies as well as their directors and officers. Companies now face renewed scrutiny from regulators. At the same time, shareholder plaintiffs have sensed a potential avenue for recovery and therefore may also pay increasing attention to FCPA-related issues.

A. *Regulatory Environment*

The SEC and the DOJ have dramatically increased their interest in FCPA violations in the last several years. Between 1978 and 2000, the SEC and the DOJ together averaged only about three FCPA-related prosecutions a year.[6] In stark contrast, the DOJ more recently estimated that there are some sixty cases of possible FCPA violations currently under investigation.[7] Another source has put the number of companies with open FCPA investigations at one hundred.[8]

Much of this increase in activity may result from the tendency of companies in the post-Sarbanes Oxley world to conduct internal investigations and "self-report" violations in hopes of gaining leniency from regulators. Fearing the harsh penalties that the SEC and the DOJ may exact for failure to take FCPA concerns seriously, many companies today are quick to launch an internal investigation in the face of credible suspicion of a potential FCPA violation. For their part, the SEC and the DOJ have enthusiastically embraced the role that self-monitoring and cooperation play in assisting their investigations.

In addition to a substantial increase in the number of FCPA-related investigations, the penalties imposed in recent actions seem to be on the rise. Notable among recent investigations is the $44 million settlement that the SEC and the DOJ announced with Baker Hughes, Inc. in April 2007. This settlement included $23 million in disgorgement and pre-judgment interest paid to the SEC, a $10 million civil penalty paid to the SEC for violating an earlier SEC cease-and-desist order, and an $11 million criminal fine.[9] The Baker Hughes settlement is the largest penalty ever imposed in an FCPA case. By way of comparison, the largest penalty before Baker Hughes was the $28 million penalty imposed in March 2005 on Titan Corporation.[10] Other large

6. Eugene R. Erbstoesser, John H. Sturc & John W.F. Chesley, *The FCPA and Analogous Foreign Anti-Bribery Laws—Overview, Recent Developments, and Acquisition Due Diligence*, 2 CAP. MARKETS L.J. 381, 386 (2007).

7. Nelson D. Schwartz & Lowell Bergman, *Payload: Taking Aim at Corporate Bribery*, N.Y. TIMES, Nov. 25, 2007, at C1.

8. GIBSON, DUNN & CRUTCHER LLP, THE FCPA ENFORCEMENT EXPLOSION CONTINUES: NINE NEW ENFORCEMENT ACTIONS IN 2007 AND APPROXIMATELY 100 ACTIVE INVESTIGATIONS (2007).

9. Press Release No. 2007-77, SEC, SEC Charges Baker Hughes with Foreign Bribery and with Violating 2001 Cease-and-Desist Order (Apr. 26, 2007) (on file with author).

10. Elliott Leary et al., *Trends in FCPA Enforcement*, METROPOLITAN CORP. COUNS., May 2007, at 18; *see also* Litigation Release No. 19107, SEC, SEC Sues Titan Corporation for Payments to Election Campaign of Benin President (Mar. 1, 2005).

settlements in 2007 included the $30 million in combined fines and penalties that Chevron Corporation paid to settle its FCPA investigation,[11] the $26 million that subsidiaries of Vetco International, Ltd. paid, and a $22 million settlement paid by York International Corporation.[12]

There is also reason to believe that the government is interested in continuing this trend towards imposing large fines to discourage FCPA violations. Consider the DOJ's pronouncement in the press release regarding the Baker Hughes settlement:

> "Today's announcement demonstrates that the Department of Justice will continue to hold U.S. companies and their subsidiaries accountable for foreign bribery," said Assistant Attorney General Alice Fisher. "The record penalties leveled in this case leave no doubt that foreign bribery is bad for business. By enforcing the FCPA, we are maintaining the integrity of U.S. markets and leveling the playing field for those companies that want to play by the rules."[13]

In addition, several jurisdictions outside the United States are also exhibiting renewed interest in enforcing their own FCPA-like laws. For example, Germany has gone from allowing companies to deduct the cost of paying bribes as a business expense,[14] to aggressively prosecuting companies that pay bribes. The pursuit by German authorities of Siemens AG is an excellent example of this change in attitude. Penalties imposed to date include a fine imposed by the Munich district court for €201 million in October 2007. This fine was paid in settlement of seventy-seven different cases of bribery of foreign officials in Russia, Nigeria, and Libya.[15]

Enforcement actions against a multinational company in one jurisdiction may also spur regulators in other jurisdictions to act. In the case of Siemens, both the DOJ and the SEC are now also investigating Siemens for violations of the FCPA. Another example is the United Kingdom's investigation of BAE Systems for alleged corruption violations in connection with defense contracts for Saudi Arabia. The United Kingdom terminated its investigation in December 2006 due to national security concerns. However, in 2007, BAE

11. Litigation Release No. 20363, SEC, SEC Files Settled Books and Records and Internal Controls Charges Against Chevron Corporation for Improper Payments to Iraq Under the U.N. Oil for Food Program—Company Agrees to Pay a Total of $30 Million (Nov. 14, 2007).

12. Litigation Release No. 20319, SEC, SEC Files Settled Foreign Corrupt Practices Act Charges Against York International Corporation for Improper Payments to UAE Officials, to Iraq Under the U.N. Oil for Food Program, and to Others—Company Agrees to Pay Over $12 Million and to Retain an Independent Compliance Monitor (Oct. 1, 2007).

13. Press Release No. 07-296, DOJ, Baker Hughes Subsidiary Pleads Guilty to Bribing Kazakh Official and Agrees to Pay $11 Million Criminal Fine as Part of the Largest Combined Sanction Ever Imposed in FCPA Case (Apr. 26, 2007).

14. Called "Schmiergelder," the payment of bribe money in Germany is now illegal. *See* Schwartz & Bergman, *supra* note 7.

15. Siemens Aktiengesellschaft, Report of Foreign Private Issuer (Form 6-K), at 31 (Nov. 8, 2007).

Systems learned that the DOJ and the SEC had opened an investigation into possible violations of the FCPA.[16] Unwanted attention of this type can thus build upon itself and cause problems for a multinational company in multiple jurisdictions.

B. *Private Litigation Environment*

Increased public sector enforcement activities may also be triggering activity in the private sector. Notwithstanding the fact that the FCPA creates no private right of action, the plaintiffs' bar in the United States has apparently sensed an opportunity.

Without a private right of enforcement, plaintiffs cannot directly sue a company and its directors and officers for violations of the FCPA. In contrast, Section 10b of the Securities Exchange Act allows a private plaintiff to bring a cause of action to recover damages incurred by shareholders from false and misleading statements made by the officers and directors of a corporation. Therefore, in cases where there appears to be an underlying FCPA violation, private plaintiffs have instead alleged that the defendants have violated Section 10b. More specifically, plaintiffs have claimed that defendants violated Section 10b by alleging that the defendant made materially false and misleading statements concerning the adequacy of internal controls designed to prevent FCPA violations.

In 2006 and 2007, plaintiffs brought at least four such Section 10b cases. Two were dismissed by the courts,[17] but two—*In re Immocur, Inc.* and *In re Nature's Sunshine Products Securities Litigation* survived motions to dismiss.[18] In these instances, the federal district courts held that the facts alleged met the heightened pleading requirements for fraud set forth in the Private Securities Litigation Reform Act. Immucor has since settled, but the Nature's Sunshine Products case is still ongoing.

C. *The Threat to Directors and Officers*

In their capacity as fiduciaries of the shareholders, directors and officers must first concern themselves with protecting the company from liability by seeking to prevent the company's employees and agents from violating the FCPA. At the same time, directors and officers naturally harbor concerns about

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16. James Boxell et al., *BAE Faces Fines in US Bribery Probe*, FIN. TIMES, June 26, 2007.

17. *In re* Syncor Int'l Corp. Sec. Litig., 239 F. App'x 318 (9th Cir. 2007); *In re* Invision Techs., Inc., Sec. Litig., No. C04-03181, 2006 WL 538752 (N.D. Cal. Feb. 22, 2006).

18. *In re* Nature's Sunshine Prods. Sec. Litig., 486 F. Supp. 2d 1301 (D. Utah 2007); *In re* Immucor Inc. Sec. Litig., No. 1:05-CV-2276-WSD, 2006 WL 3000133 (N.D. Ga. Oct. 4, 2006).

their own personal liability. On this front, most directors and officers rest easy in the knowledge that they would never pay a bribe or authorize someone else to pay a bribe.

However, protecting oneself is not that simple. Directors and especially officers may face an expanded scope of liability under the FCPA. The SEC may seek to expand personal liability to include situations in which inattention or lack of action could be seen as a violation of the FCPA.

Consider, for example, the SEC's prosecution of Monty Fu, the founder and former CEO and chairman of Syncor International Corporation. The SEC alleged that over a seventeen-year period, Syncor funneled bribes to doctors employed by private and public hospitals in Taiwan.

In addition to accusing Mr. Fu of being aware of the improper payments, which he neither admitted nor denied, the SEC sought to establish culpability for Mr. Fu for his failure to implement proper internal controls that would have prevented FCPA violations.

As described by the SEC, "[Mr.] Fu had the authority to maintain compliance with existing internal controls, and to implement additional internal controls designed to comply with the FCPA's books and records and internal controls provisions, yet failed to do so."[19] In its complaints, the SEC characterizes this behavior as a direct violation of the rule prohibiting a person from "knowingly circumvent[ing] or knowingly fail[ing] to implement a system of internal accounting controls or knowingly falsify[ing] any book, record, or account."[20] The SEC maintained that this behavior constituted "aiding and abetting Syncor's books and records [violations] and internal controls violations" of federal law.[21] The SEC's pursuit of Mr. Fu under an aiding and abetting theory of personal liability is not an isolated case and is consistent with the SEC's overall focus on prosecuting the gatekeepers of a corporation.[22]

In addition to being concerned with prosecution by the government, directors and especially officers may also be justifiably concerned about the personal liability that could result from suits brought by shareholder plaintiffs. As discussed above, shareholder plaintiffs have already made forays into bringing Section 10b cases against companies and their officers premised on alleged violations of the FCPA.

In the future, officers and directors may face an even more serious threat from the plaintiffs' bar if an FCPA investigation causes a company's stock to lose value shortly after a public offering of stock or bonds. In such

19. Complaint at 2, SEC v. Monty Fu, No. 1:07CV01735 (D.D.C. Sept. 27, 2007).

20. Securities Exchange Act of 1934 § 13(b)(5), 15 U.S.C. § 78m (2000).

21. Complaint, *supra* note 19, at 2.

22. For example, the SEC's investigation of the former CEO and Chairman of Schnitzer Steel, Robert Philip, was settled in December 2007. Complaint at 1-2, SEC v. Philip, No. CV07-1836 (D. Or. Dec. 11, 2007).

circumstances, plaintiffs may allege violations of Section 11 of the Securities Exchange Act. Under Section 11, officers and directors are held to a higher standard because false or misleading statements are made in connection with a public offering of securities. This higher standard in turn makes it easier for a plaintiff to meet the burden of proof.

Another area of risk for directors and officers comes from the lessons the plaintiffs' bar learned during the recent options backdating scandals. The lesson was that when the market fails to react to the announcement of a scandal—such as the existence of options backdating—it might still be worth a plaintiff's time to file suit in state court alleging a breach of fiduciary duty. These suits are expensive to defend and, for that reason, might prompt an earlier settlement, if only in the amount of the plaintiff attorneys' fees. In the case of FCPA issues, plaintiffs may similarly attempt to extract settlement money from a company and its directors and officers by bringing suits that allege breaches of fiduciary duties such as the duty of care.

III. Recommendations

In light of the current environment and the potential liability both for companies and their directors and officers, companies should take appropriate measures to mitigate the risks of FCPA violations. By implementing appropriate internal controls, companies not only reduce the likelihood of violations in the first instance but also mitigate the adverse consequences of violations if they do occur.

If a violation occurs, regulators often consider the efforts a company undertook to prevent the violation when deciding whether to indict the company or only go after the individual employees involved in the violation.[23] Moreover, regulators often take these same efforts into consideration when considering the quantum of penalties to be imposed on companies for violations.[24]

Broadly, companies should pursue a dual course of preventative training and proactive monitoring; companies should both train their employees to avoid FCPA violations in the first place and then should actively audit compliance with company FCPA policies. It is the role of the company's directors and officers to ensure that the company has put in place adequate measures. To ensure that the company has put in place appropriate measures, the company's board should undertake the following inquiries related to training and monitoring.

23. *See* Memorandum from Paul J. McNulty, Deputy Attorney Gen., to U.S. Attorneys, on Principles of Federal Prosecution of Business Organizations 4 (Dec. 12, 2006) (on file with author).

24. *See* U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2007).

A. *Training*

1. What is the tone at the top? This question is both the most obvious to identify and perhaps the most difficult issue to address. Nevertheless, it is critical to have the appropriate "tone at the top" when it comes to compliance with the FCPA and the company's FCPA-related policies. Senior officers should be front and center when it comes to instructing employees and other agents of the company on how to comply with the FCPA, including the senior officer who has been designated the FCPA compliance officer. This means that it must be senior business officers (i.e., high-profile personnel that are well known to all employees) and not just someone from the legal department who is leading the FCPA training. In addition to formal trainings, senior officers should be talking about FCPA issues regularly to employees as well as third party vendors and customers. Beyond talking, employees should ideally be made aware of times when senior managers refuse to compromise the integrity of the company by violating the FCPA. Finally, senior officers have to be consistent with the FCPA message. They cannot be effective at setting the tone at the top if they joke about the rules in social settings[25] or otherwise seem to have a different view on the importance of compliance depending on where and to whom they are speaking.

2. Is the written FCPA policy practical and specific? Companies should publish an FCPA policy that contains practical and specific examples of what is expected of employees. Soft, almost ambiguous, language that speaks only in terms of abstractions upon which everyone can agree (e.g., "We are a company of high ethical standards") are not helpful to an employee who is scouring the policy late at night in the hope of finding guidance on his particular FCPA-related dilemma. In particular, the company should provide additional guidance for employees doing business in jurisdictions where local business norms are less than conducive to compliance with the FCPA. The FCPA policy can be a stand-alone policy. It can also be contained within the company's Code of Business Ethics, as long as the FCPA issues are given sufficient and specific attention.

3. Has the company focused its FCPA training efforts on the most likely areas of risk? Companies should consider the relative risks of the countries in which they do business. Companies should spend proportionately more effort training those individuals that conduct company business in countries that score high on various corruption indices.[26] In addition, companies should consider which of their employees are likely to be in a position to be solicited for a

25. Stephen M. Cutler, Dir., Div. of Enforcement, SEC, Speech at Second Annual General Counsel Roundtable: Tone at the Top: Getting it Right (Dec. 3, 2004), *available at* http://www.sec.gov/news/speech/spch120304smc.htm.

26. The Corruptions Perceptions Index, for example, is maintained by Transparency International. 2007 Transparency International Corruption Perception Index, http://www.transparency.org/policy_research/surveys_indices/cpi/2007.

bribe. For example, to the extent that only a select number of the company's sales force has the authority to commit funds, the company should direct proportionately more effort training these individuals than the sales force at large. It is still the case, however, that even less-at-risk personnel need some training on FCPA issues.

4. Is FCPA training mandatory, and is that training periodically updated? The way in which a company conducts FCPA training is critical to its efficacy. There is a vast difference between mandatory, in-person training where attendance is tracked by the human resources department and a general email reminding employees to attend an open FCPA training session. In addition to mandatory training, companies should periodically repeat and update training. Veteran employees will retain little if anything of a single training session attended in the distant past—perhaps when they first joined the company—if that training is not periodically reinforced.

5. Is there an obvious and easy way for an individual to obtain guidance from the company on complying with the FCPA? Although written policies and training are both important, no amount of policy writing or employee training can cover every eventuality faced by employees in the field. Therefore, it is important to provide employees with access to immediate guidance on the specific FCPA-related issue that they may face. Having a central hotline or a chief compliance officer accessible to everyone is a helpful step. Ideally, individuals should be able to get assistance on an anonymous basis if they so desire.

B. *Monitoring*

1. What is the control environment in remote offices? It is critical that all offices and subsidiaries of a company operate in a rigorous control environment characterized by a high degree of personal accountability and transparency in financial transactions. Deciding that an office is too small to implement internal controls may create an unintended opportunity for an FCPA violation. In addition, periodic audits directed at FCPA issues are appropriate. Auditors should look for red-flags such as unusually loose credit terms or unusual payments to offshore holding companies.

2. *What verifications are done before third-party agents are hired to do business on behalf of the company?* Companies often hire agents in foreign jurisdictions to help them conduct business. There is nothing wrong with this practice as long as the company is comfortable that its agents are not violating the FCPA. Companies should follow a specific approval process for the hiring of new agents. The approval process should include a background and reference check of both the specific agent and the company that the agent represents. Part of this background check process should include understanding what other companies work with the agent in question, and considering whether those companies are the type of companies that would reject using an agent

who would violate the FCPA. In addition to background checks, consider having the agents execute contracts in which they specifically agree not to conduct themselves in a way that would violate the FCPA.[27] These contracts should be as specific and unambiguous as possible. For example, if the agent is allowed to make routine facilitating payments[28]—an extremely narrow exception found in the FCPA statute—detail about the scope and nature of acceptable payments should be enumerated. The contract might also include requirements for periodic certifications and audit rights. Where possible, someone from the company should be on the ground in the foreign jurisdiction so that the company can verify ongoing agent compliance through someone it trusts.

3. What does the company do to ensure that it understands the government affiliations of everyone with whom it is doing business? A large number of companies around the world are either partially or wholly owned by governmental entities. In conducting business with such entities, companies may be perceived as providing a governmental official with an improper benefit, even if the company thought it had merely entered into an arms-length transaction with a third party. Best practices include asking third parties to identify their ownership, and then confirming this information through other sources where possible.[29]

4. Is M&A diligence specifically concerned with uncovering potential FCPA risks of target companies? The risk of FCPA compliance must be added to the list of the risks considered when deciding whether to acquire another company. If the buyer does not unearth a seller's FCPA violations prior to the time of acquisition, the buyer risks unknowingly assuming the selling company's FCPA-related liabilities—both civil and criminal. On the other side of the table, sellers should also understand that buyers are likely to conduct an extensive FCPA-compliance review. It is clearly better to be certain about the outcome of such a compliance review than to be surprised into having to self-report the due diligence findings to the government. Indeed, many recent, high-profile FCPA investigations of would-be sellers stem from discoveries made by acquirers in the course of conducting due diligence, discoveries that led to these sellers having to self-report the violations to the government.[30]

IV. OUT IN FRONT ON THE ISSUE

Given the reality of international commerce, few modern companies are

27. For more on this concept, see Philip Urofsky, *Promoting Global Corporate Transparency*, EJOURNAL USA, Dec. 2006, http://usinfo.state.gov/journals/itdhr/1206/ijde/urofsky.htm.

28. Securities Exchange Act of 1934 § 30A(b), 15 U.S.C. § 78dd-1(b) (2000).

29. Urofsky, *supra* note 27, at 20.

30. *See, e.g.*, Complaint, SEC v. Titan Corp., No. 05-00411 (D.D.C. Mar. 1, 2005); Plea Agreement, United States v. Titan Corp., No. 05CR00314 (S.D. Cal. Feb. 28, 2005).

immune from the risks of violating the FCPA. Examining a company's FCPA compliance procedures is an urgent task. The urgency is driven by domestic and foreign regulators, both of whom are eager to send a strong anti-corruption message through aggressive investigations and prosecutions of both individuals and companies. They are also conveying their message strongly by imposing extremely large fines and penalties. Moreover, the SEC has shown a willingness to hold liable an individual officer who fails to implement adequate internal controls, even when the officer did not directly violate the FCPA himself.

Adding to the urgency is the civil litigation environment. The civil plaintiffs' bar in the United States has been making forays into using FCPA-related internal control issues to support securities class action lawsuits. The right combination of circumstances involving a failure of internal controls and resulting undetected violations of the FCPA could ultimately result in personal liability for an officer and in extreme circumstances, a director (for example, in a lawsuit involving Section 11 of the Securities Act of 1933). By proactively taking the training and monitoring measures described in this Article, directors and officers can help their companies—and themselves—substantially mitigate these risks.