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NYSE: Corporate Governance Guide

28 FCPA and compliance: a board and senior management perspective

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In today's post–financial crisis enforcement environment, companies devote greater effort and resources than in the past to overseeing the implementation and operation of an effective compliance program. Regulation has become more extensive and complex; the US government has grown more aggressive and demanding in its compliance expectations and enforcement efforts; and foreign governments have similarly increased their enforcement activities. The price of compliance has gone up, as has the cost of non-compliance.

This chapter addresses the oversight roles played by the board and senior managers of a US-listed public company with regard to compliance with the Foreign Corrupt Practices Act (FCPA). This area of compliance is critically important to listed companies with multinational operations. More generally, this discussion of compliance in the context of the FCPA illustrates issues that cut across different areas of compliance, including the appropriate roles of senior management and the board and key elements of an effective compliance program.

The legal obligations of boards and senior managers in regard to compliance

The Delaware Supreme Court's 1963 decision in *Graham v. Allis-Chalmers Mfg. Co.*[1] illustrates that, just as the board is not responsible for managing the day-to-day business affairs of a company, so too, it is not responsible for day-to-day compliance. The directors in that case were sued on the theory that they should have known that company employees engaged in behavior leading to corporate antitrust liability and that they should have brought the company into compliance, thereby preventing the loss. The Delaware Supreme Court stated in emphatic terms that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."[2]

Chancellor Allen's decision in *In re Caremark International Inc. Derivative Litigation*[3] interpreted Allis-Chalmers for the modern era. Consistent with the board's oversight responsibilities generally,

Caremark recognized a limited role for boards to help assure that senior managers adopt and implement an effective compliance program. As recognized by the Delaware Supreme Court in *Stone v. Ritter,* liability under *Caremark* may arise from "a sustained or systematic failure of the board to exercise oversight," which might be found if "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[4]

Caremark liability requires a showing of bad faith and has been called "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[5] However, the bad faith requirement also means that violations of *Caremark* duties are generally not subject to exculpation or indemnification.[6] While the standard for finding *Caremark* liability is high, the boards of companies that announce compliance problems nonetheless have been subject to such claims almost reflexively. Numerous,[7] but not all,[8] cases have been dismissed. The lesson from multiple perspectives—prevention, good governance, and defending a potential *Caremark* claim—is that the board should assure itself through its oversight that an adequate compliance program (inclusive of adequate information systems and controls) has been implemented and is continuing to function effectively. The board's oversight role should be precisely that: to receive periodic reports, and otherwise when circumstances require, to see that management is focused on these issues and has taken what appear to be proper and timely steps to identify and address compliance risks in its business. Exercising that oversight sends the message that the board itself regards compliance as important and that management should thus do so too.

While senior management should enact an effective compliance program, distinctions should be made between managers with different functions at different levels of the corporate enterprise. Senior management of large multinational companies with geographically diverse operations may not know of the day-to-day activities of employees or agents in remote locations. Senior management should thus enact systems providing for monitoring, internal reporting, and periodic reviews, and then should be able to rely on such systems, lower levels of management, and "control" functions until an issue comes to their attention requiring senior-level involvement.

When such an issue does come to senior management's attention, however, it is important to respond in a timely manner to gather facts and to implement remedial steps as needed and appropriate. This does not mean that a full-blown independent internal investigation is always required. Rather, the nature as well as the scope of the inquiry should be appropriately tailored to the circumstances. There are many circumstances where a focused effort by in-house counsel and others within the company to gather the necessary facts will suffice and be most expeditious and efficient.

Regardless of the nature of the fact-gathering process, in certain circumstances evidence of problems in the past may signal a risk of future misconduct. Senior managers who were not aware of questionable conduct in the past when it occurred, and thus may not be criticized on that basis, may be criticized for letting new violations happen "on their watch." To protect the company and all concerned, prompt consideration should be given where necessary to taking preventive measures on an interim basis pending further inquiry or other remedial steps that may be appropriate.

Summary of the FCPA

The FCPA was enacted in 1977 in the wake of revelations of widespread bribery of foreign governmental officials by American companies seeking to do business overseas. The FCPA, as amended, consists of anti-bribery provisions and also so-called accounting provisions (which in fact impose

broad record-keeping and internal control requirements on issuers).[9]

The anti-bribery provisions apply to: (1) "issuers," ie, companies with US registered securities or that are otherwise required to file periodic reports with the SEC, including foreign issuers with ADRs trading on a US exchange;[10] (2) "domestic concerns," which include US individuals (ie citizens, nationals, and residents) and US corporations, partnerships, and certain other US entities;[11] (3) foreign nationals or entities that act to further a corrupt payment while in the US;[12] and (4) officers, directors, employees, agents, and stockholders of issuers or domestic concerns.[13]

The anti-bribery provisions generally prohibit covered persons and entities from corruptly making, authorizing, promising, or offering payments ("anything of value") to foreign officials (any officer, employee, or representative of a foreign government, agency, department, or instrumentality thereof, such as a state-owned enterprise), foreign political parties or their representatives, candidates for foreign political office, and employees or representatives of a public international organization (eg International Monetary Fund [IMF], World Trade Organization [WTO], World Bank) with the purpose of assisting in "obtaining or retaining business."[14] That so-called "business purpose test" does not require that the bribe's purpose specifically be to facilitate obtaining or keeping a government contract. US enforcement authorities interpret the business purpose test broadly, treating bribes for the purpose of obtaining a business advantage as meeting this statutory requirement.[15]

The FCPA requires that the payment be made or offered "corruptly," essentially with an intent to wrongfully influence the recipient to misuse his official position. Thus, while the FCPA does not specify a minimum value of what is offered or paid, a gift of company promotional items of nominal value normally would not reflect corrupt intent.

Given the prevalence of state-owned or controlled entities engaged in commercial activities, for example in China, it should be highlighted that foreign officials may include officers or employees of such "agenc[ies]" or "instrumentalit[ies]" of a foreign government.[16]

The FCPA by its terms applies to the activities of agents or intermediaries who would pay a bribe, and the issuers or others who would employ them to do so. The FCPA specifically prohibits payments or offers to a third party (such as an agent) while "knowing" that all or a portion of such payment to the third party will be passed on or offered to a foreign official.[17] It is not necessary that the identity of the foreign official be known. The FCPA contains a definition of "knowing" that relaxes the traditional meaning of that word in certain respects—for example, it presumes the "knowing" condition to be satisfied where the allegedly knowing party is aware of a high probability of the existence of the relevant circumstance.[18]

The FCPA applies to other "indirect" benefits as well. For example, the FCPA may be implicated in certain circumstances by making charitable donations or underwriting sponsorships at the behest of a foreign official or to organizations associated with a foreign official.[19] Similarly, hiring or otherwise benefiting members of the family of a foreign official may present FCPA issues. The government remains focused on these and other alleged means of "evading" the FCPA.

There are two affirmative defenses to the anti-bribery prohibitions of the FCPA for which a defendant would bear the burden of proof. One affirmative defense is for expenses directly related to the bona fide "promotion, demonstration, or explanation" of a company's products or performance of a contract, but not a trip for personal entertainment.[20] The other affirmative defense is for payments that are lawful under the written local law of the foreign country; however, absence of law prohibiting a payment or conduct, or the fact that corrupt payments may not be prosecuted or are

otherwise part of the generally accepted custom and practice in a foreign jurisdiction, do not fall within this defense.[21] There is also an exception for payments to facilitate or expedite "routine government action" involving "nondiscretionary acts," although US enforcement authorities have taken a narrow view of this exception."[22]

The accounting provisions of the FCPA require issuers to make and keep books and records that, in reasonable detail, accurately and fairly reflect an issuer's transactions and dispositions of an issuer's assets, and further require issuers to devise and maintain a system of internal accounting controls sufficient to assure management's control, authority, and responsibility over the firm's assets.[23] The FCPA's accounting provisions are not limited to the subject matter of foreign bribery. Individuals and businesses may not knowingly falsify the company's books and records, or circumvent or fail to implement a system of controls.

The US Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) share responsibility to enforce the FCPA. The DOJ has sole authority to bring criminal cases, including for violations of the accounting provisions.[24] For an individual defendant to be criminally prosecuted, he or she must have acted "wilfully," which requires that the defendant acted voluntarily, purposefully, and with "knowledge that [the defendant] was doing a 'bad' act under the general rules of law," without, according to the US government and certain cases, requiring that the defendant "have known of the specific terms of the [FCPA] or even the existence of the statute."[25]

Regardless of such legal standards, most cases, including criminal cases, against corporations settle. They often involve (in the case of an anti-bribery violation) a guilty plea, criminal and/or civil fines, disgorgement of profits from the wrongful conduct, and ancillary "remedies" such as the imposition of a compliance monitor. There can be collateral consequences from an announced FCPA violation as well, including possible debarment from government contracting, civil litigation, management distraction, and stock drops. While the DOJ and SEC have consistently stated that they will reward cooperation, including self-reporting ("if we [the government] find the violations on our own, the consequences will surely be worse than if you had self-reported the conduct"[26]), a "pass" may not be available,[27] and there continue to be substantial costs in any event. This includes the cost of the company's internal investigation itself. Without compromising the integrity of the investigation, it must be carefully managed to ensure efficiency and proportionality. The DOJ and SEC have also signaled their intent to pursue FCPA charges against individuals more aggressively.

An effective FCPA compliance program

The following discussion is intended to highlight certain important elements of an effective FCPA compliance program. Familiarity with these elements, and more generally with the issues raised by corporate compliance programs, should enable nonexperts to ask better questions and to improve compliance efforts.

Tone at the top and at ground level—An effective compliance program requires that management set the correct "tone at the top"—that is, that compliance with applicable laws and regulations, including the FCPA, is "the" priority, that management expects employees to make compliance part of the day-to-day business culture of the company and that non-compliance should not be "balanced" against business or other considerations, however compelling. Thus, the message should be conveyed specifically that it is not a justification for "looking the other way" that it is impossible to do business in a jurisdiction without paying a bribe. That tone at the top can be set by management actions (eg rewarding good compliance and punishing bad) and words (eg sending periodic reminders emphasizing the importance of compliance such as after another firm has been charged with an FCPA violation or announced an investigation).

Equally important, managers at the local, operational, or "ground" level doing business overseas should reinforce the message that compliance with the FCPA is an important part of doing day-to-day business. An effective compliance program will focus on both levels: providing for standard-setting and overall monitoring at the top, implementation and controls at ground level, and effective communication up and down the organization.

Tailored procedures that enforce policies—An effective compliance program requires, in addition to strong written FCPA policies, procedures—that is, corporate controls and processes—designed to ensure that the company's FCPA policies are being followed as business is conducted. For example, companies retaining third-party agents in foreign jurisdictions should implement specific procedures to vet, document, train, and monitor the agents' activities on their behalf. Another example is that companies that do business with foreign governmental counterparties should implement specific procedures to approve and monitor promotional and other activities involving transfers of value, such as travel and entertainment, gift giving, and charitable and political donations, to ensure that they not mask improper payments.

It is almost always possible for the government, in retrospect, to criticize a company for not having a procedure that would have helped prevent the particular problem that occurred. Nonetheless, it is important that a company design a "reasonable" (or in the parlance of the UK Bribery Act, "proportionate"[28]) set of procedures tailored to the particular risks inherent in its business activities. Industry "best practices" may be considered along with other factors in determining what procedures will pass muster as "reasonable."

A prerequisite to developing an appropriate set of "reasonable" FCPA procedures is that management perform an assessment of, and thereby attempt to understand, the particular risks inherent in its business. Different industries have different kinds and levels of risk, as do different companies operating within those industries and different business practices. The different countries in which a company may operate also will present greatly varying levels of risk. Improving visibility into local practices in foreign countries is an important element in shaping an effective compliance program.

In-house and, in certain cases, outside counsel can play a critical role in identifying FCPA risks so that a set of procedures can be tailored accordingly. Identifying such risks requires an assessment of government-related "touch points" in the particular business, both "direct" ones (such as doing business with a governmental department/agency or state-owned enterprise as counterparty) and "indirect" ones (such as governmental licenses/permits/approvals, tax, labor/employment or environmental rulings, audits and inspections, and import/export duties). Being able to gather information on a privileged basis can be essential in certain circumstances to improving compliance prospectively while avoiding pitfalls. An FCPA risk assessment also requires an understanding of where "value" may be created in the business from which an improper payment may be made (eg unusual discounts, rebates, or margin in sales or distribution transactions). Finally, it is also important that companies reassess these touch points and risks inherent in their business periodically and when entering new businesses or new foreign markets (or implementing new business approaches) to ensure that FCPA risks are identified and addressed proactively.

Training—An effective compliance program must operate at "ground" level, and this includes training. While Internet-based training is typically an efficient way of conducting basic training for large groups of employees, tailored training of employees who perform critical roles overseas on the front lines of FCPA compliance may improve the tone on the ground and the overall effectiveness of the program. Thus, for example, training of country managers and local/regional controllers and similar

personnel may be best conducted at group meetings for other management purposes, where senior management can convey the importance of compliance and performance expectations. The law may be complex, but the best training is often simple—that is, geared to what will educate and persuade particular audiences to spot as early as possible the issues that arise in their business so that they may, where necessary, bring the matter to the attention of others who are best positioned to deal with the complexity and to safeguard corporate interests beyond local business needs.

Detection—An effective compliance program should also include adequate systems to detect possible instances of wrongdoing. Line managers are often in the best position to detect possible wrongdoing, and there are a variety of techniques designed to ensure that line managers are looking for, and timely reporting, issues. For example, bottom-up certifications may serve to detect questionable conduct in addition to supplying a basis on which the company and its senior management may rely. Ground-level finance, compliance, and other "control" personnel also may play a key role in preventing and detecting possible wrongdoing. On a centralized level, periodic internal audits focused on anti-corruption issues may detect risks and potentially wrongful activities. And in-house counsel, alone or operating with the assistance of outside counsel, may conduct inquiries to evaluate specific issues (including possible instances of wrongdoing) on a privileged basis. The availability of internal whistle-blower systems, and the ease of use of such systems, is also important to detection.

Mergers & acquisitions—Companies that devote considerable effort to their own FCPA compliance may nonetheless "inherit" the FCPA risk of the companies they combine with or acquire. FCPA due diligence should be tailored to the risk profile of the target, including the direct and indirect governmental touch points discussed above. Due diligence should specifically focus on assessing the adequacy of the target's existing compliance program, and identifying past or ongoing FCPA issues. Representations and warranties and other deal terms may be used to allocate or otherwise manage FCPA risk in the transaction. In any event, FCPA compliance at the newly acquired company should be integrated in a timely manner in coordination with other integration efforts.

Agents—It is important that a company assess its dealings with "agents" or other third parties whose actions on behalf of the company could create FCPA liability. This has historically been a major problem area for companies, as a very high percentage of FCPA enforcement actions involve misconduct by agents or other third-party intermediaries.[29] There are a variety of different compliance measures that address this risk, including performing due diligence concerning the agent, carefully documenting the agent's retention, training the agent, obtaining representations and warranties, monitoring the agent's activities, and promptly responding to "red flags."

Conclusion

It is important that directors and senior managers fulfill their respective roles with respect to compliance with the FCPA, as well as other laws and regulations generally. While questions exist as to whether the government adequately "rewards" effective compliance when problems do arise, an effective compliance program is critically important to giving the company the chance to: (1) prevent wrongful conduct before it occurs; (2) detect potential wrongful conduct earlier; (3) remediate wrongful conduct in a more timely and effective manner; (4) achieve a "better" outcome in the event of an enforcement investigation; and (5) best protect the company, and its board, senior management, and other constituents, from potential civil liability and other collateral consequences.

Notes

[1] 188 A.2d 125 (Del. 1963).

[2] 188 A.2d at 130.

[3] 698 A.2d 959 (Del. Ch. 1996).

[4] 911 A.2d 362, 369-70 (Del. 2006).

[5] *In re Caremark*, 698 A.2d at 967.

[6] *See* DEL. CODE ANN. tit. 8, §§102(b)(7), 145(a) (West 2011).

[7] *Wood v. Baum*, 953 A.2d 136 (Del. 2008); *In re Intel Corp. Deriv. Litig.*, 621 F. Supp. 2d 165 (D. Del. 2009); *Desimone v. Barrows*, 924 A.2d 908 (Del. Ch. 2007).

[8] *American International Group v. Greenberg, et al.*, 965 A.2d 763 (Del. Ch. 2009); *In re Countrywide Corp. Deriv. Litig.*, 554 F. Supp. 2d 1044 (C.D. Cal. 2008).

[9] Other jurisdictions have their own anti-bribery laws, eg, the UK Bribery Act. An effective anti-corruption compliance program would take into account all potentially applicable foreign and local laws.

[10] 15 U.S.C. § 78dd-1 *et seq*.

[11] *Id*. § 78dd-2.

[12] *Id*. § 78dd-3.

[13] *Id*. §§ 78dd-1(a); 78dd-2(a).

[14] *Id*. §§ 78dd-1(a)(1)(B)-(a)(2)(B); 78dd-2(a)(1)(B)-(a)(2)(B); 78dd-3(a)(1)(B)-(a)(2)(B).

[15] *See*, eg, *United States v. Kay*, 359 F.3d 738, 755 (5th Cir. 2004) ("Congress intended for the FCPA to apply broadly to payments intended to assist the payor, either directly or indirectly, in obtaining or retaining business for some person, and that bribes paid to foreign tax officials to secure illegally reduced customs and tax liability constitute a type of payment that can fall within this broad coverage."). *See* US Department of Justice, Criminal Division & Securities and Exchange Commission, Enforcement Division, *A Resource Guide to the US Foreign Corrupt Practices Act* (Nov. 2012) at 12-13. ("FCPA Resource Guide").

[16] 15 U.S.C. §§ 78dd-1(f)(1)(A); 78dd-2(h)(2)(A); 78dd-3(f)(2)(A).

[17] *Id*. §§ 78dd-1(a)(3); 78dd-2(a)(3); 78dd-3(a)(3).

[18] *Id*. §§ 78dd-1(f)(2)(A)(i)-(ii); 78dd-2(h)(3)(A)(i)-(ii); 78dd-3(f)(3)(A)(i)-(ii).

[19] *SEC v. Schering-Plough Corp.*, No. 04-cv-945 (D.D.C. June 9, 2004) (Compliant) and *In re Schering-Pough Corp.*, Exchange Act Release No. (June 9, 2004).

[20] *Id*. §§ 78dd-1(c)(2)(A); 78dd-2(c)(2)(A); 78dd-3(c)(2)(A). FCPA Resource Guide at 24.

[21] *Id*. §§ 78dd-1(c)(1); 78dd-2(c)(1); 78dd-3(c)(1). *See*, eg, *United States v. Kozeny*, 582 F. Supp. 2d 535 (S.D.N.Y. 2008) (rejecting local law defense where written Azeri law did not legalize the improper payment at issue; local law relief from criminal liability for bribe payer who made voluntary disclosure to local authorities was insufficient).

[22] *Id*. §§ 78dd-1(b); 78dd-2(b); 78dd-3(b). FCPA Resource Guide at 25. It should also be noted that the UK Bribery Act does not contain an exception for facilitation payments and so care must be exercised to ensure applicability of the exception to a company's activities.

[23] *Id*. § 78m(2)(A)-(B).

[24] FCPA Resource Guide at 4.

[25] Eg, *United States v. Kay*, 513 F.3d 432, 447-48 (5th Cir. 2007).

[26] Andrew Ceresney, Keynote Address at the International Conference on the Foreign Corrupt Practices Act (Nov. 19, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370540392284.

[27] *Compare* eg, Press Release, SEC, SEC Announces Non-Prosecution Agreement with Ralph Lauren Corporation Involving FCPA Misconduct (Apr. 22, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171514780 *with* Press Release, DOJ, Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA (Apr. 25, 2012), *available at* http://www.justice.gov/opa/pr/2012/April/12-crm-534.html. *See also* DOJ, "A Resource Guide to the U.S. Foreign Corrupt Practices Act," at 21-23 (discussing bribes paid by foreign agents).

[28] *See* Ministry of Justice, *The Bribery Act 2010: Guidance*, at 21, *available at* http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf ("Adequate bribery prevention procedures ought to be proportionate to the risks that the organisation faces.").

[29] *See*, eg, Press Release, DOJ, Marubeni Corporation Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay a $54.6 Million Criminal Penalty (Jan. 17, 2012), *available at* http://www.justice.gov/opa/pr/2012/January/12-crm-060.html; Press Release, DOJ, Oil Services Companies and a Freight Forwarding Company Agree to Resolve Foreign Bribery Investigations and to Pay More than $156 Million in Criminal Penalties (Nov. 4, 2010), *available at* http://www.justice.gov/opa/pr/2010/November/10-crm-1251.html.