FOREIGN CORRUPT PRACTICES ACT ENFORCEMENT AFTER *U.S. V. KAY*

Hector Gonzalez
Claudius O. Sokenu
Mayer, Brown, Rowe & Maw LLP

Foreword
The Honorable Dick Thornburgh
Kirkpatrick & Lockhart Nicholson Graham LLP

Introduction
Kenneth R. Cunningham
Grant Thornton LLP

WASHINGTON LEGAL FOUNDATION
Washington, D.C.

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Library of Congress Catalog Card No. 2004113580

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FOREWORD

By
The Honorable Dick Thornburgh*

Thirty years ago, in the wake of the Watergate scandal, legislators and law enforcement officials in Washington took a dramatically increased interest in public corruption. Among the disturbing revelations of that era was how American companies exploited the permissive attitude towards corruption in foreign nations for their business advantage. As Assistant Attorney General in charge of the Justice Department's Criminal Division at that time, I had the responsibility to oversee the seminal prosecutions of U.S. companies which used bribery to gain lucrative contracts overseas.

The practices revealed by the investigations during that era and the ensuing prosecutions led to the passage in 1977 of the Foreign Corrupt Practices Act (FCPA). The FCPA took two related approaches to combating corruption. It directly prohibited bribery payments to foreign government officials, and it required public companies to maintain detailed accounting records and internal controls to insure the proper use of corporate assets.

At the time of its passage, most of the rest of the world viewed the FCPA as an attempt to impose American business morality on other societies, an effort at once both naïve and offensive. Many U.S. businesses felt the law put them at a competitive disadvantage in overseas trade.

Over time, however, other countries and international organizations have come around to American policy makers' views on corruption, recognizing the corrosive effect bribery and similar activities have on

*__The Honorable Dick Thornburgh__ has served as Governor of Pennsylvania, Attorney General of the United States, and Under-Secretary-General of the United Nations during a public career which has spanned over 30 years. He was elected Governor of Pennsylvania in 1978, and re-elected for a second term in 1982. He served as Attorney General of the United States from 1988-1991. He began his career as a member of the legal department at ALCOA in Pittsburgh and is currently counsel to the national law firm of Kirkpatrick & Lockhart Nicholson Graham LLP in its Washington, D.C. office. Mr. Thornburgh is the Chairman of Washington Legal Foundation's Legal Policy Advisory Board.

social, political, and economic systems. The Organization for Economic Cooperation and Development, the United Nations, the Organization of American States, and the World Bank have all adopted conventions on corruption or devoted specific programs to it. The attitude worldwide today is in stark contrast to that which prevailed during the 1970s when Congress passed the FCPA.

As welcome as these developments are from a social, political and economic perspective, anticorruption laws can create risks and compliance headaches for individual businesses. This is particularly true for U.S. companies, for no nation over the past several years has enforced its anticorruption laws as vigorously as the United States. Over the past several years, FCPA investigations and prosecutions by the statute's primary enforcers, the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) have increased substantially. In addition to SEC and DOJ publicly identifying the FCPA as an enforcement priority, corporations as well seem to have an increased focus on this law. Commentators have noted the rise in voluntary corporate disclosures related to mergers and Sarbanes-Oxley compliance as attributable to the intensified anticorruption enforcement. As the authors of this Washington Legal Foundation (WLF) Monograph note, this surge in enforcement activity coincides with the significant decision by the U.S. Court of Appeals for the Fifth Circuit in *United States v. Kay*, which accepts the government's expansive interpretation of the FCPA's reach.

Attorneys Hector Gonzales and Claudius Sokenu appropriately use the *Kay* case as a starting point for their excellent discussion of the SEC's FCPA enforcement program and the lessons that regulated businesses must absorb from the latest cases and settlements. This brief but very informative Monograph begins with an overview of the FCPA and its two main components – the antibribery and accounting provisions – that the government usually pursues simultaneously. It then examines the significance of the Fifth Circuit's *Kay* decision, which addresses the important question of whether bribes paid to reduce taxes and import duties were payments made "to obtain or retain business," and thus prohibited by the FCPA. The trial court ruled that such payments were not "to obtain or retain business" in that the company already had the contracts in hand and therefore the payments did not violate the FCPA. The Court of Appeals adopted a broader reading of this key phase and concluded that the payments could violate the Act if they were intended to make the existing business more profitable, or otherwise provide a competitive advantage.

This prosecution is a highly visible sign of an increasingly aggressive enforcement program. In the twenty-four months following the *Kay* ruling, the SEC brought more FCPA enforcement actions than in any other similar period since its 1977 passage. In the Monograph's third section, Gonzales and Sokenu review eight of the most significant of these recent actions. In the Monograph's final section, the authors draw on these cases to highlight developments emerging from the SEC's enforcement actions over the past two years. Two new "remedial" measures in particular stand out as further expansions of the FCPA. One is the SEC's pursuit of disgorgement of profits earned through corrupt conduct in addition to monetary penalties in FCPA cases. As the authors point out, the statute does not grant the SEC clear authority to seek disgorgement, so the Commission must take care not to use the demands as punitive measures or to simply increase the fines that public companies must pay. The second development is the requirement that firms retain independent consultants acceptable to the Commission to oversee FCPA compliance. In concluding, the authors reinforce a lesson which resonates throughout all corporate dealings with government enforcers today: the importance of prompt and thorough cooperation once the company becomes the subject of an investigation.

For business leaders, the most important lesson to be learned from this Monograph is that the best protection against exposure is vigilance through the creation, application and constant reevaluation of corporate compliance programs. The FCPA creates an enforcement regime where, despite senior management's best intentions, exposure can still be created through the acts of employees, consultants and agents, particularly those operating overseas in countries that still have a culture of corruption. As the *Kay* decision illustrates, the FCPA's reach is broader than one might expect and the aggressive and creative strategies of federal enforcers may push its boundaries yet further. Given that many multinational companies do business in over 150 countries and may be responsible for the conduct of their subsidiaries, as well as local partners and agents, fashioning a viable program may well be a daunting task. Familiarity with the FCPA and of the way the government enforces it is a critical first step toward effective compliance. This Monograph contributes well to readers' understanding of these topics.

INTRODUCTION

By
Kenneth R. Cunningham[†]

The risk of liability to U.S. issuers posed by the Foreign Corrupt Practices Act ("FCPA") has increased significantly in the recent past. Spurred by the increased globalization of trade, U.S. issuers increasingly conduct business in the far corners of the world. Certain parts of Asia, Africa, and Central America and South America do not possess the regulatory infrastructure common in other parts of the world. Additionally, in certain areas, business is often facilitated with kickbacks and improper payment schemes. Issuers new to conducting business in those areas may not properly train their employees to detect and avoid making improper payments for the purpose of obtaining or retaining business. Those issuers may also lack the internal controls necessary to detect these improper payments. Hence, those issuers increasingly run afoul of the FCPA's antibribery and books and records provisions.

As U.S. issuers increasingly conduct business in areas of the world with a culture of improper payment schemes, regulators are more often working together to investigate and prosecute FCPA violations. In September 2001, the Securities and Exchange Commission and the Department of Justice filed their first ever joint FCPA enforcement action. This action signaled a new level of cooperation among civil and criminal authorities investigating and prosecuting FCPA matters.

In addition to working closely together to investigate potential FCPA violations, regulators now seek onerous settlement for corporate wrongdoing in general. In the wake of recent high-profile corporate

[†]**Kenneth R. Cunningham** is a Senior Counsel in Grant Thornton LLP's Risk, Regulatory and Legal Affairs group where he handles Securities and Exchange Commission and PCAOB enforcement matters and general litigation matters. He is a former Senior Counsel with the Securities and Exchange Commission, Division of Enforcement, in Washington, D.C. At the Commission, he investigated a wide range of securities issues, with an emphasis on complex financial fraud and Foreign Corrupt Practices Act violations. Grant Thornton LLP is the U.S. member firm of Grant Thornton International, one of the six global accounting, tax and business advisory organizations.

fraud, regulators seek to impose a stronger deterrent by imposing harsher penalties and settlement terms on those issuers found to have violated the law. FCPA violations are no exception. Regulators routinely seek monetary penalties, disgorgement of ill-gotten gains, and the appointment of an independent consultant to monitor the violators' ongoing compliance with the FCPA. In 2005, two individuals found to have violated the FCPA's antibribery provisions received jail sentences.

Finally, the outer limits of liability under the FCPA were expanded in February 2004 by the United States Court of Appeals for the Fifth Circuit's ruling in *United States v. Kay*. In that case, the court refused to exclude from the purview of the FCPA, as a matter of law, improper payments to foreign government officials for the purpose of reducing a U.S. issuer's tax liability.

All of these factors have created a perfect storm of liability for U.S. issuers unfamiliar with the nuances of the FCPA. It is critical, therefore, that U.S. issuers, and their lawyers and accountants, be able to navigate the complex provision of the FCPA. Issuers must understand the manner in which their employees' conduct could run afoul of the FCPA, the difficulties of managing an investigation brought jointly by the SEC and DOJ, and the importance of cooperating with those investigations.

This Washington Legal Foundation Monograph provides a timely and clear outline of the FCPA's complex provisions, explores the significance of the *Kay* decision, and provides an excellent overview of the regulators' prosecution of FCPA matters since the *Kay* decision. Authors Gonzalez and Sokenu identify the key trends in FCPA prosecutions. The Monograph thereby provides a valuable and user-friendly guidance to U.S. issuers on how to detect and prevent potential violations. The Monograph also provides a useful analysis of the benefits of self-reporting FCPA violations and cooperating with the regulators' investigations.

ABOUT THE AUTHORS

Hector Gonzalez is a litigation partner in the New York office of Mayer, Brown, Rowe & Maw LLP and a former Assistant United States Attorney in the Southern District of New York. As a former federal prosecutor, Mr. Gonzalez tried more than 15 federal and state jury trials, including RICO, public corruption, and bribery cases. He has argued more than 30 cases in federal and state appellate courts. Mr. Gonzalez was awarded the Director's Award for Superior Performance as an Assistant U.S. Attorney in 1998 and 1999.

Mr. Gonzalez represents corporations and corporate executives in all aspects of criminal and related civil and administrative matters relating to SEC enforcement proceedings, internal investigations, grand jury investigations, NASD and NYSE arbitrations. Mr. Gonzalez has conducted extensive criminal investigations, involving labor racketeering, RICO and public corruption. Mr. Gonzalez also represents clients in commercial, securities, antitrust, and professional liability litigation.

Mr. Gonzalez graduated from the University of Pennsylvania Law School in 1988. He was the editor of the University of Pennsylvania Law Review. Prior to law school, Mr. Gonzalez obtained his B.S. from Manhattan College in 1985, where he was on the Dean's List. As a Fulbright Scholar in Guatemala, Mr. Gonzalez taught trial advocacy in a post-graduate law degree program at the University of San Carlos, Guatemala City. Mr. Gonzalez is admitted to the bar in New York, New Jersey, U.S. Court of Appeals for the Second Circuit, United States Court of Appeals for the Armed Forces, U.S. District Court for the Eastern and Southern Districts of New York, and the U.S. District Court for the District of New Jersey.

Mr. Gonzalez has published numerous articles including: "*Scope of Foreign Corrupt Practices Act's Bribery Provision Set*," Outside Counsel, *N.Y.L.J.*, June 29, 2005, at 4 col. 1, "*Harmless Error Analysis in Reviewing 'Sandoval' Claims*," Outside Counsel, *N.Y.L.J.*, July 30, 1992, at 1 col. 1. He has also lectured extensively, including: Association of the Bar of the City of New York, What Every Criminal and Corporate Lawyer Needs To Know About Monitors*, 2005*; Conducting Internal Corporate Investigations, 2005; Association of the

Bar of the City of New York, Taking and Defending Depositions, 2005; New York County Lawyers Association, Federal Criminal Practice Institute, The Sentencing Guidelines*,* 2004; Hispanic National Bar Association, The Ethics and Practice of Plea Bargaining and Cooperation in Federal and State *Courts,* 2004; American Embassy, El Salvador, Participated in the "Proyecto Pro Bono," sponsored by the American Embassy to establish an awareness of and encourage commitment to pro bono projects on the part of law firms in El Salvador, 2001; Association of the Bar of the City of New York, The ABCs of Federal Criminal Litigation*,* 2001; Criminal Justice Forum, John Jay College of the City University of New York, Ethical Issues in Federal and State Prosecutions*,* 1994.

Among other civil activities, Mr. Gonzalez was appointed Chairman of the New York City Civilian Complaint Review Board (an independent mayoral agency that investigates charges of police misconduct) in 2002. He is a member of the N.Y. State Federal Judicial Screening Committee, and a member of the board of directors for New York Lawyers for the Public Interest, Puerto Rican Legal Defense and Education Fund, and the Manhattan College, Board of Trustees.

Claudius O. Sokenu is a senior litigation associate in the New York office of Mayer, Brown, Rowe & Maw LLP where he concentrates his practice in the areas of securities litigation, SEC enforcement actions, white collar criminal defense, corporate internal investigations, National Association of Securities Dealers, New York Stock Exchange and other self-regulatory organizations enforcement and arbitration proceedings, and general commercial litigation. Mr. Sokenu represents broker-dealers, investment banks, hedge funds, accounting firms, and public and private companies in all aspects of securities regulation, enforcement and litigation. Mr. Sokenu has handled matters that require concurrent representation in the civil, criminal and political spheres.

Prior to joining Mayer, Brown, Rowe & Maw, Mr. Sokenu was a Senior Counsel in the Washington, D.C. office of the Securities & Exchange Commission's Division of Enforcement. While at the Commission, Mr. Sokenu was responsible for investigating a broad range of the SEC's domestic and international enforcement matters, including investigations involving issuer accounting fraud, insider trading, initial public offerings, illicit payments under the Foreign

Corrupt Practices Act, investment companies and investment advisers, market manipulation, and broker-dealer misconduct. As a member of the enforcement staff, Mr. Sokenu handled a number of high profile enforcement matters and initiatives, including leading the Commission's first ever joint enforcement action with the Department of Justice discussed in this article against KPMG and Baker Hughes Inc. for violations of the Foreign Corrupt Practices Act, and the Commission's enforcement action against Goldman Sachs & Co. for violating the federal securities laws in connection with the international public offerings of PetroChina Company Limited, China Telecom Hong Kong Limited, Chinadotcom Corp. and Giga Media Limited for which Goldman Sachs served as underwriter.

At Mayer, Brown, Rowe & Maw, Mr. Sokenu has successfully represented issuers, underwriters, hedge funds and accountants in securities fraud class actions, including representing certain issuers in the IPO allocation cases, *In re Initial Public Offering Secs. Litig.*, 241 F. Supp. 2d 281 (S.D.N.Y. 2003), and Arthur Andersen LLP in the consolidated class action related to alleged wrongdoing at Global Crossing Ltd. *In re Global Crossing Ltd. Secs. Litig.*, 02 Civ. 910 (S.D.N.Y.) (GEL). Mr. Sokenu won a motion to dismiss in favor of two hedge funds, Q Funding, L.P. and R^2 Investments, LDC in *PHP Liquidating, LLC v. Robbins*, 291 B.R. 592 (D. Del. 2003) involving settlement payment for securities transactions. Mr. Sokenu also obtained dismissal of a fraud claim on behalf of CIBC World Markets Corp. In that case, the New York State Supreme Court, Appellate Division, First Department ruled for the first time that a clearing broker does not owe customers of its introducing broker a fiduciary duty. *Goldstein v. CIBC World Mkts. Corp.*, 776 N.Y.S. 2d 12 (1st Dep't 2004). Mr. Sokenu was also a member of the Mayer, Brown, Rowe & Maw team that successfully appealed the conviction for obstruction of justice and witness tampering of Frank Quattrone. *United States v. Quattrone*, 441 F.3d 153 (2d Cir. 2006).

Mr. Sokenu has lectured and published extensively in the area of securities litigation and enforcement and has been quoted in the financial press on securities law issues. In 2005, the Association of the Bar of the City of New York appointed Mr. Sokenu to serve on the Task Force on the Role of Attorneys in Corporate Governance. In 2003, the Minority Corporate Counsel Association, an organization founded by the law departments of Fortune 500 companies to promote diversity in the legal community, honored Mr. Sokenu as an outstanding outside corporate counsel.

In May 1998, Mr. Sokenu obtained an LL.M. in Securities and Financial Regulation from Georgetown University Law Center. At Georgetown, he was the features editor for the Georgetown Law Weekly. Prior to Georgetown, in September 1995, Mr. Sokenu obtained an LL.M in Corporations and Insurance law from London School of Economics and King's College, London. He was the editor of the King's College Law Newsletter. Mr. Sokenu obtained his LL.B with Upper Second Class Honors (J.D., *magna cum laude* equivalent) in June 1994 from South Bank University, London, England, where he was the editor of the South Bank Law Review and Chair of the Moot Court and Debate Team. He is admitted to the bar in New York, District of Columbia and the U.S. Court of Appeals for the 3d Circuit.

Mr. Sokenu's has published numerous articles in the area of securities regulation, including: "*Much Ado About Nothing: SEC Announces Principles for Imposing Monetary Penalties on Issuers*," 20 *Andrews Sec. Litig. & Reg. Rep.* 1, Feb. 8, 2006; 17 *Andrews Corp. Off. & Dirs. Liab. Litig. Rep.* 1, Feb 20, 2006; "*Scope of Foreign Corrupt Practices Act's Bribery Provision Set*," with Hector Gonzalez, *New York Law Journal* , Jun. 29, 2005; "*No Longer Kinder and Gentler: SEC Raises Stakes in Settled Enforcement Actions*," *Washington Legal Foundation*, Legal Backgrounder, Vol. 18, No. 51, Dec. 5, 2003; "*SEC Expands Foreign Corruption Law Beyond Congressional Intent*," 8 *Andrews Sec. Litig. & Reg. Rep*. 5, Aug. 14, 2002, 8 *Derivatives Litig. Rep.* 19, Aug. 14, 2002*, Washington Legal Foundation,* Legal Backgrounder, Vol. 17 No. 28, Jul. 26, 2002; "*Web Portals Rouse SEC: Who is a Trader, After All*?" *The National Law Journal*, Mar. 11, 2002; "*SEC Self-Policing Policy Presents Benefits and Pitfalls*," with Richard Spehr, *White Collar Crime Rep*., Vol. 16 No. 7, Jun. 24, 2002, 7 *Andrews Sec. Litig. & Reg. Rep*. 17, Feb 27, 2002; "*Web Portals Caught in the Web of Broker-Dealer Regulation*," *New York Bus. Law Journal*, Spring 2002, *eSecurities*, Vol. 4 No. 7, at 3, Mar. 2002; "*Avoiding Civil Monetary Penalties in SEC Enforcement Actions*," *New York Bus. Law Journal*, Spring 2002, *New Jersey Law Journal*, Dec. 24, 2001.

The views expressed here are those of the authors and do not necessarily reflect the views of the firm or any of its clients.

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INTRODUCTION

In a decision of first impression issued in February 2004, the United States Court of Appeals for the Fifth Circuit ruled that bribes paid to foreign government officials to secure a reduction in a corporation's customs duties or sales taxes fall squarely within the ambit of the Foreign Corrupt Practices Act (the "FCPA") so long as the bargained-for reduction in custom duties or sales taxes was intended to produce an effect that would assist the corporation in obtaining or retaining business. *United States v. Kay*, 359 F.3d 738 (5^{th} Cir. 2004). Judge Weiner, writing for a unanimous court, agreed with the district court's ruling that the scope of the FCPA is ambiguous but rejected the district court's conclusion that, as a matter of law, an indictment alleging illicit payments to foreign officials for the purpose of avoiding substantial portions of customs duties and sales taxes to obtain or retain business are not the kinds of bribes that the FCPA criminalizes.[1] *Kay*, 359 F.3d at 740.

The Fifth Circuit's decision resolves a long-standing dispute concerning the outer limits of the FCPA's scope. Both the Securities and Exchange Commission (the "SEC" or the "Commission") and the Department of Justice ("DOJ") have been steadfast in maintaining that the FCPA covers payments to reduce foreign income taxes, customs duties and sales taxes. *See*, *e.g.*, *In the Matter of Baker Hughes Inc.*, Exchange Act Release No. 44784 (Sept. 12, 2001) (alleging that Baker Hughes

[1] *United States v. Kay*, 200 F. Supp. 2d 681, 683 (S.D. Tex 2002).

made illicit payments to foreign government officials in Indonesia to reduce Baker Hughes's income tax liabilities); *United States v. KPMG Siddharta Siddharta & Harsono,* Litigation Release No. 17127 (Sept. 12, 2001) (alleging, in the first-ever joint enforcement action by the SEC and DOJ, that KPMG Siddharta Siddharta & Harsono ("KPMG-SSH") agreed to make an illicit payment to influence an Indonesian tax official to reduce a tax assessment for one of KPMG-SSH's clients); *SEC v. Triton Energy Corp.*, Litigation Release No. 15266 (Feb. 27, 1997) (alleging that Triton Energy authorized payments to Indonesian government officials to obtain lower tax assessments on Triton Energy's oil and gas operations); *United States v. Saybolt, Inc.*, 98 CR 10266 WGY (D. Mass. 1998) (alleging that Saybolt bribed officials of the government of the Republic of Panama to secure, among other things, exemptions from import taxes on materials and equipment and reduction in annual profit taxes).

In the two years following the Fifth Circuit's decision, the SEC and the DOJ have instituted (and settled) an unprecedented number of FCPA cases against issuers and individuals. These post-*Kay* cases reveal an FCPA enforcement program that appears more aggressive than at any other time since the statute's enactment. For example, in the post-*Kay* cases, the SEC has insisted on settlements that provide for the disgorgement of supposedly ill-gotten gains. Likewise, virtually every settled case since the Fifth Circuit's decision in *Kay* has included an agreement by the settling company to retain an independent consultant acceptable to the SEC and DOJ to evaluate the settling company's compliance with the FCPA. This Monograph will examine the SEC's post-*Kay* FCPA enforcement program and the increasingly onerous settlements that companies are compelled to accept. First, this Monograph will briefly discuss the antibribery and accounting provisions of the FCPA. Second, it will explore the Fifth Circuit's decision in *Kay*. Third, it will review the post-*Kay* enforcement actions instituted by the SEC and DOJ. Finally, it will outline the ways in which settling FCPA cases with the SEC have become more onerous.

I.

THE FCPA'S ANTIBRIBERY AND ACCOUNTING PROVISIONS

In the maelstrom of outrage that followed the Watergate scandal, and in response to the SEC's extensive investigation into questionable (or illegal) payments by U.S. corporations to foreign government officials, politicians, and/or political parties, Congress enacted the FCPA in 1977. 15 U.S.C. §§ 78*dd*-1, 78*dd*-2, and 78*ff* (1994), *amended by* Pub. L. No. 105-366, 3302 (1988). To give effect to the Organization for Economic Cooperation and Development treaty, Congress amended the FCPA again in 1998. The 1998 amendment added a new § 78*dd*-3 to include the "any person" provision over which the DOJ has jurisdiction. The FCPA contains two landmark provisions: (i) the antibribery provisions; and (ii) the accounting and internal control provisions. Together, these provisions represent Congress' intent to address the problem of U.S. companies bribing foreign government officials and/or their operatives in order to obtain or retain business opportunities.

A. The Antibribery Provisions

Generally, the antibribery provisions of the FCPA prohibit U.S. issuers, persons or anyone acting at their behest from authorizing, paying or offering to pay money or anything of value, directly or indirectly, to any foreign official and/or foreign political party or party official in order to obtain or retain business.[2] A violation of the antibribery provisions may be parsed into the following eight elements:

[2]Section 30A(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78*dd*-1, provides: It shall be unlawful for any issuer which has a class of securities registered pursuant to section 78l of this title or which is required to file reports under section 78o(d) of this title, or for any officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of such issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an

1. use of instrumentality of interstate commerce;

2. to authorize a payment, make a payment, offer a payment, promise a payment;

3. of money or anything of value;

4. with corrupt intent;

5. to a covered person. Covered persons include: (a) foreign official; (b) foreign political party; (c) foreign party official; (d) candidate for foreign political office; and (e) any person while knowing or having reason to know that that person

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offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to: (1) any foreign official for purposes of – (A) (i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage; or (B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; (2) any foreign political party or official thereof or any candidate for foreign political office for purposes of – (A) (i) influencing any act or decision of such party, official, or candidate in its or his official capacity, (ii) inducing such party, official, or candidate to do or omit to do an act in violation of the lawful duty of such party, official, or candidate, or (iii) securing any improper advantage; or (B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; or (3) any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes of – (A) (i) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity, (ii) inducing such foreign official, political party, party official, or candidate to do or omit to do any act in violation of the lawful duty of such foreign official, political party, party official, or candidate, or (iii) securing any improper advantage; or (B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

intended to pass any part of the payment to any of the above enumerated persons;

6. by a covered person. Covered persons include: (a) issuers; (b) domestic concerns; and (c) any officer, director, employee, or agent of such issuer or domestic concern or any stockholder thereof acting on behalf of such issuer or domestic concern;

7. to (a) influence any act or decision of the foreign official in his official capacity; (b) induce such foreign official to do or omit to do any act in violation of the lawful duty of the official; (c) induce such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality; or (d) secure any improper advantage; and

8. in order to assist in obtaining or retaining business for or with, or directing business to, any person.

Payments to facilitate or expedite the performance of "routine governmental action" are not covered under the antibribery provisions of the FCPA.[3] The following are examples of expedited payments:

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[3]Section 30A(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78*dd*-1, provides: It shall be unlawful for any issuer which has a class of securities registered pursuant to section 78l of this title or which is required to file reports under section 78o(d) of this title, or for any officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of such issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to: (1) any foreign official for purposes of – (A) (i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage; or (B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; (2) any foreign political party or

obtaining permits, licenses, or other official documents; processing governmental papers, such as visas and work orders; providing police protection, mail pick-up and delivery; providing phone service, power and water supply, loading and unloading cargo, or protecting perishable products; and scheduling inspections associated with contract performance or transit of goods across country. Section 30A(f)(3)(A), 15 U.S.C. § 78dd-1 (f)(3)(A).

Similarly, a person charged with violations of the antibribery provisions of the FCPA may assert as an affirmative defense that the payment or promise to pay was lawful under the written laws and regulations of the foreign official's country or that the payment or promise to pay was a reasonable and bona fide expenditure such as travel and lodging expenses to (i) promote, demonstrate or explain products or

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official thereof or any candidate for foreign political office for purposes of – (A) (i) influencing any act or decision of such party, official, or candidate in its or his official capacity, (ii) inducing such party, official, or candidate to do or omit to do an act in violation of the lawful duty of such party, official, or candidate, or (iii) securing any improper advantage; or (B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; or (3) any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes of – (A) (i) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity, (ii) inducing such foreign official, political party, party official, or candidate to do or omit to do any act in violation of the lawful duty of such foreign official, political party, party official, or candidate, or (iii) securing any improper advantage; or (B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

services, and (ii) execute or perform a contractual obligation.[4] Section 30A(c) of the Exchange Act, 15 U.S.C. §§ 78dd-1(c).

B. The FCPA's Accounting Provisions

Embracing a fundamental purpose of the federal securities laws, the accounting and internal control provisions (often referred to as the books and records provisions) requires a U.S. issuer to "make and keep books, records and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions" of its assets.[5] The accounting provision also requires that issuers devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's authorization, (ii) transactions are recorded as necessary to (a) permit preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") and (b) maintain accountability for assets, (iii) access to assets is permitted only in accordance with management's authorization, and (iv) the recorded accountability for

[4]Section 30A(c) of the Exchange Act, 15 U.S.C. § 78*dd-1*(c) provides: It shall be an affirmative defense to actions under subsection (a) or (g) of this section that – (1) the payment, gift, offer, or promise of anything of value that was made, was lawful under the written laws and regulations of the foreign official's, political party's, party official's, or candidate's country; or (2) the payment, gift, offer, or promise of anything of value that was made, was a reasonable and bona fide expenditure, such as travel and lodging expenses, incurred by or on behalf of a foreign official, party, party official, or candidate and was directly related to – (A) the promotion, demonstration, or explanation of products or services; or (B) the execution or performance of a contract with a foreign government or agency thereof.

[5]Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78*m*(b)(2)(A), provides: Every issuer which has a class of securities registered pursuant to section 78l of this title and every issuer which is required to file reports pursuant to Section 78o(d) of this title shall – (A) 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.

assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[6]

Especially in the context of civil cases, the accounting provisions provide an endless series of bases for the SEC to take action against issuers and their employees because proof of intent is not required. The accounting provisions mandate that no criminal liability shall be imposed for failing to comply with the provisions of Section 13(b)(4) of the Exchange Act, 15 U.S.C. § 78*m*(b)(4). However, criminal liability may be imposed where a person knowingly circumvents or fails to implement a system of internal controls, or knowingly falsifies any book, record or account described above. Section 13(b)(5) of the Exchange Act, 15 U.S.C. § 78*m*(b)(5).

II.

THE FIFTH CIRCUIT'S DECISION IN *UNITED STATES V. KAY*

A grand jury indictment returned in 2001 charged David Kay ("Kay"), a then vice president of Caribbean operations for American Rice Inc. ("American Rice"), and Douglas Murphy ("Murphy"), American Rice's president and a member of its board of directors during the relevant period, with 12 counts of FCPA violations. *Kay*, 359 F.3d at

[6] Section 13(b)(2)(B) of the Exchange Act, 15 U.S.C. § 78*m*(b)(2)(B), provides: Every issuer which has a class of securities registered pursuant to section 78l of this title and every issuer which is required to file reports pursuant to section 78o(d) of this title shall – (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that – (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

741. American Rice is a Houston, Texas-based company that exports rice to foreign countries, including Haiti. Rice Corporation of Haiti ("Rice Corporation"), a wholly owned subsidiary of American Rice, represented American Rice's interests in Haiti. *Id*. Notably, the indictment detailed (i) the timing and purposes of Congress' enactment of the FCPA, (ii) American Rice's status as an issuer under the FCPA, (iii) Rice Corporation's status as a wholly owned subsidiary and "service corporation" of American Rice, (iv) Kay's and Murphy's citizenship, and (v) Kay's and Murphy's positions with American Rice. *Id*. Furthermore, the indictment charged Kay and Murphy with bribing and authorizing the payment of bribes to Haitian customs officials to accept false bills of lading and other documentation that intentionally understated by one-third the quantity of rice shipped to Haiti. *Id*. The indictment also detailed how Kay and Murphy illicitly orchestrated the bribing of Haitian customs officials to, among other things, accept false bills of lading and other documentation that intentionally understated by one-third the quantity of rice shipped to Haiti, thereby significantly reducing American Rice's customs duties and sales taxes. *Id*. In sharp contrast to the detailed misconduct by Kay and Murphy, the indictment was devoid of any factual allegations from which it could be inferred that Kay and Murphy engaged in the illicit conduct (*i.e.*, bribery of Haitian government officials) in order to assist American Rice in obtaining and retaining business for, and directing business to, American Rice and Rice Corporation (*i.e.*, the business nexus element). *Id*.

Based on these facts, the district court had to answer two related questions of first impression: (i) were the illicit payments described in the indictment violative of the FCPA, and (ii) if so, did the grand jury's indictment sufficiently allege the business nexus element that is at the crux of the FCPA. *Kay*, 200 F. Supp. 2d at 682. With respect to the question of whether the conduct complained of in the indictment can ever violate the FCPA, the district court began its analysis by reviewing the plain language of the FCPA. *Kay*, 200 F. Supp. 2d at 683. Reading the "obtain or retain business" language of the FCPA together with the FCPA's facilitating payment exception, the district court concluded that the plain language of the FCPA is ambiguous. Given this ambiguity, the district court looked to the FCPA's 1977 legislative history for guidance on interpreting Congress' intent when it first enacted the FCPA. The government, however, urged that the answer lies not in the 1977 legislative history but in the FCPA's 1988 legislative history. Rejecting the government's argument, the district court concluded that when Congress enacted the FCPA in 1977, it "chose to limit the scope of the prohibited activities under the FCPA and did not intend to cover payments made to influence any and all governmental decisions." *Kay*, 200 F. Supp. 2d at 684. The district court pointed to the legislative history of the 1998 amendment as further support for its decision. *Kay*, 200 F. Supp. 2d at 686. The district court reasoned that Congress, as it did in 1988 when amending other parts of the FCPA, declined to amend the FCPA's "obtain and retain business" language in 1998. *Kay*, 200 F. Supp. 2d at 686. Thus, the district court concluded that, since Congress had on two separate occasions (in 1988 and 1998) considered and rejected amendments that would have covered the specific conduct alleged in the indictment, the complained of conduct did not fall within the scope of the FCPA. *Kay*, 200 F. Supp. 2d at 686.

On appeal, the Fifth Circuit reversed. Although the Fifth Circuit agreed with the district court that the plain language of the FCPA is ambiguous, it completely rejected the district court's analysis of the FCPA's legislative history. *Kay*, 359 F.3d at 743–44. The Fifth Circuit agreed that neither the ordinary meaning nor the provisions surrounding the disputed text (the business nexus element) are sufficiently clear to make the statutory language susceptible to but one reasonable interpretation. *Kay*, 359 F.3d at 745. Finding that Congress chose to phrase the business nexus "obliquely" and to say "nothing to suggest how remote or how proximate the business nexus must be," the Fifth Circuit ruled that it cannot conclude on the basis of the language of the provision itself that the statute is either as narrow or as expansive as the parties claim. *Kay*, 359 F.3d at 745–46. Like the district court, this conclusion meant that the Fifth Circuit would look to the FCPA's legislative history for guidance on the intended scope of the FCPA.

The Fifth Circuit began its analysis of the FCPA's legislative history with a review of the 1977 legislative history. *Kay*, 359 F.3d at 747. In particular, the Fifth Circuit focused on the Senate's legislative proposal, because the FCPA's final language was drawn from both it and the SEC's report on questionable and illegal corporate payments and practices. *Kay*, 359 F.3d at 747. Observing that Congress made the "decision to clamp down on bribes intended to prompt foreign officials to misuse their discretionary authority for the benefit of a domestic entity's business in that country[,]" and that Congress' concern with the "immorality, inefficiency, and unethical character of bribery presumably does not vanish simply because the tainted payments are intended to secure a favorable decision less significant than winning a contract bid[,]" the Fifth Circuit noted that although the statute's ultimate language of "obtaining or retaining business" mirrors identical language in the SEC Report, the FCPA, incorporating the Senate Report's language, prohibits payments that assist in any business, not just government contracts as highlighted in the SEC's Report. *Kay*, 359 F.3d at 748. Thus, the Fifth Circuit surmised that in using the word business, when it easily could have used the phraseology of the SEC Report, Congress intended the FCPA to apply to payments beyond the narrow scope of the payments sufficient to "obtain or retain government contracts." *Kay*, 359 F.3d at 748.

Having decided that Congress intended for the FCPA to apply to payments beyond the narrow scope of government contracts, the Fifth Circuit still had to decide whether payments to affect the administration of tax, customs and other laws and regulations affecting the revenue of foreign states was within the ambit contemplated by Congress when it enacted the FCPA. Foreshadowing its ultimate conclusion, the Fifth Circuit reasoned that there is little difference between a company that bribes a foreign government official to award a construction, supply or services contract and a company that lawfully obtained a contract from an honest official or agency by submitting the lowest bid and, either before or after doing so, bribed a different government official to reduce taxes thereby ensuring that the under-bid venture is nevertheless profitable. *Kay*, 359 F.3d at 749. Both, according to the Fifth Circuit, could violate the FCPA because "[a]voiding or lowering taxes reduces operating costs and thus increases profit margins, thereby freeing up funds that the business is otherwise legally obligated to expend." *Kay*, 359 F.3d at 749. However, the question of whether bribing a foreign government official to reduce customs and sales taxes violates the FCPA turns on whether the bribe was intended to lower the company's cost of doing business enough to have a "sufficient nexus to garnering business there or to maintaining or increasing business operations" that the company already had so as to come within the scope of the FCPA's business nexus element. *Kay*, 359 F.3d at 749. In other words, the issue was the alleged bribe by Kay and Murphy intended to lower American Rice's cost of doing business in Haiti enough to have a sufficient nexus to garnering business in Haiti or to maintaining or increasing business operations that American Rice already had there so as to come within the business nexus element of the FCPA.

In settling for an expansive reading of the FCPA's scope, the Fifth Circuit believed Congress' intent in enacting the FCPA (particularly the grease payment exception and affirmative defenses) was "bribery paid to engender assistance in improving the business opportunities of the payor or his beneficiary, irrespective of whether that assistance be direct or indirect, and irrespective of whether it be related to administering the law, awarding, extending, or renewing a contract, or executing or preserving an agreement." *Kay*, 359 F.3d at 750. In light of this analysis of the FCPA's 1977 legislative history, the Fifth Circuit reasoned that the subsequent 1988 and 1998 legislative history is only important to the extent it confirms or conflicts with the interpretation of the 1977 legislative history. *Kay*, 359 F.3d at 750.

In overruling the district court's rejection of the FCPA's 1988 legislative history as irrelevant, the Fifth Circuit reasoned that, because Congress amended the FCPA in 1988 (with the express intent of clarifying (rather than changing) the scope of the FCPA), the 1988 legislative history was central to understanding the "original scope of the [FCPA] and concomitantly to the business nexus element." *Kay*, 359 F.3d at 752. Moreover, the Fifth Circuit gave deference to language in the 1988 Conference Report that "retaining business' includes . . . payments such as those made 'to a foreign official for the purpose of obtaining more favorable tax treatment." *Kay*, 359 F.3d at 753 (internal quotation omitted). The Fifth Circuit believed this language to be particularly instructive because, when the FCPA was first enacted in

1977, the SEC was concerned with exactly these types of untoward payments. *Kay*, 359 F.3d at 752. This language in the 1988 Conference Report, according to the Fifth Circuit, "reflect[s] the concerns that initially motivated Congress to enact the FCPA" in the first place and thus deserves to be considered in determining the scope of the FCPA's reach. *Kay*, 359 F.3d at 752.

Similarly, the Fifth Circuit found that the FCPA's 1998 legislative history supported its broad reading of the FCPA's scope. In 1998, the Senate ratified and Congress implemented the Combating Bribery of Foreign Public Officials in International Business treaty passed by the Organization for Economic Cooperation and Development (the "OECD"). As amended, the FCPA now "prohibits payments to foreign officials not just to buy any act or decision, and not just to induce the doing or omitting of an official function to assist . . . in obtaining or retaining business for or with, or directing business to, any person, but also the making of a payment to such a foreign official to secure an improper advantage that will assist in obtaining or retaining business." *Kay*, 359 F.3d at 754. Giving short shrift to the district court's finding and appellees' arguments that by adding the "improper advantage" language to the two existing kinds of prohibited acts, Congress again declined to amend the FCPA, the Fifth Circuit found that there was no need for Congress to amend the business nexus element by adding the OECD's "improper advantage" language because "Congress already intended for the business nexus element to apply broadly, and thus declined to be redundant." *Kay*, 359 F.3d at 754.

Although the Fifth Circuit concluded that a bribe paid to a foreign government official in consideration for unlawful evasion of customs duties and sales taxes could fall within the purview of the FCPA, it added that "this conduct does not automatically constitute a violation of the FCPA: It still must be shown that the bribery was intended to produce an effect that would assist in obtaining or retaining business." *Kay*, 359 F.3d at 756. Stated differently, the indictment must allege that the bribe was intended to assist in obtaining or retaining business. In assessing whether the Kay indictment satisfied this pleading requirement, the Fifth Circuit had to determine whether it is enough for the indictment to simply parrot the language of the statute rather than alleging facts from which such an inference could be drawn.

To answer this question, the Fifth Circuit had to determine whether the "obtain or retain business" element of the FCPA goes to the "core of the criminality" under the FCPA. If the business nexus element of the FCPA goes to the core of the FCPA's criminality, the indictment would be insufficient in that it merely parroted the language of the statute rather than alleging facts from which the business nexus element could be inferred. Holding that the business nexus element did not go to the core of the FCPA's criminality, the Fifth Circuit ruled that the indictment's paraphrasing of the FCPA's language was sufficient as a matter of law. *Kay*, 359 F.3d at 761. The Fifth Circuit reasoned that, when read as a whole, the core of the FCPA's criminality is seen to be bribery of a foreign official to induce him to perform an official duty in a corrupt manner. *Kay*, 359 F.3d at 761. The business nexus element merely serves to delimit the scope of the FCPA by "eschewing applicability to those bribes of foreign [government] officials that are not intended to assist in getting or keeping business, just as the 'grease' provisions eschew applicability of the FCPA to payments to foreign [government] officials to cut through bureaucratic red tape and thereby facilitate matters." *Kay*, 359 F.3d at 761.

Curiously, however, the Fifth Circuit stated that, on remand, the appellees may choose to submit a motion asking the district court to compel the government to allege more specific facts regarding the business nexus element of the FCPA. *Kay*, 359 F.3d at 761 n.96. It is unclear why the Fifth Circuit, having concluded that the indictment was sufficient, felt it necessary to suggest that the appellees seek more specific facts regarding the business nexus element. While some may see this suggestion as a silver lining, the government should have no difficulty in developing facts during its investigation that would allow it to plead with particularity facts from which it can be inferred that a bribe was intended to assist in obtaining or retaining business.[7]

[7]As the Fifth Circuit recognized, such specific facts include: (1) the nature of the assistance purportedly intended or produced by, in this case, the lowered taxes; (2) the

III.

THE POST-*KAY* FCPA ENFORCEMENT REGIME

Since the Fifth Circuit's decision in February 2004, the SEC and DOJ have intensified their respective FCPA enforcement programs. Indeed, on October 6, 2004, in a speech at the Practicing Law Institute in New York City, Stephen Cutler, the then-SEC Enforcement Director, indicated that the SEC was seeing more FCPA cases, and that the SEC staff intended to keep pursuing FCPA violations aggressively. In the two years since the Fifth Circuit's decision in *Kay*, the SEC brought more FCPA enforcement actions than in any 24-month period since the statute's enactment. *SEC v. Yaw Osei Amoaka*, Litigation Release No. 19356 (Sept. 1, 2005); *Matter of Diagnostic Prods. Corp.*, Exchange Act Release No. 51724 (May 20, 2005); *SEC v. Titan Corp*., Litigation Release No. 19107 (Mar. 1, 2005); *Matter of GE InVision, Inc.*, Exchange Act Release No. 51199 (Feb. 14, 2005); *SEC v. GE InVision*, Litigation Release No. 19078 (Feb. 14, 2005); *SEC v. Monsanto Co*., Exchange Act Release No. 50978 (Jan. 6, 2005) and *Matter of Monsanto*, Litigation Release No. (Jan. 6, 2005); *SEC v. ABB Ltd.*, Litigation Release No. 18775 (July 6, 2004); *SEC v. Schering-Plough Corp*., Litigation Release No. 18740 (June 9, 2004); *Matter of BJ Servs. Co.*, Exchange Act Release No. 49390 (Mar. 10,

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identity of the particular business or business opportunity the obtaining or retaining of which was being sought; or (3) the way (nexus) such assistance was supposed to help in getting or keeping such business or opportunity. *Kay*, 359 F.3d at 761. For example, in their first combined civil enforcement action, the SEC and DOJ alleged that in 1999, Baker Hughes Inc. and one of its subsidiaries, PT Eastman Christensen ("PTEC"), authorized KPMG-SSH to bribe an Indonesian tax official in order to influence the official to reduce PTEC's tax assessment from \$3.2 million to \$270,000. The SEC and DOJ further alleged that the over \$3 million in tax reduction allowed Baker Hughes and PTEC to retain an identified business opportunity in Indonesia. *KPMG Siddharta Siddharta & Harsono,* Litigation Release No. 17127.

2004).[8] These cases signal the SEC's resolve to pursue FCPA violators, as well as its intention to use creative tools to enforce the statute.

A. *SEC v. Yaw Osei Amoaka*, Litigation Release No. 19356 (Sept. 1, 2005)

The SEC announced on September 1, 2005 that it had filed suit against the former regional director of ITXC Corp. for violations of the antibribery provisions of the FCPA. ITXC Corp. was an international telecommunications carrier based in Princeton, New Jersey, before it ceased to exist as a separate entity on June 1, 2004 having merged with another company.

According to the SEC's complaint, Yaw Osei Amoaka bribed an official of the government-owned telephone company in Nigeria, known as NITEL. According to the complaint, Amoaka paid the NITEL official a total of $166,541.31 in bribes in 2002 and 2004 in order to obtain a lucrative contract for ITXC. Furthermore, the SEC alleged that ITXC made over $1 million in net profits from the contract. The SEC is seeking to disgorge Amoaka's ill-gotten gains derived from his misconduct and to assess a civil penalty. This matter is ongoing.

B. *In the Matter of Diagnostic Prods. Corp.*, Exchange Act Release No. 51724 (May 20, 2005)

On May 20, 2005, the SEC announced its acceptance of a settlement offer from Diagnostic Products Corp. in connection with its alleged violation of the FCPA. Diagnostic Products is a Los Angeles, California-based company that manufactures medical diagnostic test systems and

[8] *See also SEC v. Kay*, Litigation Release No. 19026 (Jan. 7, 2005) (announcing the final judgment entered by the United States District Court for the Southern District of Texas permanently enjoining an individual from violating the FCPA and ordering him to pay a civil penalty for aiding and abetting the American Rice bribery scheme in violation of the FCPA).

related test kits. According to the Commission, in 1991, Diagnostic Products established DePu Biotechnological & Medical Products Inc. ("DePu") in Tiajin, China as a joint venture with a local Chinese government entity. DePu's customers primarily consist of state-owned hospitals in China. The SEC alleged that from 1991 through 2002, Diagnostic Products routinely made improper commission payments to doctors and laboratory employees who controlled purchasing decisions at the state-owned hospitals. The payments allegedly totaled approximately $1.6 million and were made through DePu.

C. *SEC v. Titan Corp.*, Litigation Release No. 19107 (Mar. 1, 2005)

On March 1, 2005, the SEC announced that it had filed a settled civil enforcement action against Titan Corp., a San Diego, California-based military and communications company, for violating the antibribery, internal controls, and books and records provisions of the FCPA.

From 1999 to 2001, Titan allegedly paid more than $3.5 million to its agent in the Republic of Benin, whom Titan knew to be the business advisor to the President of Benin. Allegedly, Titan failed to conduct any meaningful due diligence into the background of its agent either before or after his retention and also failed to ensure that the services alleged to be performed by the agent, and described in his invoices, were in fact provided to Titan. In 2001, at the direction of at least one former senior Titan officer based in the United States, Titan funneled approximately $2 million, via its agent in Benin, to the election campaign of Benin's then-incumbent President. Titan made the payments to assist it in its development of a telecommunications project in Benin and to get the Benin government to agree to an increase in Titan's project management fees. A former Titan officer directed that these payments be falsely invoiced by the agent as "consulting services" and that actual payment of the money be broken into smaller increments and spread over time.

The SEC further alleged that, from 1999 to 2003, Titan improperly recorded payments in its books and records, directed agents to falsify invoices submitted to Titan, and failed to devise or maintain an effective system of internal controls to prevent or detect other FCPA violations. Titan also allegedly falsified documents that enabled its agents to underreport foreign commission payments and payments on exported equipment. Additionally, Titan allegedly (i) paid a World Bank Group analyst cash to assist Titan in its project in Benin, and (ii) paid a Benin government official approximately $14,000 in travel expenses from 1999 to 2001.

D. *In the Matter of GE InVision, Inc.*, Exchange Act Release No. 51199 (Feb. 14, 2005) and *SEC v. GE InVision, Inc.*, Litigation Release No. 19078 (Feb. 14, 2005)

Matter of GE InVision, Inc. involved alleged violations of the FCPA in China, the Philippines and Thailand by GE InVision, a Newark, California-based manufacturer of explosives detection systems used by airports.

The violations in China involved a November 2002 agreement to sell two explosives detection machines for use at a government owned and operated airport under construction in Guangzhou. GE InVision's local distributor purchased the two machines from GE InVision for $2.8 million. Under the terms of the transaction, GE InVision was obligated to deliver the two machines by mid-2003. However, due to problems obtaining an export license from the U.S. government, GE InVision did not deliver the machines until October 2003. During the delay, GE InVision's distributor informed the sales manager that the airport intended to impose a financial penalty on GE InVision, but that the penalty could be avoided by offering foreign travel and other benefits to airport officials. A senior executive at GE InVision agreed to the distributor's request for costs incurred as a result of the delay, including compensation for benefits the distributor intended to offer airport officials in the amount of $95,000. GE InVision subsequently improperly recorded the payment in its books as a cost of goods sold, and realized profits of about $589,000 from the sale of the machines.

In the Philipines, GE InVision sold two explosives detection machines for use in an airport in November 2001. The sale was made directly by GE InVision to the subcontractor responsible for building the airport terminal's handling system through a sales agent. Soon after the November 2001 sale, GE InVision received repeated requests for a commission on the sale from its sales agent in the Philippines. The agent indicated that it intended to use part of any commission it received in connection with the sale to make gifts or pay cash to government officials in order to influence their decision to purchase additional GE InVision products. In December 2001, a senior executive at GE InVision paid the agent a commission of over $100,000, knowing that part of the commission would likely be used to make gifts or pay cash to influence government officials in violation of the FCPA.

In 2002, GE InVision competed for the right to supply explosive detection machines to an airport under construction in Bangkok, Thailand. Construction of the airport was overseen by a corporation controlled by the government of Thailand. GE InVision retained a distributor in Thailand to lobby the airport corporation and the government of Thailand on GE InVision's behalf. Under the terms of the transaction, the distributor would purchase the machines from GE InVision and then make its profit from reselling them for a higher price to the airport. From January 2003 to April 2004, the distributor indicated it had offered to make gifts or payments to officials with influence over the airport corporation. Based on the information provided by the agent, GE InVision was aware of a high probability that the distributor intended to fund any gifts or offers out of the difference between what the distributor paid to GE InVision to acquire the machines and the resale price. Despite this awareness, and without any effort to ensure compliance with the FCPA, GE InVision entered into the transaction with its distributor.

E. *SEC v. Monsanto Co.*, Litigation Release No. 19023 (Jan. 6, 2005) and *In the Matter of Monsanto*, Exchange Act Release No. 50978 (Jan. 6, 2005)

On January 6, 2005, the SEC filed two settled civil enforcement proceedings charging Monsanto Company, a global producer of technology-based solutions and agricultural products headquartered in St. Louis, with making illicit payments in violation of the FCPA.

The SEC charged that, in 2002, a senior Monsanto manager based in the United States directed an Indonesian consulting firm to make an illegal payment totaling $50,000 to a senior Indonesian Ministry of Environment official. The bribe was made to influence the senior official to repeal an unfavorable decree that likely would have an adverse effect on Monsanto's business. Although the payment was made, the unfavorable decree was not repealed. Subsequently, the senior Monsanto manager allegedly devised a scheme whereby false invoices were submitted to Monsanto and the senior Monsanto manager approved the invoices for payment.

The SEC also charged that, from 1997 to 2002, Monsanto inaccurately recorded approximately $700,000 of illegal or questionable payments made to at least 140 current and former Indonesian government officials and their family members. The $700,000 was derived from a bogus product registration scheme undertaken by two Indonesian entities controlled by Monsanto. The largest single set of payments was for the purchase of land and the design and construction of a house in the name of the wife of a senior Ministry of Agriculture official.

F. *SEC v. ABB Ltd.*, Litigation Release No. 18775 (July 6, 2004)

On July 6, 2004, the SEC filed a settled civil enforcement action in the U.S. District Court for the District of Columbia charging ABB Ltd., a global provider of power and automation technologies headquartered in Zurich, Switzerland, with violating the antibribery, books and records, and internal accounting controls provisions of the FCPA.

In its complaint, the SEC charged that from 1998 through early 2003, ABB's U.S. and foreign-based subsidiaries doing business in Nigeria, Angola, and Kazakhstan made illicit payments totaling over $1.1 million to government officials in Nigeria, Angola, and Kazakhstan. All of the payments were intended to assist ABB's subsidiaries in obtaining and retaining business. The complaint further alleged that the payments were made with the knowledge and approval of certain management level personnel of the relevant ABB subsidiaries. Finally, the complaint charged that ABB improperly recorded these payments in its books and records, and lacked any meaningful internal controls to prevent or detect such illicit payments.

G. *SEC v. Schering-Plough Corp.*, Litigation Release No. 18740 (Jun. 9, 2004)

On June 9, 2004, the SEC announced that it filed and settled a civil enforcement proceeding against Schering-Plough Corporation, a Kenilworth, New Jersey-based corporation, for violations of the FCPA. The SEC's complaint charged that, between February 1999 and March 2002, one of Schering-Plough's foreign subsidiaries, Schering-Plough Poland, made improper payments to a charitable organization called the Chudow Castle Foundation. The Foundation was headed by an individual who was also the director of a Polish governmental body that provided money for the purchase of pharmaceutical products and influenced the purchase of the products by hospitals. According to the complaint, Schering-Plough Poland paid 315,800 zlotys (approximately $76,000) to the Chudow Castle Foundation to induce the Polish government official to influence the purchase of Schering-Plough's pharmaceutical products.

The complaint alleged further that none of the payments made by Schering-Plough Poland to the Foundation were accurately reflected in the subsidiary's books and records, and the company's system of internal accounting controls was inadequate to prevent or detect the improper payments.

H. *In the Matter of BJ Servs. Co.*, Exchange Act Release No. 49390 (Mar. 10, 2004)

BJ Services is a Delaware corporation based in Houston, Texas, that provides oil field services, products, and equipment to petroleum producers worldwide. According to the Commission, in January 2001, BJ Services made illegal or questionable payments totaling roughly 72,000 pesos to Argentinean customs officials. These payments allegedly were made through BJ Services' wholly owned subsidiary in Argentina. The SEC alleged that certain equipment that BJ Services was attempting to import into Argentina was not properly imported under Argentina's customs laws and was being held by customs. The bribe, which was approved by managers in BJ Services' Argentinean operations, was paid to a customs official in order to avoid (i) forfeiting the import taxes that it previously paid, (ii) paying additional taxes to properly re-import the equipment and (iii) paying a penalty of 1 to 5 times the value of the equipment. Allegedly, BJ Services made further illicit payments in September 2001 to avoid further fines that could have been imposed for additional violations of Argentina's customs laws.

Furthermore, the SEC alleged that from 1998 through 2002, payments totaling approximately 151,000 pesos were made that were either undocumented or improperly characterized, including a 10,994 peso facilitation payment to an official in the office of Argentina's Secretary of Industry and Commerce. In some cases, entries were made in BJ Services' books and records to conceal such payments.

IV.

LESSONS FROM THE POST-*KAY* ENFORCEMENT ACTIONS

At least five important lessons about the way the SEC and DOJ intend to prosecute future violations of the FCPA can be gleaned from these recent cases. First, it appears the SEC and the DOJ will continue to work together to prosecute violations of the FCPA. Second, the SEC is increasingly seeking disgorgement in FCPA cases. Third, the SEC will now almost always seek to have an independent consultant oversee a violative company's FCPA compliance program for a specified period. Lastly, cooperation with SEC and DOJ investigations can be instrumental in determining the outcome of an FCPA investigation.

A. Increased Cooperation Between SEC and DOJ in Enforcing the FCPA

In 2001, the SEC and DOJ filed the first ever joint civil action for violations of the FCPA. *United States v. KPMG Siddharta Siddharta & Harsono,* Litigation Release No. 17127 (alleging that KPMG-SSH agreed to make an illicit payment to influence an Indonesian tax official to reduce a tax assessment for one of KPMG-SSH's clients). This bold foray heightened the awareness of companies to their FCPA obligations. It also foreshadowed the current trend of joint SEC and DOJ joint investigations. Indeed, five of the eight cases filed since *United States v. Kay* involved joint investigations by the SEC and DOJ. *Matter of Diagnostic Prods. Corp.*, Exchange Act Release No. 51724; *Titan Corp.*, Litigation Release No. 19107; *Matter of GE InVision, Inc.*, Exchange Act Release No. 51199; *Monsanto Co.*, Litigation Release No. 19023; *ABB Ltd.*, Litigation Release No. 18775. Joint civil and criminal investigations can be particularly difficult to manage. Additionally, these joint investigations raise serious constitutional due process rights questions with which courts are increasingly grappling. *See*, *e.g.*, *United States v.*

Stringer, CR 03-432-HA, 2006 WL 44193, at *6 (D. Or. Jan. 9, 2005) ("A government agency may not develop a criminal investigation under the auspices of a civil investigation. It would be a flagrant disregard of individuals' rights to deliberately deceive, or even lull someone into incriminating themselves in the civil context when activities of an obvious criminal nature are under investigation.") (internal quotations and citations omitted); *United States v. Scrushy*, 366 F. Supp. 2d 1134, 1140 (N.D. Ala 2005) ("because this is a case where the government has undoubtedly manipulated simultaneous criminal and civil proceedings, both of which it controls, there is a special danger that the government can effectively undermine rights that would exist in a criminal investigation by conducting a de facto criminal investigation using nominally civil means. In that special situation the risk to individuals' constitutional rights is arguably magnified.") (citing *SEC v. HealthSouth Corp.*, 261 F. Supp. 2d 1298 (N.D. Ala. 2003) (internal quotations omitted).

B. Disgorgement of Supposedly Ill-gotten Gains

Given the recent increase in the amount of monetary penalties being paid by public companies to settle allegations of federal securities law violations, perhaps it is not surprising that the Commission has upped the financial ante in FCPA cases.[9] Among other draconian remedies, the

[9] *See, e.g.*, *SEC v. Vivendi Universal, S.A.*, Litigation Release No. 18523 (Dec. 24, 2003) (Vivendi agreed to pay $50 million in penalties to settle allegations of financial fraud charges); *SEC v. WorldCom Inc.*, Litigation Release No. 18219 (July 7, 2003) (WorldCom Inc. agreed to pay $2.25 billion in penalties to settle allegations of financial fraud; the WorldCom settlement was to be satisfied, post-bankruptcy, by the company's payment of $500 million in cash, and common stock in the reorganized company valued at $250 million). Moreover, between March and December of 2003, four financial services firms agreed to pay a combined total of $197.5 million in civil penalties, ranging from $37.5 million to $65 million, to settle charges relating to the accounting fraud at Enron. *SEC v. Merrill Lynch & Co., Inc.*, Litigation Release No. 18038 (Mar. 17, 2003); *SEC v. J.P. Morgan Chase & Co.*, Litigation Release No. 18252 (July 28, 2003); *In the Matter of Citigroup, Inc.*, Exchange Act Release No. 48230 (July 28, 2003); *SEC v. CIBC World Mkts.*, Litigation Release No. 18517 (Dec. 22, 2003). In the same period, the Commission settled charges relating to the global research analyst conflict of interest matters with

Commission has begun seeking disgorgement in FCPA cases. *Compare Titan Corp.*, Litigation Release No. 19107 (disgorgement sought) *with SEC v. Syncor Int'l Corp.*, Litigation Release No. 17887 (Dec. 10, 2002) (no disgorgement sought). In settling allegations that it funneled more than $2 million to the re-election of Benin's then-incumbent president in exchange for assistance in its development of a telecommunications project in Benin and to obtain the Benin government's consent to an increase in the percentage of its project management fees, Titan agreed to pay over $15 million in disgorgement and prejudgment interests. *Titan Corp.*, Litigation Release No. 19107. Likewise, GE InVision settled charges with the SEC by agreeing to disgorge $589,000 in profits from its FCPA violations. *Matter of GE InVision, Inc.*, Exchange Act Release No. 51199. Similarly, ABB agreed to disgorge $5.9 million to settle allegations that, from 1998 through early 2003, ABB's U.S. and foreign-based subsidiaries doing business in Nigeria, Angola, and Kazakhstan offered and made illicit payments totaling over $1.1 million to government officials in these countries in order to assist certain ABB subsidiaries to obtain and retain business. *ABB Ltd.*, Litigation Release No. 18775. These disgorgement payments were in addition to criminal fines and/or civil monetary penalties of $13 million, $500,000 and $10.5 million, respectively. *United States v. Titan Corp.*, Case No. 05 CR 0314-BEN (S.D. Cal. Mar. 1, 2005) (criminal fine); *SEC v. GE InVision, Inc.*, Litigation Release No. 19078 (Feb. 14, 2005) (civil penalty); *United States v. ABB Vetco Gray, Inc.*, Case No. 04 CR 279-01 (S.D. Tex. July 6, 2004) (criminal fine).

While it is settled law that the SEC can seek and a court can grant disgorgement in SEC actions, the increasing use of disgorgement in FCPA cases raises significant concerns about whether FCPA cases are the types of cases that lend themselves to a proper claim for disgorgement. Although the federal securities laws do not specifically provide the Commission with authority to seek disgorgement, Congress has expressly

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Citigroup for a staggering $150 million and $75 million against Credit Suisse First Boston. *SEC v. Citigroup Global Mkts. Inc.*, Litigation Release No. 18111 (Apr. 28, 2003); *SEC v. Credit Suisse First Boston LLC*, Litigation Release No. 18110 (Apr. 28, 2003).

endorsed disgorgement as an appropriate remedy in federal securities law cases. *See SEC v. Palmisano*, 135 F.3d 860, 865 (2d Cir. 1998) (citing H.R. Rep. No. 101-616, at 13 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1379, 1380). It is also well established that disgorgement is within the general equity powers granted to the courts by Section 27 of the Exchange Act, 15 U.S.C. § 78*aa*. *See id.* at 865–66 (citing *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991); *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1103 (2d Cir. 1972)).

Unlike damages, disgorgement is an equitable remedy and it is not intended to be punitive, nor is it to be used as such. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (Fed. Cir. 1989) (citing *SEC v. Blatt*, 583 F.2d 1325, 1335 (5^{th} Cir. 1978); *Manor Nursing Ctrs., Inc.*, 458 F.2d at 1104). The primary goal of disgorgement is inherent in its name: Disgorgement is intended simply to divest wrongdoers of their ill-gotten gains, a means to "make sure that wrongdoers will not profit from their wrongdoing." *See SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987). Ill-gotten gains, in turn, has been construed to mean money obtained through "fraud or wrongdoing." *Cement Masons and Welfare Trust Fund for Northern California v. Stone*, 197 F.3d 1003, 1006–07 (9^{th} Cir. 1999).[10]

[10]A district court has broad discretion with regard to determining the amount to be disgorged from a wrongdoer. *See SEC v. U.S. Envtl., Inc.*, No. 94 Civ. 6608, 2003 WL 21697891, at *27 (S.D.N.Y. July 21, 2003) (citing *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 1996) ("The decision to order disgorgement of ill-gotten gains, and the calculation of those gains, lie within the discretion of the trial court, which 'must be given wide latitude in these matters.'"). Where profits derive from both lawful and unlawful conduct, the SEC bears the burden of distinguishing between legally and illegally obtained proceeds. *See CFTC v. British Am. Commodity Options Corp.*, 788 F.2d 92, 93 (2d Cir. 1986) (citing *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971); *SEC v. Willis*, 472 F. Supp. 1250, 1276 (D.D.C. 1978)); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) ("The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment."). Furthermore, courts may discount the disgorgement to be paid by the defendant's expenses incurred in perpetrating the allegedly wrongful conduct. *Compare SEC v. McCaskey,* No. 98 Civ. 6153, 2002 WL 850001, at *4 (S.D.N.Y. Mar. 26, 2002) (deducting from the amount of illegal profits to be disgorged from defendant's direct transaction costs, which "plainly reduce the wrongdoer's actual profit"); *SEC v. Thomas James Assocs., Inc.*, 738 F. Supp. 88, 94 (W.D.N.Y. 1990) (court may consider offset for sums paid to effect a fraudulent transaction) *with SEC v. Great Lakes Equities*

Measuring the proper amount of disgorgement in most FCPA cases without turning disgorgement into a punitive remedy is a tricky proposition, and it is not entirely clear that violations of the antibribery provisions of the FCPA lend themselves to a claim for disgorgement of ill-gotten gains. With the exception of the limited cases such as *United States v. KPMG Siddharta Siddharta & Harsono* where, allegedly, a bribe was paid to obtain a reduction in the amount of taxes owed to a foreign government, it is dubious, at best, to demand that an issuer disgorge profits it made under an otherwise valid contract because it bribed a government official to obtain the contract. There is certainly no case law supporting the Commission's position that disgorgement is an appropriate remedy in such cases. It remains to be seen how the court in *SEC v. Yaw Osei Amoaka* will resolve the Commission's disgorgement claim against Amoaka. *SEC v. Yaw Osei Amoaka*, Litigation Release No. 19356.

C. Increased Use of Independent Consultants

Six of the eight settled FCPA cases that the Commission has announced since the Fifth Circuit's decision in *United States v. Kay* have included an agreement by the issuers to retain an independent consultant acceptable to the SEC to evaluate compliance with the FCPA. *Matter of Diagnostic Prods. Corp.*, Exchange Act Release No. 51724; *Titan Corp.*, Litigation Release No. 19107; *Matter of GE InVision, Inc.*, Exchange Act Release No. 51199; *Monsanto Co.*, Exchange Act Release No. 50978; *ABB Ltd.*, Litigation Release No. 18775; *Schering-Plough Corp.*, Litigation Release No. 18740.

However, the scope of the independent consultant's review can vary drastically. For example, in *GE InVision*, GE InVision agreed to retain an independent consultant to (i) merely "evaluate the efficacy" of the integration of GE InVision into General Electric's FCPA compliance program, and (ii) provide the independent consultant with access to its files, books, records and personnel for the purposes of the consultant's

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Co., 775 F. Supp. 211, 214–15 (E.D. Mich. 1991) (offset for overhead and other expenses incurred in perpetuating fraud not warranted).

"evaluation." *Matter of GE InVision, Inc.*, Exchange Act Release No. 51199. Thereafter, the independent consultant is to report back to the SEC on GE InVision's efforts to integrate into General Electric's compliance program. *Id.* On the other hand, in the SEC's case against Monsanto, Monsanto agreed to retain a consultant to essentially police the company for three years. *Monsanto Co*., Exchange Act Release No. 50978. As in *GE InVision*, the consultant in *Monsanto* was required to review and evaluate Monsanto's internal controls, procedures and policies, and report its findings. *Monsanto Co*., Exchange Act Release No. 50978. In addition, however, the consultant was given the task of undertaking a "special review" of Monsanto's policies and procedures as they relate to compliance with the FCPA during the first year, and in the third year, following the consultant's retention. *Id.* During these reviews, the consultant is required to "(i) certify that Monsanto's policies and procedures are appropriately designed to accomplish their goals, (ii) monitor Monsanto's implementation and compliance with the policies and procedures, and (iii) report [his or her] findings to Monsanto's Corporate Compliance Officer as to the effectiveness of the policies and procedures." *Id.* Moreover, the Monsanto settlement provided that, should the consultant determine during the three-year period that "there is a reasonable likelihood that corrupt payments have been offered, promised, paid, or authorized by any Monsanto entity," the consultant must report such activity to Monsanto's compliance officer. *Id.* If Monsanto does not then promptly self-report, the consultant must independently disclose its findings to the SEC. *Id.*

While the role of the independent consultant in the GE InVision settlement seems narrow and benign, the role of the independent consultant in Monsanto appears to be far more expansive and intrusive. One way to avoid such an onerous imposition is to take the remedial steps described in the GE InVision and Monsanto settlements preferably prior to any SEC interest, but certainly no later than during the investigative stage, so as to avoid the need for an independent consultant that will be required to stand watch over the company's every move for years. Taking these and other remedial steps will also likely inure to the company's benefit during settlement discussions.

D. Cooperation with SEC and DOJ Investigations

One key factor that the SEC looks to in determining whether a company has fully cooperated with its investigation is the degree to which a company self-polices in an effort to ensure compliance with the federal securities laws, including establishing effective compliance procedures.[11] Other factors include: (i) self-reporting of misconduct when it is discovered, including conducting a thorough review of the nature, extent, origins and consequences of the misconduct, and promptly, completely, and effectively disclosing the misconduct to the public, to regulators, and to self-regulator organizations; (ii) remediation, including dismissing or appropriately disciplining wrongdoers, modifying and improving internal controls and procedures to prevent recurrence of the misconduct, and appropriately compensating those adversely affected; and (iii) cooperation with law enforcement authorities, including providing the Commission staff with all information relevant to the underlying violations and the company's remedial efforts. *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement*

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[11]Correspondingly, the DOJ also looks to a corporation's compliance programs. In January 2003, the DOJ released a memorandum by Deputy Attorney General Larry D. Thompson, entitled "Principles of Federal Prosecution of Business Organizations." Prosecutors are instructed to scrutinize compliance programs closely to ensure corporations have put effective programs in place. However, having a compliance program that appears adequate is no longer enough. Prosecutors are now directed to determine whether a compliance program is truly effective or whether it is merely a "paper-program" – *i.e.*, a program that looks good on paper but is actually ineffective in practice. Factors that point to a satisfactory compliance program include, the promptness of reporting wrongdoing by the company to the government, the company's subsequent cooperation in the investigation, whether directors exercise independent review over proposed corporate actions, whether directors receive enough information to exercise independent judgment, whether internal audit functions allow for independent and accurate audits, and whether there is an adequate information and reporting system that enables directors to receive the information they need. *See Principles of Federal Prosecution of Business Organizations*. The memorandum can be found at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm (last visited Aug. 16, 2006).

on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44969 (Oct. 23, 2001).[12]

Sufficient internal controls are integral to a company's ability to self-report potential FCPA violations. Notably, seven of the eight FCPA cases filed by the SEC since the Fifth Circuit's decision in *United States v. Kay* included allegations that the defendants' self-policing mechanisms, if any, failed to detect and/or prevent the allegedly violative conduct. *Matter of Diagnostic Prods. Corp.*, Exchange Act Release No. 51724 (Commission alleged that Diagnostics Products failed to establish an internal system sufficient to prevent and detect violations of the FCPA); *Titan Corp.*, Litigation Release No. 19107 (alleging that Titan "failed to devise or maintain an effective system of internal controls to prevent or detect . . . FCPA violations"); *Matter of GE InVision, Inc.*, Exchange Act Release No. 51199 ("InVision failed to establish an internal system sufficient to prevent and detect violations of the FCPA."); *Matter of Monsanto Co.*, Exchange Act Release No. 50978 ("During the review period, Monsanto lacked internal controls sufficient to detect or prevent the illicit payment schemes operated by the Indonesian affiliates."); *ABB Ltd.*, Litigation Release No. 18775 (alleging that ABB "lacked any meaningful internal controls to prevent or detect such illicit payments"); *Schering-Plough Corp.*, Litigation Release No. 18740 ("The complaint also alleges that the company's system of internal accounting controls was inadequate to prevent or detect the improper payments."); *Matter of BJ Servs. Co.*, Exchange Act Release No. 49390 (Commission alleged that BJ Services breached its "existing accounting policies, controls and procedures" from 1998 to 2002).

The SEC's more particularized allegations in *GE InVision* and *Titan* offer an indication of exactly what types of mechanisms, or lack thereof, will be considered significant in determining the sufficiency of a company's internal controls. Specifically, in *GE InVision*, the SEC alleged three specific internal control failures. First, that GE InVision, in selecting its foreign sales agents and distributors, failed to conduct

[12]The Report can be found at http://www.sec.gov/litigation/investreport/34-44969.htm (last visited Aug. 16 (2006).

meaningful, if any, background investigations. *Matter of GE InVision, Inc.*, Exchange Act Release No. 51199. Second, that GE InVision failed to provide any formal training or education to its employees or sales agents for selecting foreign agents and distributors. *Id.* Finally, that GE InVision failed to establish a program to monitor its foreign agents and distributors with regard to FCPA compliance. *Id.*

In *Titan*, the SEC alleged that Titan lacked internal controls on very similar grounds. In particular, the SEC noted that, despite utilizing over 120 agents and consultants in over 60 countries worldwide, Titan never had a formal company-wide FCPA policy, nor did it implement a formal FCPA compliance program. *Titan Corp.*, Litigation Release No. 19107. Titan also allegedly disregarded or circumvented the limited policies and procedures that did exist. *Id.* In addition, the SEC alleged that Titan "failed to maintain sufficient due diligence files on its foreign agents, and failed to have meaningful oversight over its foreign agents." *Id.* These settled cases clearly illustrate the types of self-policing steps that the SEC expects from public companies conducting business outside the United States.

Similarly, taking decisive remedial steps during a government investigation can also go a long way in the SEC's assessment of a company's cooperation. For example, in the SEC's settlement with Monsanto, the SEC identified several remedial measures taken by Monsanto, including, but not limited to, (i) a revision to the accounting treatment of the subject illicit payments; (ii) the termination of all Monsanto employees involved in improper financial activities or who failed to properly supervise such activities; (iii) the termination of Monsanto's relationship with its foreign-based consulting firm; (iv) the restructuring of Monsanto's Indonesian affiliates; and (v) the improvement of its FCPA compliance program, including the hiring of a new Director of Business Conduct. *Matter of Monsanto Co.*, Exchange Act Release No. 50978; *see also Matter of BJ Servs. Co.*, Exchange Act Release No. 49390 (undertaking several remedial actions including replacing the management of its Latin American Region operations). Lastly, cooperation, according to the SEC, will also be a factor in determining the appropriate civil monetary penalty a company will be required to pay to settle alleged violations of the federal securities laws.[13]

E. FCPA Representation Disclosures

On March 1, 2005, in connection with its investigation of illicit payments by Titan Corp., the Commission issued a Section 21(a) of the Exchange Act report titled "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on potential Exchange Act Section 10(b) and Section 14(a) Liability ("Commission Report")." Exchange Act Release No. 51283 (Mar. 1, 2005). The Commission took the opportunity to "provide guidance" concerning potential liability under Sections 10(b) and 14(a) of the Exchange Act, and Rules 10b-5 promulgated thereunder, for publication of false or misleading material disclosures regarding contractual provisions, including representations and covenants. *Id.*

On September 15, 2003, Titan and Lockheed Martin Corporation ("Lockheed Martin") entered into a merger agreement in which Lockheed Martin agreed to acquire Titan pending certain contingencies (the "Merger Agreement"). In the Merger Agreement, Titan affirmatively represented that:

To the knowledge of the Company, neither Company nor any of its Subsidiaries, nor any director, officer, agent or employee of the Company or any of its Subsidiaries, has . . . taken any action which would cause the Company or any of its Subsidiaries to be in violation of the Foreign Corrupt Practices Act of 1977, as amended, or any applicable law of similar effect. ("FCPA Representation.") *Id*.

Notably, the FCPA Representation was publicly disclosed and disseminated by Titan in at least two places. First, Titan's proxy

[13] Securities and Exchange Commission, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006) *available at* http://www.sec.gov/news/press/2006-4.htm (last visited Aug. 16 2006).

statement disclosed that "the [M]erger [A]greement contains representations and warranties by Titan that expire upon completion of the merger as to, among other things . . . Titan's compliance with the [FCPA], as amended." *Id*. Second, the Merger Agreement containing the FCPA Representation was appended to Titan's proxy statement, and the proxy statement was filed with the Commission and sent to Titan's shareholders. *Id*. According to the Commission Report, the Merger Agreement and the proxy statement were amended at various times after September 15, 2003, primarily due to the SEC and DOJ joint investigation of potential violations of the FCPA by Titan. *Id*. Throughout this period, however, the FCPA Representation itself remained unchanged. *Id*. In June 2004, Lockheed terminated the Merger Agreement. *Id*.

Without charging that Titan violated the antifraud provisions of Sections 10(b) and 14(a) of the Exchange Act and Rules 10b-5 and 14a-9 promulgated thereunder, the Commission warned that "disclosures regarding material contractual terms such as [Titan's] FCPA Representation[s] may be actionable by the Commission."[14] *Id.* The Commission added further that it "will consider bringing enforcement action under the [Exchange Act] in the future if [it] determine[s] that the subject matter of representations or other contractual provisions is materially misleading to shareholders because material facts necessary to

[14]It is settled law that investors have a private right of action under both Sections 10(b) and 14(a) of the Exchange Act and Rules 10b-5 and 14a-9 promulgated thereunder. *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964) ("Private enforcement of the proxy rules provides a necessary supplement to Commission action."); *Cohen v. Colvin*, 266 F. Supp. 677, 685 (S.D.N.Y. 1967); *Hoover v. Allen*, 241 F. Supp. 213, 230 (S.D.N.Y. 1965); *Barnett v. Anaconda Co.*, 238 F. Supp. 766, 77l (S.D.N.Y. 1965); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983) ("a private right of action under § 10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years. The existence of this implied remedy is simply beyond peradventure."); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976) (holding that the existence of a private cause of action for violations of Section 10(b) of the Exchange Act Rule 10b-5 promulgated thereunder is now well established); *In re Craftmatic Secs. Litig*., 890 F.2d 628, 639 (3d Cir. 1989) ("federal securities law recognizes a right of action for omitting material facts that would assume significance in the deliberations of a reasonable shareholder"); *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (ED Pa. 1946) (same).

make that disclosure not misleading are omitted." *Id*. Moreover, the Commission made clear that an issuer cannot avoid its disclosure obligations by arguing that the information published was contained in a document that was not prepared as, or intended to be, a disclosure document. *Id.*

With respect to Titan's disclosure, the Commission acknowledged that Titan shareholders were not the intended audience of the FCPA Representation in the Merger Agreement. *Id*. Nevertheless, the Commission noted that Titan's inclusion of the FCPA Representation in a disclosure document filed with the SEC (*i.e.*, the proxy statement) constituted a disclosure to investors and that, depending on the context in which the disclosure was made (including the significance of the representation or other contractual provisions and the total mix of information available to the investor), a reasonable investor could conclude that the information therein is accurate and material. Such public disclosures, the Commission notes, puts the onus on an issuer to disclose any additional material facts that may contradict or qualify the issuer's earlier disclosures. *Id*.

The Commission's Report serves as a warning to all issuers that all disclosures must be complete and accurate with regard to material representations, whether or not they are intended for the benefit of shareholders. *Id.* ("This report highlights for issuers their responsibility to ensure that disclosures regarding material contractual provisions . . . are not misleading."). Furthermore, as evidenced by the Commission's report, representations relating to a company's potential liability under the FCPA may be material and, therefore, must be complete and accurate wherever they are made.

CONCLUSION

Perhaps by happenstance, since the Fifth Circuit decision in *United States v. Kay* resolved the longstanding question about the scope of the FCPA, the SEC's FCPA enforcement program has enjoyed a renaissance of sorts. The perceived or real threat of criminal prosecution, possible disgorgement of the profits from multimillion (if not billion) dollar contracts, appointment of an independent consultant to oversee a company's FCPA program, not to mention the likely collateral consequences of a finding of civil or criminal liability, often compel companies to focus significant resources on FCPA compliance. Yet, as U.S. companies engage in business ventures in far-flung places with a myriad of cultural norms, the ubiquitous FCPA looms large. Companies are best advised to review their compliance and training programs to ensure that those programs meet the minimum standards articulated in these cases.

While it is almost impossible to police every single employee or agent in every nook and corner of the world, companies can take some small comfort in instituting and strenuously self-enforcing FCPA compliance and training programs that will withstand the glare of the SEC and DOJ.

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2009 Massachusetts Ave., NW
Washington, DC 20036
202.588.0302
www.wlf.org