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Foreign Corrupt Practices Act Update

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Schering-Plough Settles FCPA Case with SEC for Payments to Charity Headed by Government Official

On June 16, 2004, Schering-Plough Corporation settled with the Securities and Exchange Commission ("SEC"), agreeing to pay a civil penalty of $500,000 for violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA").[1] The settlement stems from donations made by Schering-Plough's Polish subsidiary to a charitable foundation headed by a Polish government official. The SEC alleged that these payments were made to induce the official to purchase Schering-Plough's pharmaceutical products for his region's health fund. Although the donations were made without the knowledge or approval of any employee in the United States, the SEC charged that the U.S. parent company's internal controls were inadequate to prevent or detect the improper payments. It also charged the parent company with violations of the FCPA's recordkeeping provisions for the inaccurate records kept by its foreign subsidiary. The case is significant in suggesting that payments to a bona fide charity could violate the FCPA if made to influence the actions of a government official. Although the SEC did not state that these payments were bribes within the meaning of the FCPA, in charging FCPA accounting violations for these payments, the SEC strongly signaled that it believes that charitable donations could violate the FCPA if made at the direction of a government employee to induce official action.

The FCPA's Antibribery and Accounting Provisions

The FCPA antibribery provisions make it unlawful for any issuer, domestic concern, or person acting within the United States to make or offer to make a payment of anything of value directly or indirectly to a foreign official, international organization official, political party or party official, or any candidate for public office, for the purpose of influencing that official to assist in obtaining or retaining business. 15 U.S.C. § 78m(b). The FCPA's accounting provisions require companies with securities listed in U.S. trading markets to keep books, records, and accounts, which accurately and fairly reflect any transaction and disposition

[1] *SEC v. Schering-Plough Corp.,* Case No. 1:04CV00945 (D.D.C. June 9, 2004); *In the Matter of Schering-Plough Corp.,* Administrative Proceeding File No. 3-11517, Rel. No. 49838, June 9, 2004.

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of assets in reasonable detail, and to maintain an adequate system of internal accounting controls. 15 U.S.C. § 78dd-1 to -3. A U.S. parent company is not liable for corrupt payments made by a foreign subsidiary unless the parent knowingly participates in or authorizes the corrupt payment. On the other hand, a U.S. company is responsible for ensuring that its foreign subsidiary complies with the FCPA's accounting provisions. The parent must assure that its subsidiary both maintains accurate books and records and establishes and implements adequate internal accounting controls. The parent can be held liable for its failure to ensure the accuracy of a subsidiary's books and records even if the parent company has no knowledge or reason to know of the inadequate recordkeeping.

The SEC's Findings

Schering-Plough, a New Jersey-based company, provides pharmaceutical products to hospitals throughout the world. Schering-Plough Poland (S-P Poland) is a branch office of Schering-Plough Central East AG, a wholly owned subsidiary of the Swiss division of Schering-Plough.

According to the SEC, from February 1999 through March 2002, S-P Poland made payments to the Chudow Castle Foundation ("Foundation"), a charitable organization dedicated to the restoration of castles and other historic sites in the Silesian region of Poland. The Foundation was founded and is run by the Director of the Silesian Health Fund ("Fund"), one of sixteen regional government health authorities in Poland. Among other things, the Fund provides monies for the purchase of pharmaceutical products by hospitals and other medical centers. The SEC alleged that payments made to the Foundation were made to induce the Health Fund Director to purchase Schering-Plough's pharmaceutical products. According to the SEC, those payments totaled approximately $76,000. The SEC further alleged that the payments were structured at or below the local Schering-Plough's Manager's approval limit, for the express purpose of concealing the nature of the payments, and that the Manager provided false medical justifications for the payments on documents he submitted to the company's finance department.

The payments to the Foundation were allegedly improperly recorded on the books and records of S-P Poland as medical donations. Although the SEC conceded that the Foundation was a bona fide charity, it noted that the Manager did not view the payments as charitable, but rather as "dues" that were required to be paid for the assistance of the Director.

Additionally, the SEC noted that prior to March 2002, Schering-Plough's policies and procedures for detecting possible FCPA violations by its foreign subsidiaries were inadequate. Schering-Plough did not require employees to conduct any due diligence prior to making promotional or charitable donations to determine whether any government officials were affiliated with the proposed recipients. The SEC further asserted that the company should have been alerted to the potential FCPA issues because: (1) the Foundation was not a healthcare related entity, yet still received payments; (2) the payments to the Foundation were significant in relation to the company's budget for such donations; (3) the numerous individual payments were structured by the Manger to allow him to exceed his authorization limits; and (4) the Director was founder and Chairman of the Foundation and also a Polish government official with the ability to influence the purchase of S-P Poland's products by hospitals within the Silesian Health Fund.

In settling with the SEC, Schering-Plough agreed to pay a $500,000 civil penalty and to retain an independent consultant to review and evaluate its internal controls, record-keeping, and financial reporting policies and procedures. Schering-Plough further agreed to adopt all recommendations reported by the independent consultant, unless unduly burdensome, impractical, or costly.

Significance of Schering-Plough Settlement

The Schering-Plough settlement is significant for several reasons. First, although it is not a litigated case and thus is not binding precedent, it suggests that the SEC takes a broad view of improper payments under the FCPA. While the SEC did not go so far as to state that the charitable donations were bribes within the meaning of the FCPA (and it could not have charged FCPA bribery violations for these payments in any event since S-P Poland is not itself an FCPA-covered entity and there was no involvement by U.S. personnel), the case strongly suggests that the SEC views a payment made to a charity to induce action on the part of a government official as a payment of something of value that would violate the FCPA. It is difficult to say with certainty whether that view would extend to donations directed by an official to a charity that he did not head, but the case suggests that the SEC is likely to take an aggressive position on such donations. We are aware of cases in the enforcement pipeline that may well present this issue more squarely.

The case also reaffirms the aggressiveness with which the SEC is now pursuing actions against parent companies for the alleged bribery of foreign officials by subsidiaries, even when the SEC has no indication that the parent companies themselves were involved in any bribe or alleged FCPA violations. Along with recent FCPA settlements by IBM, Chiquita, BellSouth, and Syncor,[2] this case demonstrates that the SEC expects an issuer's internal controls to prevent and detect FCPA violations by the issuer's foreign subsidiaries. And, the SEC will not hesitate to use the FCPA's books-and-records and internal controls provisions to hold issuers accountable for their subsidiaries conduct. Indeed, there is some reason to infer from this line of cases that anytime there is a questionable payment involving a subsidiary, the SEC's position is that the adequacy of the parent's internal controls is subject to question.

Finally, the case is the second recent FCPA case in which the government required the appointment of an independent compliance monitor to review and evaluate a company's internal controls, record-keeping, and financial reporting policies and procedures to ensure compliance with the FCPA. The SEC also included this requirement in the Syncor International settlement. Again, we are aware of other cases in the enforcement pipeline where the SEC may insist on the appointment of an independent monitor. It is increasingly looking to independent monitors to assist in the implementation of settlements of this nature.

U.S. companies should take care to implement a comprehensive FCPA compliance program that will prevent FCPA violations by their foreign subsidiaries. The minimum components of an effective FCPA compliance regime are:

- Adopting a clear corporate ethics policy prohibiting violations of the FCPA and establishing compliance standards and procedures that are reasonably capable of reducing the prospect of violations;
- Assigning responsibility for the FCPA compliance program to senior managers;
- Training officers, employees, agents, and consultants regularly concerning the requirements of the FCPA;
- Implementing appropriate disciplinary mechanisms for violations or failure to detect violations;

[2] *Securities and Exchange Commission v. International Business Machines Corp.*, 1:00CV030400 (D.D.C. Dec. 21, 2000); *In the Matter of International Business Machines Corp.,* Administrative Proceeding File No. 3-13097, Rel. No. 34-43761, Dec. 21, 2000; *Securities and Exchange Commission v. Chiquita Brands International, Inc.*, 1:01CV02079 (D.D.C. October 3, 2001); *In the Matter of Chiquita Brands International, Inc.,* Administrative Proceeding File No. 3-10613, Rel. No. 17169, October 3, 2001; *Securities and Exchange Commission v. BellSouth Corporation*, 1:02-CV-0113 (N.D. Ga.) Jan. 15, 2002); *In the Matter of BellSouth Corporation,* Administrative Proceeding File No. 3-10678, Rel. No. 45379 (Jan. 15, 2002); *U.S. v. Syncor Taiwan, Inc.*, CR02-1244-SVW (C.D.C.A., Dec. 2002) ("Plea Agreement"); *Securities and Exchange Commission v. Syncor International Corp.,* 1:02CV02421 (D.D.C. Dec. 10, 2002); *In the Matter of Syncor International Corp.,* Administrative Proceeding File No. 3-10969, Rel. No. 1687 (Dec. 10, 2002).

- Establishing a system by which officers, employees, agents, and consultants can report suspected violations without fear of retribution;

- Adopting corporate procedures, including a recorded due diligence inquiry, to ensure that the company forms business relationships with reputable agents, consultants, representatives, and joint venture partners;

- Adopting corporate procedures to ensure that companies do not delegate substantial discretionary authority to individuals with a propensity to engage in illegal activities;

- Including in all contracts with agents, consultants, joint venture partners, and other representatives, warranties that no payments of money or anything of value will be offered, promised or paid, directly or indirectly, to any foreign official, foreign political party, party official, or candidate for foreign public or political office to induce such officials to use their influence with a foreign government or instrumentality to obtain an improper business advantage for the company;

- Including in all contracts with agents, consultants, and other representatives a warranty that the agent, consultant, or representative shall not retain any sub-agent or representative without prior written consent.

In addition, company review of potential charitable donations abroad should now include an inquiry as to whether the donation is made at the suggestion or behest of any foreign government official and whether the charity, even if bona fide, is connected in any way to any foreign government official.

For a fuller discussion of these and other FCPA issues, see Roger M. Witten, *Complying with the Foreign Corrupt Practices Act* (Matthew Bender, 4th ed. 2003). If you have any questions or need additional information, please contact:

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