Rising Risk of FCPA Enforcement Targeting Board Members

By Roger M. Witten, Kimberly A. Parker, Jay Holtmeier

Recent developments signal that boards of directors and their members are an increasing focus of government agencies that enforce the Foreign Corrupt Practices Act (FCPA). The FCPA makes it a crime for any U.S. person, which includes U.S. citizens who sit on the boards of non-U.S. companies, or foreign person while in the U.S., to make, authorize, or condone a corrupt payment to a foreign official to obtain or retain business or business advantages where the individual has information that would lead a reasonable person to suspect that a corrupt payment was being made. Thus, a director could be charged even though s/he does not have actual knowledge of the corrupt transaction.

"The prospect of significant prison sentences for individuals should make clear to every corporate executive [and] every board member … that we will seek to hold you personally accountable for FCPA violations," said Lanny Breuer, Assistant Attorney General for the DOJ's Criminal Division, in a speech in November 2009. He repeated these remarks more recently in February 2010.

Also of note is a recent SEC enforcement action brought against two corporate officers (one of whom was also a director) of Nature's Sunshine Products, Inc.[1] This action was not premised on allegations of personal knowledge of the alleged bribery. Instead, the defendants were faulted for inadequately supervising personnel and were liable as "control persons," for failing to maintain proper records and internal controls. The SEC's willingness to use control person liability could be a powerful enforcement tool to pursue directors who could have taken preventative actions to stop potentially corrupt transactions had they inquired more probingly about the activities of the company in connection with the exercise of their supervisory responsibilities.[2] On September 24, 2009, SEC Assistant Director Kara N. Brockmeyer discussed the "control person" charge in the case, stating that when the SEC invokes this theory of liability, it is "signaling that it believes there were red flags" to which the control person "should have been paying attention."

The tough rhetoric from DOJ, reflected in Breuer's speeches, and the SEC's aggressive theories are backed up by the commitment of additional government resources in both agencies to fighting corporate bribery of foreign officials. The

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[1] *See* Press Release, Securities and Exchange Commission, SEC Charges Nature's Sunshine Products, Inc. with Making Illegal Foreign Payments (July 31, 2009), http://www.sec.gov/litigation/litreleases/2009/lr21162.htm.

[2] Although mere negligence does not ordinarily trigger control person liability, exactly who is a control person under Section 20(a) of the Securities Exchange Act of 1934 is not precisely or uniformly defined. The SEC has defined control as the "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person [*i.e.*, a company], whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405. However, many courts have chosen not to defer to the SEC's definition. *See* Erin L. Massey, *Control Person Liability Under Section 20(a): Striking a Balance of Interest for Plaintiff and Defendants*, 5 HOUS. BUS. & TAX L.J. 109, 114 (2005). The majority test, known as the "potential control" test, focuses on "whether the defendant had the potential to, or actually did, control the primary violator" of the Act. *Id.* at 118. The minority test, known as the "culpable participation" test, which is applied in New York, requires that a person have exercised control over the primary violator and have been meaningfully involved in the fraud forming that violation. *Id.* at 115. A third view, which is not generally widely applied today, looks at a person's position within a company and his or her relationship to the primary violator, which could lead to a nearly "strict liability" view of control person liability. *See* Laura Greco, *The Buck Stops Where? Defining Controlling Person Liability*, 73 S. CAL. L. REV., Vol. 169, 173-74 (1999).

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SEC recently created a special FCPA enforcement unit that will include a large team of attorneys dedicated to FCPA investigations and enforcement actions. The DOJ is also expected to add attorneys and FBI agents to its FCPA unit.

This growing exposure of board members to liability is not limited to the U.S. The United Kingdom recently reformed its laws by enacting the Bribery Act, which is expected to come into force by this fall. Among other things, the new law punishes individuals who bribe foreign government officials where any of the relevant acts or omissions take place in the U.K.[3] It also penalizes corporate senior officers with whose "consent or connivance" bribery is committed.[4] Moreover, companies, but not individuals, can be held strictly liable for the failure to prevent bribery. The only defense to liability under this provision is proof that the company had "adequate procedures" in place to prevent the bribery from occurring.

According to a recent Ernst & Young Global Fraud Survey, while board members appear to be increasingly aware of their exposure to liability, many could be doing more to manage the risks involved.[5] Seventy-six percent of CFOs interviewed by E&Y reported that the members of their boards are concerned about personal liability for fraudulent and corrupt actions carried out by the company. At the same time, half of the CFOs agreed that in order to effectively safeguard against such practices, boards needed to acquire a better understanding of the company's exposure. Finally, only 40 percent of CFOs interviewed had been asked by their boards to review anti-fraud and corruption controls in the past 12 months and only 28 percent had been asked to produce a fraud risk assessment.

In light of these developments, it is increasingly important for directors to take an active role in ensuring that the company's management has taken sufficient steps to establish and maintain a comprehensive anti-corruption program, not only on paper but also in practice. Importantly, directors should consider whether management has devoted sufficient resources to such programs, in light of the company's corruption risk profile and industry best practices. Specifically, directors should:

- Ensure that their companies develop and maintain effective anti-corruption compliance programs that are adequately resourced.
- Ensure that senior compliance program officers have access to the board where necessary and appropriate to raise potential concerns about anti-bribery compliance.
- Insist that periodic reports be made to the board on the implementation and effectiveness of the company's anti-corruption compliance controls and any issues that have arisen.
- Exercise active oversight over anti-corruption compliance issues.
- Periodically reevaluate, with expert assistance, whether the company's existing controls are adequate in light of changes in the business (e.g., expansion into countries with a reputation or history of corruption), changes in best practices, and/or changes in the law.

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[3] The Act also applies to overseas bribery carried out by individuals who have a "close connection" with the U.K.

[4] Although where none of the relevant acts or omissions take place in the U.K., this provision applies only to those senior officials who have a "close connection" with the U.K.

[5] Ernst & Young 11th Global Fraud Survey, *Driving ethical growth – new markets, new challenges*, at 2, 11-13 (2010), http://www.ey.com/Publication/vwLUAssets/EY_11th_GLOBAL_FRAUD_Survey/$FILE/EY_11th_GLOBAL_FRAUD_Survey.pdf.

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For more information on this or other FCPA matters, please contact:

Roger Witten
roger.witten@wilmerhale.com
212 230 8850

Kimberly Parker
kimberly.parker@wilmerhale.com
202 663 6987

Jay Holtmeier
jay.holtmeier@wilmerhale.com
212 295 6413

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