



Avoiding the Next D&O Liability Disaster: FCPA Prosecutions ¹

By Priya Cherian Huskins, Esq.

“Don’t ask, don’t tell” is not a winning strategy when it comes to compliance with the Foreign Corrupt Practices Act (FCPA). Both public and private companies need a more hands-on approach, and urgently so.

There are numerous reports in the press of the increased scrutiny that the United States Department of Justice and the Securities and Exchange Commission are bringing to FCPA issues. The government has in its crosshairs the question of whether businesses are complying with the FCPA’s laws against bribing foreign officials. Of particular concern is an emerging focus by the SEC on holding individual officers personally liable for failing to implement proper internal controls designed to prevent FCPA violations. Putting further pressure on companies in this regard is the renewed interest jurisdictions outside of the United States have in enforcing their own FCPA-like laws. Finally—and notwithstanding the fact that the FCPA creates no private right of action—the civil plaintiffs’ bar has started to experiment with ways to use FCPA investigations and prosecutions to bolster securities class action law suits against companies and their directors and officers. Derivative suits cannot be far behind.

Directors and officers will best serve their shareholders and protect themselves and their companies by assessing their FCPA-related risks and putting into place procedures and internal controls designed to mitigate these risks. Companies that take these steps may still find themselves faced with a violation of the FCPA. However, when deciding whether to indict the company or only pursue the individual employees

involved in the violation, regulators often consider the efforts a company undertook to prevent the violation. Regulators also take these same efforts into account when considering the quantum of penalties to be imposed on companies for violations.

Broadly, a company should pursue a dual course of preventative training and proactive monitoring; it should train employees to avoid FCPA violations in the first place and then should actively audit compliance with company FCPA policies. It is the role of the company’s directors and officers to ensure that the company has put in place adequate measures. Here are some inquiries that a company’s directors and officers can undertake to gauge whether their company has in place appropriate measures to address the company’s FCPA risk.

TRAINING

1. *What is the tone at the top?*

To set the proper tone, a company should consider having its senior officers lead employee training sessions. Senior officers should be front and center when it comes to instructing employees and other agents of the company on how to comply with the FCPA. In addition, a senior officer should be the designated FCPA compliance officer.

2. *Is the written FCPA Policy practical and specific?*

A company’s FCPA policy—which can be a stand alone policy or can be contained within a company’s Code of Business Ethics or Conduct—should contain practical and specific examples of what is expected of employees. Soft, abstract language that does little more than advance generic platitudes (“We are a company of high ethical standards”) is not helpful to an employee who is scouring the policy in the hope of finding guidance on his particular FCPA-related dilemma. The company should provide additional guidance for employees doing business in jurisdictions where local business norms are less than conducive to compliance with the FCPA.

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¹ *The initial research and another paper addressing this topic by Priya Cherian Huskins were first developed in connection with the Stanford Law Review’s 2008 Annual Symposium titled “New Directions in Corporate Governance.”*

3. *Has the company focused its FCPA training efforts on the most likely areas of risk?*

Many companies find themselves doing business in a wide variety of countries. A company should spend proportionately more effort training individuals who conduct company business in countries that score high on various corruption indices, such as the Corruptions Perceptions Index maintained by Transparency International. In addition, a company should consider which of its employees are likely to be in a position to be solicited for a bribe. For example, to the extent that only a select number of the company's sales force has the authority to commit funds, the company should direct proportionately more effort training these individuals than the sales force at large. Of course, even less-at-risk personnel still need some training on FCPA issues.

4. *Is FCPA training mandatory, and is that training periodically updated?*

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

5. *Is there an obvious and easy way for an individual to obtain guidance from the company on complying with the FCPA?*

Although written policies and training are important, no amount of policy writing or employee training can cover every eventuality faced by employees in the field. Coupling FCPA training with employee access to immediate guidance on the specific FCPA-related issues that they may face is much more effective than providing training alone. Employees should have access to a central hotline or a chief compliance officer. Ideally, employees should be able to get assistance on an anonymous basis if they so desire.

What is the FCPA?

The Foreign Corrupt Practices Act was first passed in 1977. The FCPA fundamentally stands for the proposition that— notwithstanding local customs or business pressures to the contrary—U.S. businesses and U.S. persons should not bribe foreign officials or foreign political parties.

The FCPA's provisions are broadly written. They include both anti-bribery provisions and accounting provisions. The anti-bribery provisions prohibit public companies from using bribes to secure an "improper advantage." To stop companies from hiding behind the bribing activities of third parties, the FCPA prohibits giving any person something of value "while knowing that all or a portion of such money or thing of value will be offered" for a bribe. Although there are some limited exceptions to these broad prohibitions— such as if the payment in question is legal in the foreign jurisdiction involved—these exceptions are narrowly tailored. Relying on these exceptions without very careful and thorough legal counsel is extremely risky.

The accounting provisions of the FCPA mandate that companies maintain internal controls that will result in their books and records accurately reflecting all transactions. This is to stop companies from maintaining off-the-books slush funds and turning a blind eye to them.

The penalties for violations of the FCPA can be significant. In 2007 companies saw record fines and penalties imposed by the SEC and the DOJ on companies for violations of the FCPA. For example, consider the \$44 million settlement that the SEC and the DOJ announced with Baker Hughes, Inc. in April 2007. This settlement included \$23 million in disgorgement and pre-judgment interest paid to the SEC, a \$10 million civil fine penalty paid to the SEC for violating an earlier SEC cease-and-desist order, and an \$11 million criminal fine. The Baker Hughes settlement is the largest penalty ever imposed in an FCPA case. Other large settlements in 2007 include the \$30 million in combined fines and penalties that Chevron Corporation paid to settle its FCPA investigation, the \$26 million that subsidiaries of Vetco International, Ltd. paid, and a \$22 million settlement paid by York International Corporation.

Penalties can also fall on individuals. Under the FCPA, any person who is an "officer, director, employee or agent" of a company in violation of the FCPA—if that violation is willful—may be faced with a penalty of up to 5 years in jail and \$100,000. Books and records violations can garner more severe criminal penalties, and the SEC has the ability to impose even larger civil fines. Moreover, the SEC has recently pursued some individuals not just for making bribes themselves, but also for failing to implement proper internal controls that would have prevented FCPA violations.

MONITORING

1. *What is the control environment in remote offices?*

Deciding that an office is too small to implement internal controls may create an unintended opportunity for a FCPA violation. All foreign offices and subsidiaries of a company should operate in a rigorous control environment characterized by a high degree of personal accountability and visibility into financial transactions. In addition, periodic audits directed at FCPA issues are appropriate. It is through these audits that red flags can be revealed, red flags such as unusually loose credit terms or unusual payments to offshore holding companies.

2. *What background checks or other verifications are done before third-party agents are hired to do business on behalf of the company?*

There is nothing wrong with hiring local agents to facilitate business in a foreign jurisdiction as long as the company is comfortable that its agents are not violating the FCPA. A company should follow a specific approval process for the hiring of new agents. In addition to background checks, consider having the agents execute contracts in which they specifically agree not to conduct themselves in a way that would violate the FCPA.² The contract might also include requirements for periodic certifications and audit rights.

3. *What does the company do to ensure that it understands the government affiliations of everyone with whom it is doing business?*

A company can inadvertently find itself in the position of seeming to have provided a governmental official

² For more on this concept, see Philip Urofsky, *Promoting Global Corporate Transparency*, *eJournal USA*, December 2006 (<http://usinfo.state.gov/journals/itdhr/1206/ijde/urofsky.htm>).

³ *ibid*

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Questions? Comments? Your feedback and insights on the issues raised in this article are welcome and appreciated.

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with an improper benefit when the company thought it had merely entered into an arms-length transaction with a third party. This can happen when a company does not realize that the third party with whom it is doing business is affiliated with or employed by a business organization that is in fact partially or wholly owned by a government entity, an ownership structure that is quite common in a large number of business organizations around the world. One way to avoid this issue is to ask third-parties to identify the specifics of their ownership, and then confirm this information through other sources.³

4. *Is M&A diligence specifically concerned with uncovering potential FCPA risks of target companies?*

The risk of FCPA compliance must be added to the list of the risks considered when deciding whether to acquire another company. As a buyer, the last thing a company wants to do when purchasing another company is unknowingly to assume the selling company's FCPA-related liabilities—both civil and criminal. These potential liabilities must be discovered during the due diligence process. Since any serious buyer is going to conduct a thorough FCPA-compliance review of a proposed acquisition target, companies that may be acquired are well-served by making inquiries into their own compliance before buyers do. It is clearly better to be certain about the outcome of such a compliance review than to be surprised into having to self-report unexpected due diligence findings to the government.

OUT IN FRONT ON THE ISSUE

Given the reality of international commerce, few modern companies are immune from the risk of violating the FCPA. Moreover, in light of aggressive enforcement of the FCPA, examining a company's FCPA compliance procedures is an urgent task. By proactively taking the foregoing measures, directors and officers can help their companies—and themselves—substantially mitigate these risks.