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## No Smoke and No Fire: The Rise of Internal Controls Absent Anti-Bribery Violations in FCPA Enforcement

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## NO SMOKE AND NO FIRE: THE RISE OF INTERNAL CONTROLS ABSENT ANTI-BRIBERY VIOLATIONS IN FCPA ENFORCEMENT

Karen E. Woody<sup>†</sup>

*The Foreign Corrupt Practices Act (FCPA) prohibits bribery of foreign public officials in order to obtain or retain business. It is, for all intents and purposes, an anti-bribery statute. To detect bribery, the FCPA contains accounting provisions related to bookkeeping and internal controls. The books and records provision requires issuers to make and maintain accurate books, records, and accounts; likewise, the internal controls provision requires that issuers devise and maintain reasonable internal accounting controls aimed at preventing and detecting FCPA violations. If one considers the analogy that bribery is the “fire” in FCPA enforcement actions, and books and records violations are the “smoke,” internal controls are the “smoke detectors.”*

*The government is increasingly punishing, or threatening to punish, companies for the potential ineffectiveness of these “smoke detectors.” Internal controls violations arguably are not substantive violations, but instead are violations arising out of the potential for other violations. The recent increase in the number of enforcement actions alleging violations of the internal controls provision in the absence of any correlating anti-bribery provision violations suggests that enforcement of the Act has (d)evolved to a place well beyond its stated purpose. Additionally problematic is that the internal controls required by the FCPA are not a fixed standard but instead a fairly ambiguous set of recommendations and guidelines that depend on the characteristics of each company and industry. The result of this is overcriminalization and overenforcement of the statute by the government, and overcompliance by the private sector. This Article addresses the alarming shift in the interpretation of the breadth of the statute by the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ), and discusses the vast theoretical ramifications of this overcriminalization and overenforcement.*

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## INTRODUCTION

Consider the following increasingly common scenario. You are a young partner at a large law firm. Your client is a multinational company, headquartered in the United States but with numerous subsidiaries around the globe. Nearly five years ago, you helped the

company establish a rigorous anti-corruption compliance program, complete with an anti-corruption hotline, risk assessment matrices by geographical area, and anti-corruption policies available in every language in which the company transacts around the world. You personally have delivered training sessions for the company executives on anti-corruption measures, and established company-wide training modules that every employee, regardless of rank, must complete quarterly. Recently, the company has informed you that the SEC has inquired about a particular shipping contract between your Kazakh subsidiary and the customs agent at a port in Russia. You mobilize an army of attorneys to engage in a full-scale investigation into the contract. The company, per its anti-corruption policies, has already done extensive due diligence on the customs agent prior to entering the contract. Nevertheless, you and your associates perform interviews of every employee involved in the contract, from the CEO of the subsidiary down to the employees off-loading containers at the port. Thousands of attorney hours are spent hunting down any possible soupcon of bribery or potential slush fund, and the company spends millions in attorneys' fees ensuring that every rock is overturned. The company takes great pains to be sure that it complies with every government request, both for documents and availability of employees for interviews. After a multi-year investigation, you discover the terms and the performance of the contract at issue are legitimate. No bribes have been made; no slush funds created. Despite the enormous fees associated with the investigation, the company executives are pleased to find that there is no malfeasance occurring.

The SEC, for its part, agrees with your law firm's investigation's findings. Your firm closes the books on another investigation, satisfied that it met its legal duty to your client. A few months later, however, the SEC calls to tell you that your client will be facing internal controls violations. Baffled that you are receiving this call rather than a no-action letter from the agency, you ask what the basis for the allegation is. The Enforcement Division attorney explains that there *could* have been some books and records, or even bribery, issues in the company's Kazakh subsidiary. After all, she explains, it took years to determine that there were *not* any, and that fact alone gave the regulator some pause. In other words, the agency concedes that the company did not engage in any bribery, nor did it have any books and records inaccuracies. Its internal controls, however, were not as robust as they likely should have been. She begins to suggest days to have you and the client come in to discuss next steps.

The above scenario is becoming increasingly common, and provides a troubling example of routine overextension of the FCPA beyond its original breadth and purpose. Although much ink has been

spilled in the academic literature on the FCPA,<sup>1</sup> including debate over whether the statute as a whole is overenforced,<sup>2</sup> this Article's contribution to the literature is that it critiques the enforcement of the internal controls provision of the Act *in isolation*, analyzing the very recent trend in enforcement of the internal controls provision absent anti-bribery violations.

This Article explores the purpose of the internal controls provision, highlights the recent enforcement actions that have included an internal controls charge absent a bribery charge, and discusses the threat of broader internal controls prosecutions against companies and individuals. Part I details the history of the statute and the modern rise in enforcement actions since 2000. In Part II, this Article outlines three recent enforcement actions for violations of only the accounting provisions of the FCPA, underscoring the real cause for concern in the overenforcement and the broad reading of the statute by the government regulators. In Part III, this Article addresses the theoretical problems with overenforcement of the statute, leading to both overcompliance and overcriminalization that stray from the original purposes of the Act. In addition, this Part discusses that the lack of any standard for internal controls allows for a lack of uniformity in both investigating violations and enforcing punishment. Finally, Part IV discusses the future of FCPA enforcement in light of this growing trend of overcriminalization and overenforcement of the statute beyond its original intent.

## I. HISTORY OF THE FCPA

In 1977, Congress passed the FCPA,<sup>3</sup> aimed at eradicating bribery occurring overseas for the purpose of obtaining business. Specifically, the FCPA prohibits the corrupt use of the mail or any other instrumentality of interstate commerce in furtherance of any offer, payment, promise to pay, or authorization of the payment of money or any other thing of value to any person, knowing that all or some of the payment will be offered, given or promised, directly or indirectly, to a

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<sup>1</sup> See, e.g., Priya Cherian Huskins, *FCPA Prosecutions: Liability Trend to Watch*, 60 STAN. L. REV. 1447 (2008); Mike Koehler, *The Uncomfortable Truths and Double Standards of Bribery Enforcement*, 84 FORDHAM L. REV. 525 (2015); Steven R. Salbu, *Bribery in the Global Market: A Critical Analysis of the Foreign Corrupt Practices Act*, 54 WASH. & LEE L. REV. 229 (1997). These are just a few of the many exceptional pieces discussing various aspects of the FCPA.

<sup>2</sup> See, e.g., Joseph W. Yockey, *Choosing Governance in the FCPA Reform Debate*, 38 J. CORP. L. 325 (2013).

<sup>3</sup> Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended 15 U.S.C. §§ 78dd-1 to -3 (2012)).

foreign official to influence or induce the foreign official to either commit an act in violation of his or her lawful duty, or to secure an improper advantage in obtaining or retaining business.<sup>4</sup> In addition to the anti-bribery provision, the FCPA also includes accounting provisions. Among the FCPA accounting provisions, the books and records provision requires issuers to make and maintain accurate books, records, and accounts.<sup>5</sup> Likewise, the internal controls provision requires that issuers devise and maintain reasonable internal accounting controls aimed at preventing and detecting FCPA violations.<sup>6</sup> The Department of Justice (DOJ) and the SEC jointly enforce both the anti-bribery and the accounting provisions.

### A. Legislative History

The impetus for this legislation was that in the wake of the Watergate scandal, the SEC set out to investigate questionable corporate payments that were often disguised on the corporate books and records.<sup>7</sup> As a result of its extensive “questionable payments” investigation, the SEC discovered over 400 companies had made questionable payments totaling over \$300 million to foreign officials.<sup>8</sup> Notably, the SEC was chiefly concerned with the accuracy of the corporate books and records, rather than the fact that the payments went to foreign officials.<sup>9</sup> In its summary of the investigation, the SEC proposed legislation aimed at shoring up corporate accountability, but declined to address the issues of foreign corruption or bribery. Specifically, the SEC suggested that Congress pass legislation that would (1) prohibit the falsification of corporate books and records, (2) prohibit corporate executives and agents from making false or misleading

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<sup>4</sup> 15 U.S.C. §§ 78dd-1(a), -2(a).

<sup>5</sup> Securities Exchange Act of 1934 § 13(b)(2)(A), 15 U.S.C. § 78m(b)(2)(A).

<sup>6</sup> Securities Exchange Act of 1934 § 13(b)(2)(B), 15 U.S.C. § 78m(b)(2)(B).

<sup>7</sup> See Stanley Sporkin, *The Worldwide Banning of Schmiergeld: A Look at the Foreign Corrupt Practices Act on Its Twentieth Birthday*, 18 NW. J. INT’L L. & BUS. 269 (1998); see also Mike Koehler, *The Story of the Foreign Corrupt Practices Act*, 73 OHIO ST. L.J. 929 (2012). Sporkin stated that as he watched the Watergate scandal unfold on television, he wondered how the corporations involved put the illegal payments on their books and records. Sporkin, *supra* at 271. As then-Commissioner of the SEC, Sporkin set out to investigate the breadth of potentially illegal corporate payments. *Id.*

<sup>8</sup> See Daniel Patrick Ashe, Comment, *The Lengthening Anti-Bribery Lasso of the United States: The Recent Extraterritorial Application of the U.S. Foreign Corrupt Practices Act*, 73 FORDHAM L. REV. 2897, 2902–03 (2005).

<sup>9</sup> STAFF OF S. COMM. ON BANKING, HOUS. & URBAN AFFAIRS, 94TH CONG., REP. OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES, at b (Comm. Print 1976) (“[T]he primary thrust of our actions has been to restore the efficacy of the system of corporate accountability . . .”).

statements to auditors, and (3) mandate that corporate management establish and maintain adequate accounting controls such that corporate transactions are properly recorded.<sup>10</sup>

The Senate Report sparking the FCPA, however, explains that foreign policy was the primary *congressional* reason for the passage of the FCPA.<sup>11</sup> Specifically, the Senate Report stated:

Bribery of foreign officials by U.S. corporations . . . creates severe foreign policy problems. The revelations of improper payments invariably tends to embarrass friendly regimes and lowers the esteem for the United States among the foreign public. It lends credence to the worse suspicions sown by extreme nationalists or Marxists that American businesses operating in their country have a corrupting influence on their political systems. It increases the likelihood that when an angry citizenry demands reform, the target will be not only the corrupt local officials, but also the United States and U.S. owned business.

Bribery by U.S. companies also undermines the foreign policy objective of the United States to promote democratically accountable governments and professionalized civil services in developing countries.<sup>12</sup>

In addition to foreign policy concerns, congressional members expressed the need for better business ethics, and a sense of morality in foreign corporate transactions.<sup>13</sup> In other words, there was a motivation among legislators that the United States should be a global leader in prohibiting corruption.<sup>14</sup> Representative Solarz stated during the 1975 House hearing on the FCPA that

what is at stake here is really, in a number of significant respects, the reputation of our own country, and I think that we have an obligation to set a standard of honesty and integrity in our business dealings not only at home but also abroad which will be a beacon for the light of integrity for the rest of the world.<sup>15</sup>

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<sup>10</sup> *Id.* at 58–59.

<sup>11</sup> S. REP. NO. 94-1031, at 3–4 (1976); *see also* Karen E. Woody, *Securities Laws as Foreign Policy*, 15 NEV. L.J. 297, 305–06 (2014).

<sup>12</sup> S. REP. NO. 94-1031, at 3–4.

<sup>13</sup> *See* Koehler, *supra* note 7. Koehler outlines the pressures and motivations of congressional members prior to the FCPA enactment, and highlights the different aims of the SEC, DOJ, Congress, and the State Department with respect to the statute. *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 943–44 (citing *The Activities of American Multinational Corporations Abroad: Hearings Before the Subcomm. on Int'l Econ. Policy of the H. Comm. on Int'l Relations*, 94th Cong. 35 (1975) (statement of Rep. Stephen J. Solarz, Member, Subcomm. on Int'l Econ. Policy of the H. Comm. on Int'l Relations)).

In other words, the primary goal and original intent of the FCPA was prevention of bribery abroad. Transparency of corporate books and records is the *means* by which companies assure that foreign bribery is not occurring. Internal controls, in tandem with transparent books and records, are meant to ensure that bribery will not and cannot occur. As will be explored in more depth below, the enforcement of the Act seems to have evolved to a place where enforcement of the accounting provisions in the absence of any bribery, or threat of bribery, has taken center stage. This evolution of prosecutorial methods and enforcement actions is troubling on a theoretical, procedural, and practical level.

### B. *The Evolution of SEC Enforcement of FCPA Violations*

Although enacted in 1977, the FCPA was a very sleepy statute—in terms of enforcement—until the 2000s. From its enactment in 1977 until 2001, the SEC brought only nine enforcement actions under the FCPA.<sup>16</sup> Since those original cases, the FCPA industry, which includes both regulators and defense counsel, has enjoyed a boom that to date has not waned. In 2001 alone, the SEC brought five enforcement actions, including one administrative proceeding.<sup>17</sup> In 2007, as an example, the SEC's enforcement actions under the FCPA rose to eighteen.<sup>18</sup> In 2010, the SEC created a specialized unit in its Enforcement Division, devoted solely to FCPA matters.<sup>19</sup> Likewise, in 2010, the agency brought fifteen enforcement actions.<sup>20</sup> The number of enforcement actions per year has remained at least eight every year since.<sup>21</sup>

The fines associated with FCPA violations rose as quickly as the number of enforcement actions. The largest fine associated with an

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<sup>16</sup> See *SEC Enforcement Actions: FCPA Cases*, U.S. SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml> (last visited Jan. 12, 2016). Note that this list includes only the SEC enforcement actions and not the parallel DOJ proceedings that occurred in many of these cases.

<sup>17</sup> *Id.* The administrative proceeding was brought against Chiquita Brands International. *Id.* Two major cases in 2001 included KPMG Siddharta Siddharta & Harsono, and Baker Hughes Incorporated. *Id.* The SEC brought follow-on actions against individuals in both of these matters. *Id.*

<sup>18</sup> *Id.* These cases included three administrative proceedings against Dow Chemical, Co., Delta & Pine Land Co. (and Turk Deltapine, Inc.), and Gioacchino De Cherico & Immucor, Inc.

<sup>19</sup> Press Release, U.S. Sec. & Exch. Comm'n, SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence (Jan. 13, 2010), <https://www.sec.gov/news/press/2010/2010-5.htm>.

<sup>20</sup> See *SEC Enforcement Actions: FCPA Cases*, *supra* note 16.

<sup>21</sup> *Id.*



FCPA enforcement action was for \$800 million, and was levied against Siemens Aktiengesellschaft in 2008.<sup>22</sup> The following six largest fines are as follows: \$772 million against Alstom (2014);<sup>23</sup> \$579 million against KBR/Halliburton (2009);<sup>24</sup> \$519 million against Teva Pharmaceuticals Industries Ltd. (2016);<sup>25</sup> \$419 million against Braskem/Odebrecht (2016);<sup>26</sup> \$412 million against Och-Ziff (2016);<sup>27</sup> and \$400 million against BAE (2010).<sup>28</sup> These amounts represent the aggregate of fines and penalties paid to both the DOJ and SEC.

Just as the number of enforcement actions and the fines associated with them have risen, so too have enforcement actions that allege violations of only the accounting provisions, which include the books and records provision and the internal controls provision.<sup>29</sup> Since 2010, the percentage of enforcement actions that did not allege or find anti-bribery violations has hovered near fifty percent.<sup>30</sup> In 2011, eight out of the thirteen FCPA enforcement actions did not find, or even allege, anti-

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<sup>22</sup> SEC Files Settled Foreign Corrupt Practices Act Charges Against Siemens AG, Accounting & Auditing Enforcement Act Release No. 2911, 94 SEC Docket 2869 (Dec. 15, 2008); *see also* Complaint, SEC v. Siemens Aktiengesellschaft, No. 08-cv-02167 (D.D.C. Dec. 12, 2008) [hereinafter *Siemens Complaint*]; Richard L. Cassin, *Och-Ziff Takes Fourth Spot on Our New Top Ten List*, FCPA BLOG (Oct. 4, 2016, 8:28 AM), <http://www.fcpablog.com/blog/2016/10/4/och-ziff-takes-fourth-spot-on-our-new-top-ten-list.html>.

<sup>23</sup> Press Release, U.S. Dep't of Justice, Alstom Pleads Guilty and Agrees to Pay \$772 Million Criminal Penalty to Resolve Foreign Bribery Charges (Dec. 22, 2014), <https://www.justice.gov/opa/pr/alstom-pleads-guilty-and-agrees-pay-772-million-criminal-penalty-resolve-foreign-bribery>.

<sup>24</sup> SEC Charges KBR, Inc. with Foreign Bribery; Charges Halliburton Co. and KBR, Inc. with Related Accounting Violations, Accounting & Auditing Enforcement Act Release No. 2935A, 95 SEC Docket 570 (Feb. 11, 2009).

<sup>25</sup> Press Release, U.S. Dep't of Justice, Teva Pharmaceutical Industries Ltd. Agrees to Pay More than \$283 Million to Resolve Foreign Corrupt Practices Act Charges (Dec. 22, 2016), <https://www.justice.gov/opa/pr/teva-pharmaceutical-industries-ltd-agrees-pay-more-283-million-resolve-foreign-corrupt>.

<sup>26</sup> Press Release, U.S. Dep't of Justice, Odebrecht and Braskem Plead Guilty and Agree to Pay at Least \$3.5 Billion in Global Penalties to Resolve Largest Foreign Bribery Case in History (Dec. 21, 2016), <https://www.justice.gov/opa/pr/odebrecht-and-braskem-plead-guilty-and-agree-pay-least-35-billion-global-penalties-resolve>. This total amount listed in the press release includes payments to Brazilian and Swiss authorities.

<sup>27</sup> Och-Ziff Capital Management Group L.L.C., Exchange Act Release No. 78989, 2016 WL 5461964 (Sept. 29, 2016); Richard L. Cassin, *Och-Ziff Settles with SEC, DOJ for \$412 Million*, FCPA BLOG (Sept. 29, 2016, 3:28 PM), <http://www.fcpablog.com/blog/2016/9/29/och-ziff-settles-with-sec-doj-for-412-million.html>.

<sup>28</sup> Press Release, U.S. Dep't of Justice, BAE Systems PLC Pleads Guilty and Ordered to Pay \$400 Million Criminal Fine (Mar. 1, 2010), <https://www.justice.gov/opa/pr/bae-systems-plc-pleads-guilty-and-ordered-pay-400-million-criminal-fine>.

<sup>29</sup> *See The SEC Frequently Alleges or Finds Only Books and Records and Internal Controls Violations in FCPA Enforcement Actions*, FCPA PROFESSOR (June 11, 2015), <http://www.fcpaprofessor.com/the-sec-frequently-alleges-or-finds-only-books-and-records-and-internal-controls-violations-in-fcpa-enforcement-actions>.

<sup>30</sup> *Id.*

bribery violations.<sup>31</sup> Similarly, in 2012, four of the eight SEC enforcement actions fell into this category.<sup>32</sup> In 2013, three out of the eight enforcement actions did not allege or find anti-bribery violations, and in 2014, three out of seven did not.<sup>33</sup> 2015 saw a decrease in DOJ corporate criminal actions, but a relatively stable level of SEC enforcement actions.<sup>34</sup> Given that the FCPA is an anti-bribery statute, the rise of enforcement actions without associated bribery charges is a troubling metric.<sup>35</sup>

Of course, the statutory structure of the FCPA allows the government to take such an aggressive action in the absence of anti-bribery violations. Structurally, the internal controls provisions of the Act are independent of the anti-bribery provisions, and independent of the books and records provision.<sup>36</sup> Thus, because there is no requirement that a deficient control be linked to an improper payment, a payment that does not constitute a violation of the anti-bribery provisions still may lead to prosecution if it is attributable to an internal controls deficiency. This phenomenon is addressed below.

## II. THE MODERN RISE OF THE INTERNAL CONTROLS CHARGE

### A. Definition of “Internal Controls”

How exactly does the FCPA define internal controls? Interestingly, the statute does not provide a strict definition but instead mandates that every issuer of publicly traded securities is required to file periodic reports with the SEC and devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

1. “transactions are executed in accordance with management’s general or specific authorization;”

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<sup>31</sup> *Id.* Those enforcement actions included Aon, Watts Water, Diageo, Comverse, Rockwell Automation, Ball Corp., IBM, and Tenaris. *Id.*

<sup>32</sup> *Id.* These were Allianz, Oracle, Pfizer, and Orthofix. *Id.*

<sup>33</sup> *Id.* In 2013, these actions included ADM, Stryker, and Philips Electronics; in 2014, these included Avon, Bruker, and HP. *Id.*

<sup>34</sup> See *FCPA Resolutions Hit Nine Year Low*, CORP. CRIME REP. (Feb. 9, 2016, 2:50 PM), <http://www.corporatecrimereporter.com/news/200/fcpa-resolutions-hit-ten-year-low> (noting that although the DOJ’s criminal actions decreased in 2015, the SEC’s enforcement levels have remained relatively stable).

<sup>35</sup> See discussion and related footnotes *infra* Section II.B.

<sup>36</sup> Exchange Act section 13b(2)(A) is a separately chargeable provision from section 13b(2)(B). 15 U.S.C. § 78m(b)(2)(A)–(B) (2012).

2. "transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets;"
3. "access to assets is permitted only in accordance with management's general or specific authorization; and"
4. "the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences."<sup>37</sup>

Further, according to the statute, "[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account" described above.<sup>38</sup> Knowing violations of the statute can result in criminal liability.<sup>39</sup> For civil liability under the SEC enforcement regime, there is no scienter requirement.<sup>40</sup>

As will be discussed in depth below, there is a paucity of information regarding what constitutes sufficient internal controls. In the only judicial decision to date to discuss the provision in-depth, the court stated:

The definition of accounting controls does comprehend reasonable, but not absolute, assurances that the objectives expressed in it will be accomplished by the system. The concept of "reasonable assurances" contained in [internal control provisions] recognizes that the costs of internal controls should not exceed the benefits expected to be derived. It does not appear that either the SEC or Congress, which adopted the SEC's recommendations, intended that the statute should require that each affected issuer install a fail-safe accounting control system at all costs. It appears that Congress was fully cognizant of the cost-effective considerations which confront companies as they consider the institution of accounting controls and of the subjective elements which may lead reasonable individuals to arrive at different conclusions. Congress has demanded only that judgment be exercised in applying the standard of reasonableness. . . . It is also true that the internal accounting controls provisions contemplate the financial principle or proportionality—what is material to a small company is not necessarily material to a large company.<sup>41</sup>

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<sup>37</sup> 15 U.S.C. § 78m(b)(2)(B).

<sup>38</sup> *Id.* § 78m(b)(5).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* § 78m(b)(4).

<sup>41</sup> SEC v. World-Wide Coin Invs., 567 F. Supp. 724, 751 (N.D. Ga. 1983).

The concepts of reasonableness and proportionality are paramount to any discussion regarding the internal controls provision and the correlating fines for violations of the provision. In fact, reasonableness is the standard Congress adopted when assessing the adequacy of internal controls, rather than requiring an evaluation of materiality.<sup>42</sup> In the 1988 Amendments to the Act, Congress clarified that “reasonable assurances” should be defined as “such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs.”<sup>43</sup> Also included in the 1988 Amendments was the “prudent man” standard “in order to clarify that the current standard does not connote an unrealistic degree of exactitude or precision.”<sup>44</sup>

B. *Internal Controls Violations Without Related Anti-Bribery Charges: “Non-FCPA FCPA Enforcement Actions”*<sup>45</sup>

Enforcement of the FCPA that does not include an anti-bribery charge is often considered a “non-FCPA FCPA enforcement action.”<sup>46</sup> In other words, enforcement of the statute without charging any anti-bribery violation is not an action that is eradicating or punishing foreign bribery. As noted above, these types of enforcement actions are on the rise. This Section will highlight three notable SEC enforcement actions that suggest that the agency is moving toward enforcement of the internal controls provisions, both in the absence of anti-bribery violations and without being an add-on to a blatant books and records violation.

1. *BHP Billiton*

In the *BHP Billiton* (BHPB) administrative proceeding in 2015, the SEC secured a \$25 million fine at the end of a six-year investigation.<sup>47</sup>

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<sup>42</sup> See H. Lowell Brown, *Extraterritorial Jurisdiction Under the 1998 Amendments to the Foreign Corrupt Practices Act: Does the Government’s Reach Now Exceed Its Grasp?*, 26 N.C. J. INT’L L. & COM. REG. 239, 253 (2001).

<sup>43</sup> Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, § 5002, 102 Stat. 1107 (codified as amended at 15 U.S.C. § 78m(b)(7)).

<sup>44</sup> H.R. REP. NO. 100-576, at 917 (1988) (Conf. Rep.), as reprinted in 1988 U.S.C.C.A.N. 1547, 1950.

<sup>45</sup> Mike Koehler, *Same Alleged Legal Violations, Yet Materially Different Sanctions*, FCPA PROFESSOR (Sept. 28, 2015), <http://www.fcpaprofessor.com/same-alleged-legal-violations-yet-materially-different-sanctions>.

<sup>46</sup> *Id.*

<sup>47</sup> BHP Billiton Ltd., Exchange Act Release No. 74998, 2015 WL 2393657, at \*9 (May 20, 2015); see also Mike Koehler, *Issues to Consider from the Recent BHP Billiton Enforcement*

The enforcement action centered around the corporate hospitality offered to foreign dignitaries during the 2008 Beijing Olympics.<sup>48</sup> The SEC Press Release summarized the allegations as follows:

[BHPB] failed to devise and maintain sufficient internal controls over its global hospitality program connected to the company's sponsorship of the 2008 Summer Olympic Games in Beijing. BHP Billiton invited 176 government officials and employees of state-owned enterprises to attend the Games at the company's expense, and ultimately paid for 60 such guests as well as some spouses and others who attended along with them. Sponsored guests were primarily from countries in Africa and Asia, and they enjoyed three- and four-day hospitality packages that included event tickets, luxury hotel accommodations, and sightseeing excursions valued at \$12,000 to \$16,000 per package.<sup>49</sup>

BHPB, for its part, was aware of the bribery risks in China, and, in particular, those related to the Olympic hospitality, as is evident by the strides the company took to prevent bribery. As such, the company created a detailed compliance program to address the risks.<sup>50</sup> The compliance program included a survey that each BHPB employee had to fill out for each invitee to any BHPB events.<sup>51</sup> The survey included questions about the existing or expected business with the invitee, whether the invitation carried with it an appearance of impropriety, and whether the invitee was in a position to influence existing or potential business with BHPB, among others.<sup>52</sup> A memorandum that referenced the company's anti-bribery policies and the corporate Guide to Business Conduct accompanied the survey.<sup>53</sup> The surveys had to be approved either by the relevant BHPB group or country president.<sup>54</sup> Further, BHPB established an Ethics Panel to provide employees with advice regarding the invitations.<sup>55</sup>

Despite these compliance efforts and preventative internal controls, the SEC cited a number of reasons why these aforementioned controls were insufficient to address the risks associated with the expensive travel and entertainment packages offered by BHPB during the Beijing

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Action, FCPA PROFESSOR (May 27, 2015), <http://fcpaprofessor.com/issues-to-consider-from-the-recent-bhp-billiton-enforcement-action>.

<sup>48</sup> *BHP Billiton*, 2015 WL 2393657, at \*1.

<sup>49</sup> Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges BHP Billiton with Violating FCPA at Olympic Games (May 20, 2015), <http://www.sec.gov/news/pressrelease/2015-93.html>.

<sup>50</sup> *Id.*; *BHP Billiton*, 2015 WL 2393657, at \*4.

<sup>51</sup> *BHP Billiton*, 2015 WL 2393657, at \*4.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* at \*5.

Olympics. First, the SEC noted that BHPB did not require independent legal or compliance review of the hospitality application forms outside of the business group submitting the invitation.<sup>56</sup> Second, some hospitality applications were either inaccurate or incomplete.<sup>57</sup> Third, although BHPB had an annual Guide to Business Conduct review and certification process, as well as general training, it did not provide specific training regarding how to fill out the hospitality forms, or training on how to evaluate whether an invitation complied with the Guide.<sup>58</sup> Fourth, BHPB did not institute a process for updating the hospitality applications if the conditions changed vis-à-vis the government official invited.<sup>59</sup> Finally, the hospitality applications were filled out by individual groups within BHPB and circulated to senior managers, but there was no process to determine whether the invitee had business with another group of BHPB.<sup>60</sup> Based on this, the SEC found that the company's "books and records," namely, the Olympic hospitality applications, "did not, in reasonable detail, accurately and fairly reflect pending negotiations or business dealings between BHPB and government officials invited to the Olympics."<sup>61</sup>

The fact that the SEC could not point to any bribery, or any contract or business gained as a result of bribery, was not the biggest take-away from the *BHPB* enforcement action. What was novel about the *BHPB* enforcement action is that the books and records violation seemed to be an add-on to the internal controls violation, rather than the other way around (as is typical for most FCPA actions). In other words, it is easier for an SEC enforcement attorney to find an accounting misrepresentation and add on an internal controls violation by the principles inherent in the theory of *res ipsa loquitur*.<sup>62</sup> Meaning, if an accounting misrepresentation occurred, there clearly was not an internal control that prevented or detected it.<sup>63</sup> In the *BHPB* case,

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<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at \*6.

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at \*9.

<sup>62</sup> *Res ipsa loquitur*, BLACK'S LAW DICTIONARY (9th ed. 2009) ("The doctrine providing that, in some circumstances, the mere fact of an accident's occurrence raises an inference of negligence that establishes a prime facie case.").

<sup>63</sup> The Morgan Stanley Deferred Prosecution Agreement (DPA) was an exception to this theory. In that case, the DOJ and SEC declined to prosecute Morgan Stanley for internal controls despite charging a Morgan Stanley employee for violating the FCPA's bribery provisions, finding that the company had sufficient controls in place. See Press Release, U.S. Dep't of Justice, Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA (Apr. 25, 2012), <http://www.justice.gov/opa/pr/former-morgan-stanley-managing-director-pleads-guilty-role-evading-internal-controls-required>;

however, the alleged failing of an internal control system did not result in any accounting misrepresentations or falsified books.<sup>64</sup> Instead, the SEC seemingly tacked on a books and records violation by defining the Olympic hospitality forms as “records.” Moreover, this case also represented a company that *did have* significant internal controls after identifying a specific corruption risk. Nonetheless, the SEC determined that the company’s control system was not robust *enough*. The theoretical, procedural, and practical implications of this agency interpretation and action are vast and discussed in detail below.

## 2. Oracle

In 2012, the government took the novel position that knowledge of the absence of FCPA anti-bribery violations in a subsidiary is also considered a requirement of an internal controls program.<sup>65</sup> In *SEC v. Oracle Corp.*, the SEC charged Oracle with books and records and internal controls violations for failing to audit local distributors in its Indian subsidiary.<sup>66</sup> Specifically, the SEC alleged in its complaint:

On approximately 14 occasions related to 8 different government contracts between 2005 and 2007, certain Oracle India employees created extra margins between the end user and distributor price and directed the distributors to hold the extra margin in side funds. Oracle India’s employees made these margins large enough to ensure a side fund existed to pay third parties. At the direction of the Oracle India employees, the distributor then made payments out of the side funds to third parties, purportedly for marketing and development expenses. Some of the recipients of these payments were not on Oracle’s approved local vendor list; indeed, some of the third parties did not exist and were merely storefronts.

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Press Release, U.S. Sec. & Exch. Comm’n, SEC Charges Former Morgan Stanley Executive with FCPA Violations and Investment Adviser Fraud (Apr. 25, 2012), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171488702>.

<sup>64</sup> See, e.g., Lucinda A. Low & Tom Best, *Does SEC’s Enforcement Action Against BHP Billiton Take the FCPA’s Accounting Provisions Too Far?*, STEPTOE & JOHNSON L.L.P. (May 27, 2015), <http://www.steptoelaw.com/publications-10482.html>; Mark F. Mendelsohn et al., *SEC Extends Application of FCPA Accounting Provisions in BHP Billiton Enforcement Action*, PAUL WEISS (May 28, 2015), <https://www.paulweiss.com/media/2946569/28may15alert.pdf>.

<sup>65</sup> See Complaint at 5, *SEC v. Oracle Corp.*, No. 3:12-cv-04310 (N.D. Cal. Aug. 16, 2012) [hereinafter *Oracle Complaint*]. This case was settled for \$2 million. Press Release, U.S. Sec. & Exch. Comm’n, SEC Charges Oracle Corporation with FCPA Violations Related to Secret Side Funds in India (Aug. 16, 2012), <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171483848>.

<sup>66</sup> *Oracle Complaint*, *supra* note 65, at 1.

Because the Oracle India employees concealed the existence of the side fund, Oracle did not properly account for these side funds. These funds constituted prepaid marketing expenses incurred by Oracle India and should have been recorded as an asset and rolled up to Oracle's corporate books and records.<sup>67</sup>

Importantly, the government never contended that the local distributors were actually making any improper payments to foreign officials.<sup>68</sup> This is the reason that the SEC only charged books and records and internal controls violations—it did not find any evidence of actual bribery.<sup>69</sup> For the same reason, there was not a parallel DOJ investigation.

The *Oracle* case sent shockwaves across the FCPA landscape, particularly in the defense bar.<sup>70</sup> Although in 2005 the SEC had issued an enforcement action related to distributor margin, in that action the SEC alleged that the parent company was aware of the high probability that the margin was being used for improper purposes.<sup>71</sup> In the case of *Oracle*, the SEC did not allege that Oracle, as a parent company, even knew of the “side funds” that its Indian subsidiary had parked for payments to local distributors.<sup>72</sup> In this instance, however, the government used the parent's *lack of knowledge* as an indication that its internal controls were insufficient.<sup>73</sup> The SEC complaint made that clear:

Oracle lacked the proper controls to prevent its employees at Oracle India from creating and misusing the parked funds. For example, Oracle knew distributor discounts created a margin of cash from which distributors received payments for their services. Before 2009, however, the Company failed to audit and compare the

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<sup>67</sup> *Id.* at 3.

<sup>68</sup> *Id.*

<sup>69</sup> Amy L. Riella, Tirzah S. Lollar & Kevin M. Davis, *No Oracle Could Have Foreseen Oracle's FCPA Settlement*, LAW360 (Sept. 5, 2012, 12:08 PM), <https://www.law360.com/articles/375113/no-oracle-could-have-foreseen-oracle-s-fcpa-settlement>.

<sup>70</sup> See, e.g., Thomas Fox, *Are FCPA Books and Records and Internal Controls Defenses Becoming Obsolete?*, FCPA BLOG (Mar. 9, 2015, 7:02 AM), <http://www.fcpablog.com/blog/2015/3/9/are-fcpa-books-and-records-and-internal-controls-defenses-be.html>; Mike Koehler, *The Dilution of FCPA Enforcement Has Reached a New Level with the SEC's Enforcement Action Against Oracle*, FCPA PROFESSOR (Aug. 17, 2012), <http://fcpaprofessor.com/the-dilution-of-fcpa-enforcement-has-reached-a-new-level-with-the-secs-enforcement-action-against-oracle>; Michael Volkov, *Stretching the FCPA: The Danger of the Oracle Case*, VOLKOV (June 27, 2013), <http://blog.volkovlaw.com/2013/06/stretching-the-fcpa-the-danger-of-the-oracle-case>.

<sup>71</sup> See SEC Settles Charges Against Invision Technologies for \$1.1 Million for Violations of the Foreign Corrupt Practices Act, Accounting and Auditing Enforcement Act Release No. 2187, 88 SEC Docket 2206 (Feb. 14, 2005).

<sup>72</sup> See *Oracle Complaint*, *supra* note 65, at 5.

<sup>73</sup> *Id.*



distributor's margin against the end user price to ensure excess margins were not being built into the pricing structure.

In addition, although Oracle maintained corporate policies requiring approvals for payment of marketing expenses, Oracle failed to seek transparency in or audit third party payments made by distributors on Oracle India's behalf. This control would have enabled Oracle to check that payments were made to appropriate recipients.<sup>74</sup>

The *Oracle* case underscored the fact that the FCPA is a strict liability statute and lack of knowledge of a violation does not protect a parent company from liability based on acts of its subsidiary. This concept was underscored in 2015 with the enforcement action against Mead Johnson, detailed below.<sup>75</sup>

### 3. *Mead Johnson*

In another matter involving improper activity that occurred at a foreign subsidiary, the SEC issued an administrative cease and desist order against Mead Johnson, a global manufacturer and marketer of infant formula, and fined the company \$12 million in July 2015.<sup>76</sup> In that case, the SEC alleged the following:

The conduct at issue relates primarily to the misuse of marketing and sales funds in China. Despite prohibitions in the FCPA and Mead Johnson's internal policies, certain employees of Mead Johnson's majority-owned subsidiary in China, Mead Johnson Nutrition (China) Co., Ltd. ("Mead Johnson China"), made improper payments to certain health care professionals ("HCPs") at state-owned hospitals in China to recommend Mead Johnson's nutrition products to, and provide information about, expectant and new mothers. These payments were made to assist Mead Johnson China in developing its business. For the period from 2008 through 2013, Mead Johnson China paid approximately \$2,070,000 to HCPs in improper payments and derived profits therefrom of approximately \$7,770,000.

Mead Johnson China failed to accurately reflect the improper payments in its books and records. Mead Johnson China's books and records were consolidated into Mead Johnson's books and records, thereby causing Mead Johnson's consolidated books and records to

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<sup>74</sup> *Id.*

<sup>75</sup> Mead Johnson Nutrition Co., Exchange Act Release No. 75532, 2015 WL 4538145 (July 28, 2015).

<sup>76</sup> *Id.* at \*1, 5.

be inaccurate. *Mead Johnson failed to devise and maintain an adequate system of internal accounting controls over Mead Johnson China's operations sufficient to prevent and detect the improper payments that occurred over a period of years.*<sup>77</sup>

The SEC's cease and desist order in this case states in one paragraph that "Mead Johnson has established internal policies to comport with the FCPA and local laws, and to prevent related illegal and unethical conduct."<sup>78</sup> Despite these internal policies, the SEC alleged:

Mead Johnson failed to devise and maintain an adequate system of internal controls over the operations of Mead Johnson China to ensure that Mead Johnson China's method of funding marketing and sales expenditures through its distributors was not used for unauthorized purposes, such as the improper compensation of HCPs. The use of the Distributor Allowance to improperly compensate HCPs was contrary to management's authorization and Mead Johnson's internal policies. Mead Johnson failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that Mead Johnson China's funding of marketing and sales expenditures through third-party distributors was done in accordance with management's authorization.<sup>79</sup>

Like the *Oracle* case, the *Mead Johnson* cease and desist order did not allege, find, or even infer that anyone at Mead Johnson (the parent company) participated or even had knowledge of the improper conduct occurring at its China subsidiary.<sup>80</sup> And like in the case of *Oracle*, that *lack of knowledge* formed the basis for the internal controls violation. In fact, the only link between the alleged improper action and Mead Johnson was that the subsidiary's "books and records were consolidated" into the parent company's books and records.<sup>81</sup> Based on this, the SEC alleged that the parent company's books and records were inadequate, and that the parent company "failed to devise and maintain an adequate system of internal accounting controls" in its subsidiary that would have detected the improper payments to the HCPs.<sup>82</sup>

The alarming but subtle shift in the breadth of the statute, as manifested in the three examples detailed above, gives rise to a more in-depth discussion about the potential misuse and overuse of the FCPA internal controls provision. These theoretical issues should not be overlooked because the implications are wide-reaching.

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<sup>77</sup> *Id.* at \*1 (emphasis added).

<sup>78</sup> *Id.* \*2.

<sup>79</sup> *Id.* at \*3.

<sup>80</sup> *Id.*; see also *Oracle* Complaint, *supra* note 65.

<sup>81</sup> *Mead Johnson*, 2015 WL 4538145, at \*1.

<sup>82</sup> *Id.*

### III. THE PROBLEM WITH OVERENFORCEMENT OF THE INTERNAL CONTROLS PROVISION

What is the potential risk with the enforcement of the internal controls provision in the absence of anti-bribery violations? This Part outlines the many theoretical and procedural issues that arise when the SEC does not allege, or cannot find—let alone meet its burden of proof should a case go to trial<sup>83</sup>—any anti-bribery violations, yet proceeds with violations of the accounting provisions of the FCPA alone.

The most apparent problem with this scenario is that of overenforcement of the statute. Overenforcement is defined broadly as occurring when a violator of a legal rule “suffers excessive harm . . . from the actual implementation of that rule.”<sup>84</sup> Excessive harm in the case of overenforcement is harm that is greater than what is required for optimal deterrence.<sup>85</sup> As Richard Bierschbach and Alex Stein expound upon in depth, overenforcement creates two unique problems for the doctrine of corporate criminal liability. The first, they contend, is market spillover, including the significant extralegal ramifications for defendants and employees, such as reputational damage, potential debarment, and the subsequent reduction of share price, among others.<sup>86</sup> The second issue, however, is arguably more important in terms of the FCPA and corporate FCPA compliance, and it is that the scope of liability to corporations is very broad, and the FCPA is no exception.<sup>87</sup> Bierschbach and Stein put it succinctly:

Corporate liability is vicarious and, from the firm’s standpoint, strict. A firm can be criminally liable for any crimes committed by its employees while acting within the scope of their employment and to benefit the firm. . . . So long as the employee was carrying out a job-related activity, the firm can be liable, even if it expressly prohibited the wrongdoing and implemented procedures to prevent it.<sup>88</sup>

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<sup>83</sup> As will be discussed more in-depth later in this Section, most FCPA cases never go to trial. There are myriad reasons that companies are reticent to challenge the government to prove its burden in these matters, and these are explored in Section III.B.3, *infra*.

<sup>84</sup> Richard A. Bierschbach & Alex Stein, *Overenforcement*, 93 GEO. L.J. 1743, 1744 (2005). Bierschbach and Stein state that the “most obvious example” of overenforcement is when the legal system erroneously set the penalty for a violation at a level higher than necessary, “such as imposing a \$5,000 fine on all drivers who exceed a speed limit of fifty-five miles per hour.” *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.* at 1771–72 (citing Jonathan M. Karpoff & John R. Lott, Jr., *The Reputational Penalty Firms Bear from Committing Criminal Fraud*, 36 J.L. & ECON. 757 (1993) (an empirical work quantifying reputational costs to firms alleged of committing fraud)).

<sup>87</sup> *Id.* at 1772.

<sup>88</sup> *Id.* at 1773.

The risks associated with this problem of vicarious liability and the resulting overenforcement as it pertains to the internal controls provision of the FCPA cannot be overstated. No matter what measures corporations undertake to ensure compliance with the statute, any action by an employee that can be considered as “benefitting the firm” and within the scope of the employee’s terms of employment results in strict liability to the corporation.<sup>89</sup> Although potentially noble in its ideals, the internal controls provision, when considered in this lens, does not lead to any deterrence of corporate malfeasance. If anything, there is real risk that corporations will begin to shirk the costs of internal controls compliance because no matter how robust the program, they could remain “on the hook” for FCPA liability, as BHPB found itself last summer.

For purposes of this Article, I employ the term overenforcement broadly to encompass the above-discussed concept of vicarious liability to the firm, and also to cover the over-zealous prosecution of violations of the internal controls provision of the FCPA. Specifically, the remainder of this Part considers the resulting jurisdictional and remedial issues that arise when internal controls violations are charged absent bribery charges, the natural overcriminalization of the provision as a result, and the inevitable overcompliance by the private sector to meet the ever-moving target of sufficient internal controls standards.

A. *Straying from the Purpose, Jurisdiction, and Allowable Remedies*

The FCPA is aimed at eradicating bribery occurring overseas; domestic bribery is covered by other sections of the U.S. Code.<sup>90</sup> Despite its decidedly extraterritorial goals, the extraterritorial application of the Act was fairly limited until the 1998 Amendments to the Act.<sup>91</sup> The 1998 Amendments to the FCPA expanded the extraterritorial reach of the statute.<sup>92</sup> The implications of charging internal controls violations without an underlying bribery charge strips away some of the justification for the expansive extraterritorial reach of the statute.

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<sup>89</sup> See, e.g., Joseph W. Yockey, *Solicitation, Extortion, and the FCPA*, 87 NOTRE DAME L. REV. 781, 809–10 (2011).

<sup>90</sup> 18 U.S.C. § 201 (2012).

<sup>91</sup> International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (codified as amended at 15 U.S.C. §§ 78dd-2 to -3 (2012)).

<sup>92</sup> Brown, *supra* note 42, at 288–89.

### 1. Extraterritorial Jurisdiction Without the Hook of Foreign Bribery

On the heels of the Organisation for Economic Cooperation and Development Convention in 1997 mandating that signatory countries adopt legislation to combat global corruption, Congress passed the International Anti-Bribery and Fair Competition Act in 1998.<sup>93</sup> These Amendments broadened the understanding regarding who is considered a “foreign official” and, more importantly from a jurisdictional standpoint, the Amendments extended the assertion of nationality-based jurisdiction to reach acts committed by U.S. nationals outside the United States.<sup>94</sup> Additionally, jurisdiction was extended to foreign nationals (individuals and entities) for an act in furtherance of a violation that is committed within the territorial United States.<sup>95</sup> The government has read this jurisdictional authority very broadly, often asserting that any money or email that bounces through a U.S.-based server can trigger jurisdiction.<sup>96</sup>

Indeed, the internal controls provision actually applies to more than simply a publicly traded company. Instead, it applies more broadly to all “issuers,” a group not limited solely to U.S. companies.<sup>97</sup> Under the FCPA definition, issuers are those entities with a class of securities registered under section 12 of the Securities Exchange Act of 1934 or that are required to file reports (periodic or otherwise) under section 15(d) of the Securities Exchange Act of 1934.<sup>98</sup> This includes foreign entities with American depository receipts listed on a U.S. exchange.<sup>99</sup> Issuers are responsible for their own internal controls, as well as for those of their subsidiaries around the world, as was made clear in the *Oracle* case.<sup>100</sup>

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<sup>93</sup> Pub. L. No. 105-366, 112 Stat. 3302.

<sup>94</sup> *Id.* § 2(b)–(c) (codified as amended at 15 U.S.C. § 78dd-2).

<sup>95</sup> *Id.*

<sup>96</sup> *See, e.g.*, Complaint, United States v. JGC Corp., No. 11-cr-260 (S.D. Tex. Apr. 6, 2011) (suggesting that wire transfers through U.S. banks are sufficient to satisfy territorial jurisdiction).

<sup>97</sup> 15 U.S.C. §§ 78l, 78o(d).

<sup>98</sup> *Id.* § 78 dd-1(a). “A company is an ‘issuer’ under the FCPA if it has a class of securities registered under Section 12 of the Exchange Act or is required to file periodic and other reports with [the] SEC under Section 15(d) of the Exchange Act.” *See* U.S. DEP’T OF JUSTICE CRIMINAL DIV. & U.S. SEC. & EXCH. COMM’N ENF’T DIV., FCPA: A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 11 (2012) [hereinafter FCPA RESOURCE GUIDE] (footnote omitted), <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf>.

<sup>99</sup> FCPA RESOURCE GUIDE, *supra* note 98, at 11.

<sup>100</sup> However, the FCPA does limit the obligations of parent companies with respect to the internal controls of subsidiaries and/or affiliates when the parent holds voting power of fifty percent or less. 15 U.S.C. § 78m(b)(6). In these instances, all that is required are good faith

It is this extended responsibility for far-reaching, extraterritorial conduct that is often the source for expansive FCPA interpretations like *Oracle*, where the conduct occurred at the company's Indian subsidiary, and the parent company had no knowledge of the alleged improper conduct. The argument for jurisdiction under the FCPA has always been that issuers avail themselves of our markets; therefore, they must be subjected to our laws, even if those laws reach to the far corners of the earth in which a particular issuer does business.<sup>101</sup> Again, keeping in mind that the purpose of the FCPA was to eradicate foreign bribery, with the accounting provisions as a *means* to effectuating that end, there is a risk that the justification of the extraterritorial application of U.S. law evaporates when no foreign bribery can be found. The statute then morphs from being a foreign bribery prohibition to that of a corporate accounting provision that can reach into the books of foreign subsidiaries located anywhere in the world.

## 2. Remedies

The trend in enforcement actions, as detailed in Part II, points to the uptick in large settlement amounts extracted by the SEC that consist entirely of disgorgement and prejudgment interest without any finding of a violation of the anti-bribery provisions.<sup>102</sup> According to many FCPA scholars, this type of fine is termed “no-charged bribery disgorgement.”<sup>103</sup> These cases are the consternation of many in the

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efforts by the parent to ensure the sufficiency of the subsidiary's or affiliate's internal controls. *Id.* In these situations, the liability of the parent is judged on a case-by-case basis by weighing all facts presented, with the statute requiring consideration of parental ownership interests and “the laws and practices governing the business operations of the country in which such firm is located.” *Id.*

<sup>101</sup> See Matthew C. Stephenson, *Beware the Blowback: How Attempts to Strengthen FCPA Deterrence Could Narrow the Statute's Scope*, in THE RESEARCH HANDBOOK ON CORPORATE CRIME AND FINANCIAL MISDEALING (forthcoming 2016) (manuscript at 7) (on file with author) (“[I]t remains true that the U.S. government has interpreted its FCPA jurisdiction expansively to reach non-U.S. entities, and critics argue that the U.S. government has in fact adopted jurisdictional theories that go well beyond what a fair reading of domestic or international law would authorize.” (citing Annalisa Leibold, *Extraterritorial Application of the FCPA Under International Law*, 51 WILLAMETTE L. REV. 225 (2015) and Lauren Ann Ross, Note, *Using Foreign Relations Law to Limit Extraterritorial Application of the Foreign Corrupt Practices Act*, 62 DUKE L.J. 445 (2012))).

<sup>102</sup> See *supra* Part II and corresponding footnotes.

<sup>103</sup> See, e.g., Mike Koehler, *Why You Should Be Alarmed by the ADM FCPA Enforcement Action*, 9 White Collar Crime Rep. (BNA) 54 (Jan. 24, 2014), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2383938](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2383938). The first of these cases of “no-charged bribery disgorgement” was *SEC v. Textron Inc.*, No. 07-cv-1505 (D.D.C. 2007). In that case, the SEC settled the action against the Rhode Island-based industrial equipment company for violations of the FCPA in relation to the U.N. Oil for Food Program. SEC Files Settled Books and Records and Internal

defense bar, as well as some former SEC attorneys, because they represent a more punitive settlement rather than an equitable one.<sup>104</sup> A former associate director of the SEC's Enforcement Division summarized this concept by stating:

[S]ettlements invoking disgorgement but charging no primary anti-bribery violations push the law's boundaries, as disgorgement is predicated on the common-sense notion that an actual, jurisdictionally-cognizable bribe was paid to procure the revenue identified by the SEC in its complaint.

....

... Given the bedrock principle that a court's equitable power to order such a disgorgement goes only as far as the scope of the violation, it is difficult to determine how a court could lawfully allow disgorgement of profits for uncharged violations without the remedy crossing the line into "punishment" for the violations actually charged.<sup>105</sup>

In order to obtain disgorgement, the government needs to prove a causal link between the wrongdoing and the unjust enrichment.<sup>106</sup> In the case of no-charged bribery disgorgement, there typically is not any direct link between profits and allegations of misconduct, rendering the fines associated with no-charged bribery cases punitive in nature. The FCPA contains very specific guidelines and penalties for violations of both the anti-bribery and accounting provisions of the Act.<sup>107</sup> Fines imposed for bribery are not part of the SEC's section 21(d) fining

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Controls Charges Against Textron Inc., Litigation Release No. 20251, 91 SEC Docket 1197 (Aug. 23, 2007). The settlement involved Textron "disgorging" \$2.3 million in profits, and paying \$450,500 in pre-judgment interest. *Id.* In addition, Textron was forced to pay a civil penalty of \$800,000 and a \$1.1 million fine under a non-prosecution agreement (NPA) with the DOJ. *Id.* Of the three examples detailed in Part II, *supra*, only Mead Johnson had to disgorge "profits" of \$7.7 million. See discussion *supra* note 77. How the SEC arrives at that number is worth considering, but will not be addressed here. For additional commentary about valuation of SEC disgorgement amounts, see David C. Weiss, Note, *The Foreign Corrupt Practices Act, SEC Disgorgement of Profits, and the Evolving International Bribery Regime: Weighing Proportionality, Retribution, and Deterrence*, 30 MICH. J. INT'L L. 471, 507 (2009).

<sup>104</sup> Disgorgement is a remedy in equity aimed at preventing unjust enrichment and deterring illegal conduct. It is not meant as a punitive measure. Paul R. Berger, Steven S. Michaels & Amanda M. Ulrich, *Do FCPA Remedies Follow FCPA Wrongs? "Disgorgement" in Internal Controls and Books and Records Cases*, DEVEBOISE & PLIMPTON L.L.P.: FCPA UPDATE, Aug. 2011, at 1; see also *Milliken v. Bradley*, 418 U.S. 717, 738 (1974) ("[T]he nature of the violation determines the scope of the remedy.").

<sup>105</sup> Berger, Michaels & Ulrich, *supra* note 104, at 1–4 (footnote omitted).

<sup>106</sup> See, e.g., *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.D.C. 1989).

<sup>107</sup> 15 U.S.C. §§ 78dd-2(g), 78dd-3(e), 78ff (2012).

authority,<sup>108</sup> but were included into the Exchange Act as part of the 1988 Amendments to the FCPA.<sup>109</sup>

Disgorgement, however, is not included in the statute, nor is it even mentioned in the original House or Senate reports of 1977, the discussion regarding its amendments, or the 1981 U.S. General Accounting Office Report.<sup>110</sup> The first use of disgorgement in the settlement of an FCPA action was in 2004, in the case of *SEC v. ABB Ltd.*<sup>111</sup> Since that time, “the SEC has sought disgorgement ‘in virtually every’ FCPA enforcement action it has brought.”<sup>112</sup> The result of this is that companies are being fined under the auspices of having received ill-gotten gains.

By definition, disgorgement should not be a punitive remedy.<sup>113</sup> It should be used to separate the bad actor from any ill-gotten gains. However, disgorgement in FCPA enforcement actions seems to serve the purposes of both deterrence and retribution: decidedly punitive goals. This is problematic when there are no ill-gotten gains under the meaning of the statute; that is, there has not been any contract or business retained or obtained through the use of bribes to foreign officials, nor has there been any illegal accounting methods to hide those bribes. To punish a company for lack of internal controls flies in the face of both the purpose of the statute and the remedial options available to the government when pursuing these allegations.

In terms of substantive liability for bribery or inaccurate books and records, a company with no internal controls is similarly situated as one with robust internal controls, provided no bribery takes place and the

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<sup>108</sup> Securities Exchange Act of 1934 § 21(d), 15 U.S.C. § 78u(d) (2012).

<sup>109</sup> Securities Exchange Act of 1934 § 32(c), 15 U.S.C. § 78ff(c).

<sup>110</sup> See Weiss, *supra* note 103, at 474, 497. Weiss writes that “[t]he history surrounding the passage of the FCPA indicates that it is unclear whether Congress intended that the SEC pursue disgorgement in FCPA enforcement. This fact alone should at least give pause to question the normative function of disgorgement.” *Id.* at 496.

<sup>111</sup> Complaint, *SEC v. ABB Ltd.*, No. 10-cv-1648 (D.D.C. 2010); see also Sasha Kalb & Marc Alain Bohn, *An Examination of the SEC’s Application of Disgorgement in FCPA Resolutions*, CORPORATE COMPLIANCE INSIGHTS (Apr. 12, 2010), <http://www.corporatecomplianceinsights.com/disgorgement-fcpa-how-applied-calculated>. Interestingly, in that case, the settlement did not include anti-bribery violations. ABB disgorged \$5.9 million to settle books and records and internal controls violations. See ABB Settles Federal Court Action and Agrees to Disgorge \$5.9 Million in Illicit Profits, Accounting and Auditing Enforcement Act Release No. 2049, 83 SEC Docket 849 (July 6, 2004).

<sup>112</sup> Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT’L L. 907, 982 (2010). Koehler explains that there is an “intuitive appeal” to disgorgement in enforcement actions charging violations of the anti-bribery provisions of the Act. *Id.* Yet the SEC’s use of the disgorgement remedy is routine, regardless of whether the action involves only violations of the accounting provisions in the absence of anti-bribery violations. *Id.*

<sup>113</sup> Weiss, *supra* note 103, at 485 (“While disgorgement can serve deterrence purposes, it is intended not to compensate the wronged party or to serve as a complete stand-in for the deterrent effects of fining, but to recover the benefits of a wrongful act.”).



books and records are properly managed and transparent. One cannot avoid the discussion of proportionality in terms of fines for only internal controls violations versus the fines for the anti-bribery and books and records violations.<sup>114</sup> Indeed, much has been written in the academic literature about proportionality as a principle of punishment and a tool for deterrence, but this discussion is often framed in terms of the harm suffered or amount of unjust enrichment.<sup>115</sup> For internal controls violations, however, neither is present (harm or unjust enrichment). Does it not logically follow that any fines associated with a failure to establish internal controls be reflective of this fact: there was no harm done and no unjust enrichment received?

### B. Overcriminalization

The three examples detailed in Part II suggest that the current enforcement tactics for FCPA violations are trending toward overcriminalization. Overcriminalization is broadly defined as “the overuse and misuse of the . . . law to punish conduct traditionally deemed morally blameless.”<sup>116</sup> Overcriminalization results in enforcement of laws that cover “more conduct than anyone really wishes to punish.”<sup>117</sup> Although SEC enforcement actions are, by definition and institutional design, *civil* proceedings, the concept of overcriminalization is equally applicable with respect to civil SEC enforcement actions as it is to criminal actions. There are three areas in which overcriminalization can be seen. First, the SEC as an agency, and certainly when investigating potential FCPA violations, has become much more of a prosecutorial institution than a remedial one. Second, the standard for sufficient internal controls has shifted within the rhetoric of the SEC and DOJ, making it more difficult for companies’ internal controls to pass muster and elude penalty. Third, there is a

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<sup>114</sup> Indeed, other countries have encapsulated the normative concept of proportionality in writing their similar anti-corruption legislation. For example, the German criminal code prohibits disgorgement that is “disproportionate to the gravity of the offence [sic] committed and to the culpability of the perpetrator.” 7 FOREIGN CORRUPT PRACTICES ACT REPORTER app. E-8 § 74b(2), Westlaw (database updated Jan. 2017).

<sup>115</sup> See, e.g., John C. Coffee, Jr., *Making Punishment Fit the Corporation: The Problems of Finding an Optimal Corporation Criminal Sanction*, 1 N. ILL. L. REV. 3, 6–10 (1980); Regina A. Robson, *Crime and Punishment: Rehabilitating Retribution as a Justification for Organizational Criminal Liability*, 47 AM. BUS. L.J. 109 (2010).

<sup>116</sup> Todd Haugh, *Overcriminalization’s New Harm Paradigm*, 68 VAND. L. REV. 1191, 1197–98 (2015) (quoting Paul J. Larkin, Jr., *Regulation, Prohibition, and Overcriminalization: The Proper and Improper Uses of the Criminal Law*, 42 HOFSTRA L. REV. 745, 745 (2014)).

<sup>117</sup> William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505, 511 (2001).

substantial lack of judicial precedence within the case law regarding enforcement of the internal controls provision, rendering the SEC and DOJ as both prosecutor and judge during settlement negotiations. This Section will explore these three manifestations of overcriminalization, resulting in zealous overenforcement of the internal controls provision.

### 1. The Evolution of the SEC's Enforcement Division into Prosecutorial Body

In recent history, the Enforcement Division of the SEC has swallowed up the agency, both in resources/manpower and in setting the tone of the agency.<sup>118</sup> It is widely seen as the “police force” for the SEC.<sup>119</sup> Indeed, the former SEC Chair, Mary Jo White, a former prosecutor, underscored that prosecutorial tone when she adopted her “broken windows” policy for the agency.<sup>120</sup> Yet the SEC is not an arm of the Department of Justice. This fact is lost on most corporate officers who face the same level of investigation and threat of punishment regardless of whether it is the SEC or DOJ that comes calling. In short, the Enforcement Division has rendered the SEC an agency with overwhelming “police power,” at the expense of being an agency that focuses on guidance and remedial measures to keep corporations in line.<sup>121</sup>

Enforcement of the FCPA is no different; arguably the drastically increasing fines and prosecutions for violations of the FCPA since 2000 have made the FCPA one of the hottest areas in the Enforcement

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<sup>118</sup> See generally MIKE KOEHLER, *THE FOREIGN CORRUPT PRACTICES ACT IN A NEW ERA* (2014); Max Minzner, *Should Agencies Enforce?*, 99 MINN. L. REV. 2113, 2143–44 (2015) (noting that agencies may have a tendency to impose the largest penalties even when those penalties do not reflect the most serious violation, and explaining that “[t]hese problems are compounded when two enforcers [in the case of the FCPA, the DOJ and the SEC] can punish not only the same entity, but also the same conduct”).

<sup>119</sup> See Barbara Black, *The SEC and the Foreign Corrupt Practices Act: Fighting Global Corruption Is Not Part of the SEC's Mission*, 73 OHIO ST. L.J. 1093, 1108–13 (2012).

<sup>120</sup> Mary Jo White, Chairwoman, U.S. Sec. & Exch. Comm'n, Remarks at the Securities Enforcement Forum (Oct. 9, 2013) (quoting George L. Kelling & James Q. Wilson, *Broken Windows*, ATLANTIC (1982), <http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/304465>), <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100>. The theory of “no broken windows” propounds that “when a window is broken and someone fixes it,” a message is sent that “disorder will not be tolerated.” *Id.* However, when a broken window is not fixed, it is a “signal that no one cares, and so breaking more windows costs nothing.” *Id.* Chair White explained that her administration would employ the strategy of “no broken windows” to securities laws, just as New York City Mayor Rudy Giuliani had done with respect to criminal laws when Chair White was the United States Attorney for the Southern District of New York. In other words, Chair White underscored that the SEC would be pursuing even the smallest infractions of the securities laws.

<sup>121</sup> See Black, *supra* note 119.

Division.<sup>122</sup> Importantly, these internal controls charges arise from SEC enforcement actions, not from recommendations or guidance issued by the agency or its less “punitive” departments, such as the Office of Compliance Inspections and Examination (OCIE).<sup>123</sup> Meaning, the SEC’s prosecutorial arm, the Enforcement Division, is regulating and influencing corporate behavior through punishment, rather than providing agency guidance through other means.<sup>124</sup>

Yet the hard-charging enforcement of all of the Act’s provisions is not in line with the initial intent of the Act. In a speech given in 1981 that manifested some of the initial and original intent of the statute, the then-Chairman of the SEC, Harold Williams, stated the following about the FCPA in a speech to the American Institute of Certified Public Accountants:

The Act’s eventual success or failure will, therefore, depend primarily upon business’s response. The Commission’s obligation, in turn, is to provide a regulatory environment in which the private sector can address these issues meaningfully and creatively. In this regard, we must encourage public companies to develop innovative records and control systems, to modify and improve them as circumstances change, and to correct recordkeeping errors when they occur without

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<sup>122</sup> As noted above, since 2010, the SEC has had an FCPA unit within the Division of Enforcement. Press Release, U.S. Sec. & Exch. Comm’n, SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence (Jan. 13, 2010), <https://www.sec.gov/news/press/2010/2010-5.htm>; see also Wentong Zheng, *The Revolving Door*, 90 NOTRE DAME L. REV. 1265 (2015). Zheng uses the FCPA as a case study in the argument about the revolving door between government and private industry. Zheng, *supra*. Zheng points out that regulators who may have their sights set on the revolving door into private practice “have incentives to bring more enforcement actions, levy higher penalties, and work to expand the scope of matters subject to the agency’s authority.” *Id.* at 1281; see also Yockey, *supra* note 2, at 350 (“[A] brief scan of all FCPA actions from the past two years reads like a ‘who’s who’ of former government attorneys.”). By way of examples, Zheng notes that Mark Mendelsohn, Deputy Chief of the DOJ’s FCPA unit and the “architect” of the DOJ’s modern FCPA program joined Paul, Weiss, Rifkind, Wharton & Garrison L.L.P. for an annual salary of \$2.5 million. *Id.* at 1290–91. Similarly, Lanny A. Breuer, Assistant Attorney General of the DOJ’s Criminal Division, and who ushered in many of the highest FCPA penalties to date, rejoined Covington & Burling L.L.P. at an annual salary of \$4 million. *Id.* at 1291. Indeed, former Chair White also was a member of a large New York City law firm, Debevoise & Plimpton L.L.P., prior to joining the SEC. *Id.* at 1266. Ms. White returned to Debevoise & Plimpton in February 2017. Elizabeth Olson, *Mary Jo White to Rejoin Debevoise & Plimpton*, N.Y. TIMES: DEALBOOK (Feb. 15, 2017), <https://www.nytimes.com/2017/02/15/business/dealbook/mary-jo-white-debevoise-plimpton.html>.

<sup>123</sup> See *SEC Enforcement Actions: FCPA Cases*, *supra* note 16.

<sup>124</sup> See Roberta S. Karmel, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor*, 61 LAW & CONTEMP. PROBS. 33, 34 (1998) (describing how the SEC frequently makes law through enforcement cases rather than through rulemaking).

a chilling fear of penalty or inference that a violation of the Act is involved.<sup>125</sup>

The notion of “encouraging” companies and “correcting errors” without “fear of penalty” is more in line with the guiding principles of other departments in the agency rather than the “broken windows” policies of the Enforcement Division.<sup>126</sup> For example, the OCIE regularly inspects registered entities, yet does so without playing “gotcha” with the regulated entities.<sup>127</sup> In fact, Andrew Bowden, the former Director of OCIE, regularly told his staff that the department was to serve as a lifeguard for the financial industry.<sup>128</sup> In keeping with that analogy, he made clear that the best lifeguards are not the ones who make numerous saves but the ones who never have to make any saves because they have properly instructed people on the rules of the pool.<sup>129</sup>

Particularly in enforcement of an internal controls provision, the agency should look more to the guiding principles espoused by OCIE than the zealous prosecution style of the DOJ in shaping its FCPA enforcement policies. By its very nature, the internal controls provision is meant to be a risk management and prevention provision. Absent the “smoke” and “fire” of actual substantive bribery and falsified books and records, a violation of internal controls is categorically a harmless offense that does not require the full weight and punitive power of the SEC or DOJ when calculating the appropriate remedy.<sup>130</sup>

In other words, internal controls violations arguably are not substantive violations, but instead are violations arising out of the *potential* for other violations. In this way, internal controls violations are not even the equivalent of “attempted” crimes—they are simply an acknowledgement that if someone *did* attempt to bribe a foreign official or falsify books, she likely could get away with it. To bring the weight of the Enforcement Division, or even the DOJ, to bear on these offenses with the same zeal and prosecutorial tactics as one would expect for substantive violations of the Act seems to stray from the purpose of the Act, and the role of the SEC in particular.

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<sup>125</sup> KOEHLER, *supra* note 118, at 153.

<sup>126</sup> See Mary Jo White, *supra* note 120.

<sup>127</sup> See Andrew J. Bowden, Dir., U.S. Sec. & Exch. Comm’n, Office of Compliance Inspections and Examinations, Speech at the Investment Adviser Association Compliance Conference: People Handling Other Peoples’ Money (Mar. 6, 2014), <https://www.sec.gov/News/Speech/Detail/Speech/1370541260300>.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> See discussion *supra* Section III.A.

## 2. Overcriminalization in Statutory Interpretation

In the cases of *Mead Johnson* and *BHPB* detailed in Part II, the internal controls allegation centered on the companies' "failure to prevent or detect" the improper accounting at issue.<sup>131</sup> Yet "failure to prevent or detect" is not the standard for internal controls as enumerated in the statute, and the subtle shift by the SEC and DOJ in terminology is not merely semantic, but instead highly problematic.

As made clear above, the statute requires that every issuer of publicly traded securities required to file periodic reports with the SEC devise and maintain a system of internal accounting controls sufficient to provide "reasonable assurances" that:

1. "transactions are executed in accordance with management's general or specific authorization;"
2. "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;"
3. "access to assets is permitted only in accordance with management's general or specific authorization; and"
4. "the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences."<sup>132</sup>

The statute defines "reasonable assurances" as "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."<sup>133</sup> As Chairman Williams noted in his 1981 speech, "[r]easonableness, a familiar legal concept, depends on an evaluation of all the facts and circumstances."<sup>134</sup> He also stated: "The Act does not mandate any particular kind of internal controls system. The test is whether a system, taken as a whole, reasonably meets the statute's specified objectives."<sup>135</sup>

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<sup>131</sup> *Mead Johnson Nutrition Co.*, Exchange Act Release No. 75532, 2015 WL 4538145 (July 28, 2015); *BHP Billiton Ltd.*, Exchange Act Release No. 74998, 2015 WL 2393657 (May 20, 2015).

<sup>132</sup> 15 U.S.C. § 78m(b)(2)(B) (2012).

<sup>133</sup> *Id.* § 78m(b)(7).

<sup>134</sup> Harold M. Williams, Chairman, U.S. Sec. & Exch. Comm'n, Address at the SEC Developments Conference for American Institute of Certified Public Accountants: The Accounting Provisions of the Foreign Corrupt Practices Act: An Analysis (Jan. 13, 1981), <https://www.sec.gov/news/speech/1981/011381williams.pdf>.

<sup>135</sup> *Id.*

Of course, the statute's specified objectives with regard to the anti-bribery provisions are clear. With respect to the accounting provisions (books and records, and internal controls), the objectives are as follows: The primary thrust of the Act's accounting provisions, in short, was to require those public companies that lacked effective internal controls or tolerated unreliable recordkeeping to comply with the standards of their better managed peers.<sup>136</sup> That is the context in which these provisions should be construed.

Given this background, the standard in recent enforcement actions of requiring internal controls that will not "fail to prevent or detect" any accounting misstep is much stricter than the original intent of the statute. Indeed, Chairman Williams made this exact point:

The test of a company's control system is not whether occasional failings can occur. Those will happen in the most ideally managed company. But, an adequate system of internal controls means that, when such breaches do arise, they will be isolated rather than systemic, and they will be subject to a reasonable likelihood of being uncovered in a timely manner and then remedied promptly. Barring, of course, the participation or complicity of senior company officials in the deed, when discovery and correction expeditiously follow, no failing in the company's internal accounting system would have existed. To the contrary, routine discovery and correction would evidence its effectiveness.<sup>137</sup>

The recent enforcement actions requiring a much stricter standard is the result of overcriminalization, and the statute begins to be but a shadow of its former (and the intended) iteration.

### 3. Arbitrariness in Enforcement and Settlements

Despite a seemingly clear statutory mandate for establishing an internal controls regime, there is a fair amount of gray area in terms of what constitutes adequate internal controls and compliance procedures. This concept was captured in 1983, when the court in *SEC v. World-Wide Coin Investments, Ltd.* Stated: "The main problem with the internal accounting controls provision of the FCPA is that there are no specific standards by which to evaluate the sufficiency of controls; any evaluation is inevitably a highly subjective process in which

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<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

knowledgable [sic] individuals can arrive at totally different conclusions.”<sup>138</sup>

There is a wealth of material on best practices for compliance programs, but there is no set standard. Following certain industry best practices hopefully will ensure that companies evade the ever-watchful eye of the regulators, but the lesson of the three cases discussed in Part II, *Oracle*, *Mead Johnson*, and *BHP Billiton*, tells a different story. Each of those companies either had no knowledge of the improper conduct or, in the case of *BHP Billiton*, took significant measures to reduce any liability or exposure to FCPA violations. As a result, there is a modicum of randomness in compliance, where certain internal controls and compliance systems pass muster in the eyes of the regulator, whereas similar systems in other corporations may not.

Few courts have ruled on FCPA internal control violations because most defendants settle, meaning that there is little judicial precedent surrounding compliance programs. The downside to looking merely to DOJ and SEC settlement agreements for legal standards regarding compliance programs is that the settlement agreements have been created by prosecutors without judicial oversight. This problem could be significantly curtailed if more FCPA cases went to court.<sup>139</sup> However, in practicality, this concept results in the SEC being able to act as both prosecutor and judge, acting without much regard toward previous settlements.

[T]he true lesson of *Oracle* is not that this particular type of internal control is required, but rather that the internal controls provision is so broad, and the statutory standard of reasonable assurances so subjective, that the SEC has an almost unfettered ability to insist on a settlement, including a civil penalty, at the conclusion of virtually any FCPA investigation.<sup>140</sup>

William Stuntz considered a similar concept in his article about overcriminalization and the resulting shift in lawmaking and enforcement from the courts to the prosecutors or law enforcers.<sup>141</sup> In Stuntz's exposition of overcriminalization, he argues that the broadening body of criminal law allows for prosecutors to charge a number of violations for a single act, due to the overlapping criminal codes.<sup>142</sup> In the case of internal controls enforcement, this issue is not

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<sup>138</sup> SEC v. World-Wide Coin Invs., 567 F. Supp. 724, 751 (N.D. Ga. 1983).

<sup>139</sup> Stephenson, *supra* note 101 (manuscript at 2–3).

<sup>140</sup> William J. Stuckwisch & Matthew J. Alexander, *The FCPA's Internal Controls Provision: Is Oracle an Oracle for the Future of SEC Enforcement?*, CRIM. JUST., Fall 2013, at 10, 15.

<sup>141</sup> Stuntz, *supra* note 117, at 519.

<sup>142</sup> *Id.*

one of overlapping criminal codes so much as it is enhanced investigation and punishment of conduct (or the lack of conduct, i.e., establishing sufficient internal controls) that is wholly allowable because no substantive violation has occurred.

As such, SEC enforcement attorneys are able to shape the entire landscape of statutory enforcement.<sup>143</sup> They decide what actions constitute a violation of the code by being the ultimate decision-makers regarding whether to investigate, whether to bring an enforcement action, and whether and for what amount to settle the action.<sup>144</sup> All of this occurs without judicial review, up until acceptance of the settlement action by the court.<sup>145</sup> The ability to cherry-pick cases, and the arbitrary nature of settlement agreements without any precedential value, results in a lack of checks and balances (and, arguably, due process<sup>146</sup>) for a corporate defendant unwilling to take its chances in court for any number of reasons.<sup>147</sup>

### C. The Result of Overenforcement: Overcompliance

Overcriminalization of the statute and overenforcement of the internal controls provision has created a necessary culture of compliance among many large issuers. Neither the DOJ nor the SEC has explicitly stated what a model compliance program must contain to satisfy the internal controls requirement.<sup>148</sup> Both have, however, indicated in settlement decisions and non-prosecution agreements (NPA) when companies have satisfied or failed to satisfy the standard.

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<sup>143</sup> See Yockey, *supra* note 2, at 332–33 (citing David Hess, *Combating Corruption Through Corporate Transparency: Using Enforcement Discretion to Improve Disclosure*, 21 MINN. J. INT'L L. 42, 62–63 (2012)).

<sup>144</sup> Minzner, *supra* note 118 (outlining the vast discretion afforded to enforcing agencies when making charging decisions).

<sup>145</sup> Of course, after Rakoff's decision to reject the Citigroup settlement was overturned by the Second Circuit, judicial review of settlements is very limited. See *SEC v. Citigroup Global Mkts. Inc.*, 673 F.3d 158 (2d Cir. 2012) (per curiam).

<sup>146</sup> The notion that the arbitrary nature of the settlement agreements is a violation of due process is beyond the scope of this Article. It will be further explored in my future scholarship.

<sup>147</sup> See generally Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853 (2007). DPAs and NPAs are highly desirable because they do not ascribe any fault to the company. Thus, companies that need to do business with the government will not be de-barred because they do not plead guilty. Further, a recent court in France held that DPAs and NPAs render companies off-limits for foreign prosecution; whereas if a company pleads guilty to only one particular charge, a foreign government can prosecute other potential charges without violating any double-jeopardy international standards. See Frederick T. Davis, *International Double Jeopardy: U.S. Prosecutions and the Developing Law in Europe*, 31 AM. U. INT'L L. REV. 57 (2016) (analyzing the recent French decisions in the Oil-for-Food scandal).

<sup>148</sup> See Yockey, *supra* note 2, at 341 ("While the FCPA does contain a few specific rules, it is primarily a principle-based statute.").



However, the arbitrariness in the enforcement of the internal controls provision results in a real risk of overcompliance, as vast resources are spent on compliance systems that may be either insufficient in the eyes of the regulators, or worse, wholly ineffective. In a law review Article dissecting the effectiveness of corporate compliance as compared with the normative goals of compliance, Kimberly Krawiec points out that corporate compliance is not a fail-safe measure to prevent bad acts by corporate employees:

In fact, a growing body of evidence indicates that internal compliance structures do not deter prohibited conduct within firms and may largely serve a window-dressing function that provides both market legitimacy and reduced legal liability. This leads to two potential problems: (1) an under-deterrence of corporate misconduct, and (2) a proliferation of costly—but arguably ineffective—internal compliance structures.<sup>149</sup>

Krawiec buttresses her argument by pointing out that there is insufficient empirical evidence to conclude that compliance systems, including ethical codes of conduct, are effective as a means of deterring malfeasance.<sup>150</sup>

In his 1981 speech, then-Chairman Williams made a prescient observation about the future of compliance with the Act:

[U]ncertainty can have a debilitating effect on the activities of those who seek to comply with the law. My sense is that, as a consequence, many businesses have been very cautious—sometimes overly so—in assuring at least technical compliance with the Act. And, therefore, business resources may have been diverted from more productive uses to overly-burdensome compliance systems which extend beyond the requirements of sound management or the policies embodied in the Act. The public, of course, is not well served by such reactions.<sup>151</sup>

Compliance is very forward-looking in its risk-assessments and structures. However, compliance systems also are informed by the most recent regulatory actions. As such, they are inherently reactive to regulatory action. In this way, they may be a house of cards doomed to fail because those who skirt compliance measures do so in continually novel ways.

The DOJ and SEC have been reluctant to define the exact content of an FCPA compliance program because they want companies to continuously improve their compliance programs when their programs

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<sup>149</sup> Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 487 (2003).

<sup>150</sup> *Id.* at 510.

<sup>151</sup> Williams, *supra* note 134.

are either found to be ineffective or the industry adopts better standards. In the DOJ's NPA with IAP Worldwide Services Inc., the DOJ settled without prosecution partly because IAP promised to take remedial compliance measures, which included conducting periodic reviews and testing of anti-corruption measures and policies to maintain effectiveness and improve with recent developments.<sup>152</sup> By requiring measures like this, it is difficult to establish a definitive program that will satisfy the internal controls requirement. For example, a compliance program deemed effective and sufficient today may be found to be ineffective or outdated in the future, particularly if a company falls behind changing standards for compliance within its field.

In addition, as noted above, compliance is inherently a corporate cost-benefit exercise.

Companies may be willing to enter into such settlements—particularly because, in the absence of a parallel DOJ action, they need not make any factual admissions (due to the “neither admit nor deny” nature of SEC settlements in such circumstances), and the cost of a settlement is often lower than continuing investigative and representative costs. But such settlements can have severe, unintended consequences. Perhaps most significantly, these settlements can lead other companies to misdirect their scarce compliance resources.<sup>153</sup>

There are certain aspects of compliance programs that serve as the pillars of internal controls, including corporate codes of conduct,<sup>154</sup> in-

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<sup>152</sup> Press Release, U.S. Dep't of Justice, IAP Worldwide Services Inc. Resolves Foreign Corrupt Practices Act Investigation (June 16, 2015), <http://www.justice.gov/opa/pr/iap-worldwide-services-inc-resolves-foreign-corrupt-practices-act-investigation>.

<sup>153</sup> Stuckwisch & Alexander, *supra* note 140, at 15.

<sup>154</sup> The corporate code of conduct provides specific expectations for employees dealing with situations that pose potential violations, such as gift giving, foreign travel, hospitality offers, and working with foreign companies. Corporate policy statements are not effective without enforcement mechanisms to back them up, and it is clear that the SEC and DOJ consider such statements to be an important indication of whether a company is taking compliance seriously and communicating to its employees that it is a priority. *See, e.g.*, Complaint at 13, SEC v. Peterson, No. 12-cv-2033 (E.D.N.Y. Apr. 25, 2012) (“Morgan Stanley required each of its employees . . . annually to certify adherence to Morgan Stanley’s Code of Conduct, which included a portion specifically addressing corruption risks and activities that would violate the FCPA.”); *cf. Siemens* Complaint, *supra* note 22, at 10 (faulting Siemens’s internal controls program because the “tone at the top . . . was inconsistent with an effective FCPA compliance program and created a corporate culture in which bribery was tolerated”); *see also* Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, FLIR Sys., Inc., Exchange Act Release No. 74673 (Apr. 8, 2015) (finding a violation of internal controls provision despite the existence of a generic code of conduct because there were not any policies in place to govern the use of foreign travel agencies or gifts to customers).

house training,<sup>155</sup> reporting,<sup>156</sup> structural independent oversight,<sup>157</sup> regular monitoring of activities,<sup>158</sup> due diligence,<sup>159</sup> and risk

<sup>155</sup> Establishing internal ethics policies and a code of conduct is fruitless unless the policies are clearly communicated to employees. The training that employees receive is a significant factor in the DOJ's and SEC's assessment of internal controls. *See, e.g.*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Bruker Corporation, Exchange Act Release No. 73835, Accounting and Auditing Enforcement Release No. 3611 (Dec. 15, 2014) (stating that the fact that the training materials were not translated into local languages, including Mandarin, was a key component in the failure of the compliance system and, although the company had implemented an FCPA policy, it relied on China-based managers to ensure that employees understood the policies and employee handbooks).

<sup>156</sup> Self-reporting FCPA violations to the SEC and DOJ has frequently been cited as a major consideration in reducing penalties or finding that the company's internal controls were sufficient. *See, e.g.*, Press Release, U.S. Dep't of Justice, Ralph Lauren Corporation Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay \$882,000 Monetary Penalty (Apr. 22, 2013), <https://archives.fbi.gov/archives/newyork/press-releases/2013/ralph-lauren-corporation-resolves-foreign-corrupt-practices-act-investigation-and-agrees-to-pay-882-000-monetary-penalty>; Declination Letter from Daniel Kahn, Deputy Chief, U.S. Dep't of Justice, Criminal Div., to Luke Cadigan, Counsel for Nortek, Inc. (June 3, 2016), <https://www.justice.gov/criminal-fraud/file/865406/download>; Declination Letter from Daniel Kahn, Deputy Chief, U.S. Dep't of Justice, Criminal Div., to Josh Levy & Ryan Rohlfen, Counsel for Akamai Techs., Inc. (June 6, 2016), <https://www.justice.gov/criminal-fraud/file/865411/download>. In addition, in each of the six examples of past declinations to prosecute included in the FCPA Resource Guide, the companies involved had self-reported their violations. *See* FCPA RESOURCE GUIDE, *supra* note 98, at 77–79. For example, the SEC and DOJ gave considerable weight to Bio-Rad's voluntary self-reporting of an FCPA violation—reducing the company's criminal fine from \$40 million (100% of the disgorgement amount) to \$14 million (about forty percent). *See* Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Bio-Rad Labs., Inc., Exchange Act Release No. 73496, Accounting and Auditing Enforcement Release No. 3594 (Nov. 4, 2014); Andrew Ceresney, Dir., Div. of Enf't, Remarks at CBI's Pharmaceutical Compliance Congress in Washington, D.C.: FCPA, Disclosure, and Internal Controls Issues Arising in the Pharmaceutical Industry (Mar. 3, 2015), [http://www.sec.gov/news/speech/2015-spch030315ajc.html#\\_ftn10](http://www.sec.gov/news/speech/2015-spch030315ajc.html#_ftn10).

<sup>157</sup> Employees who are given authority to approve improper payments related to their own business dealings often have a stronger interest in the immediate business advantage than the payment might represent than in adhering to abstract FCPA compliance policies. The mitigation of this risk is often hiring independent compliance personnel, so that those who approve foreign expenditures and gifts are far removed from the business interests at stake. *See generally* R. Christopher Cook, *The Elements of an Effective Foreign Corrupt Practices Act Compliance Program*, JONES DAY (Mar. 2006), <http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=3208>.

<sup>158</sup> Monitoring, typically through approval of expenditures and audits, has frequently been discussed by the SEC as a significant part of effective internal controls. *See* FCPA RESOURCE GUIDE, *supra* note 98, at 40. The SEC also often requires the company to hire an approved independent monitor to periodically report back to the SEC on compliance for a period of time following a violation as a remedial measure in settlement agreements. *See, e.g.*, Consent of Defendant ABB Ltd. at 2, SEC v. ABB Ltd., No. 1:04-cv-01141 (D.D.C. Nov. 30, 2004); Press Release, U.S. Sec. & Exch. Comm'n, SEC Files Settled Foreign Corrupt Practices Act Charges Against Innospec, Inc. for Engaging in Bribery in Iraq and Indonesia with Total Disgorgement and Criminal Fines of \$40.2 Million (Mar. 18, 2010), <https://www.sec.gov/litigation/litreleases/2010/lr21454.htm> (requiring corporate monitor). As explained above, in *Oracle*, the SEC alleged that the parent company had failed to account for the \$2.2 million difference from what its subsidiary was paid (\$6.7 million) and the revenue it actually received (\$4.5 million)—this

assessments,<sup>160</sup> among others. All of these undertakings come at varying, and likely significant, costs to companies.<sup>161</sup> The cost of compliance was

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“parked” money was allegedly reserved to make future improper payments to third parties. *Oracle* Complaint at 4, *supra* note 65. The SEC found that this large disparity in payments should have been a red flag for the company’s monitors and subjected to audits and an internal investigation, but instead went unnoticed. *Id.* at 5; *see also* Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 at 6, *Stryker Corp.*, Exchange Act Release No. 7751 (Oct. 24, 2013) (“In many instances, even a cursory review of the underlying documentation, such as travel authorization forms and itineraries, would have revealed the illegitimate nature of the payments.”).

<sup>159</sup> The use of third parties, agents, and vendors, particularly intermediaries in deals with foreign companies or governments, is often highlighted by both the DOJ and SEC in their respective enforcement and prosecutorial press releases. *See, e.g.*, Press Release, U.S. Dep’t of Justice, Och-Ziff Capital Management Admits to Role in Africa Bribery Conspiracies and Agrees to Pay \$213 Million Criminal Fine (Sept. 29, 2016), <https://www.justice.gov/opa/pr/och-ziff-capital-management-admits-role-africa-bribery-conspiracies-and-agrees-pay-213>; Press Release, U.S. Sec. & Exch. Comm’n, SEC Charges Liquor Giant Diageo with FCPA Violations (July 27, 2011), <https://www.sec.gov/news/press/2011/2011-158.htm>. The FCPA Resource Guide notes that although due diligence requirements will be different based on the industry, the country, and the nature of the transaction, several guiding principles will always apply. Companies should (1) understand the qualifications and associations of third-party partners, (2) understand the business rationale for including a third party in transaction, and (3) undertake some form of ongoing monitoring for third-party relationships. FCPA RESOURCE GUIDE, *supra* note 98, at 60. For example, in an enforcement action against Alcoa, the SEC faulted the company for lacking internal controls to detect and prevent FCPA violations, and noted in particular that

Despite the red flags inherent in this arrangement [a proposed business deal that would be routed through a local third party], [Alcoa’s] in-house counsel approved the arrangement without conducting any due diligence or otherwise determining whether there was a legitimate business purpose for the use of a third party intermediary.

Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, at 5, *Alcoa Inc.*, Exchange Act Release No. 71261, Accounting and Auditing Enforcement Release No. 3525 (Jan. 9, 2014). Companies are also required to conduct due diligence as part of any merger or acquisition. As with third parties, the level of due diligence required should be determined by completing a risk assessment covering corruption risk factors (country, industry, level of regulatory exposure, etc.). Companies should also determine whether the company to be acquired previously fell under SEC or DOJ jurisdiction, as they will incur successor liability for past FCPA violations. Companies will not, however, incur successor liability when acquiring foreign firms that were not previously subject to the FCPA. FCPA RESOURCE GUIDE, *supra* note 98, at 29. Where due diligence is not possible prior to an acquisition, however, the DOJ has stated that it will not hold companies accountable for violations that occur pre-acquisition or up to 180 days post-acquisition, in order to give the acquiring company time to conduct post-acquisition due diligence. *See* Foreign Corrupt Practices Act Opinion Procedure Release, FCPA Op. No. 08-02 (Dep’t of Justice June 13, 2008), WL 2008 2608051. Halliburton was one of several companies bidding to acquire a British company, and couldn’t conduct due diligence before it actually won the bid and acquired the company. *Id.*

<sup>160</sup> A risk assessment determines the level of caution needed in other areas of the compliance program (such as how much due diligence is needed for dealing with third-party agents). A risk-based compliance approach allows companies to prioritize resources by implementing stronger controls where they are more exposed to risk and more limited measures in low-risk areas. FCPA RESOURCE GUIDE, *supra* note 98, at 59 (“DOJ and SEC will give meaningful credit

considered even at the outset of the statute. Former Chairman Williams summarized this in his 1981 speech:

Inherent in this concept [of reasonableness] is a toleration of deviations from the absolute. One measure of the reasonableness of a system relates to whether the expected benefits from improving it would be significantly greater than the anticipated costs of doing so. Thousands of dollars ordinarily should not be spent conserving hundreds. Further, not every procedure which may be individually cost-justifiable need be implemented; the Act allows a range of reasonable judgments.<sup>162</sup>

The point of this Article is not to diminish the positive strides corporations have made in compliance programs, but to point out that compliance programs are often shifting in order to meet the standards of an increasingly overcriminalized and overenforced provision of a statute. As such, compliance professionals and counsel must continually change guidelines, but without the benefit of “hard” precedence. Instead, they rely on the “soft” precedence of settlement agreements, as well as increasingly stricter standards for internal controls measures, and a playing field that is decidedly a home-court advantage for the regulators. The natural follow-on result to this is an increasingly robust and expensive compliance regime that still may not pass muster in the eyes of the regulators due to the strict liability nature of the statute and the rigorous enforcement regime in place.

#### IV. THE SLIPPERY SLOPE: WHERE OVERENFORCEMENT OF THE INTERNAL CONTROLS PROVISION LEADS

Overenforcement of the internal controls provision by the SEC has potentially major ramifications, including expanded scrutiny of

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to a company that implements in good faith a comprehensive, risk-based compliance program, even if that program does not prevent an infraction in a low risk area because greater attention and resources had been devoted to a higher risk area.”). Risk is determined using a variety of factors, including the notoriety of corruption within a country (i.e., *Nigeria vs. Denmark*), the value of the transaction, the industry involved, and whether parties to the transaction are government-owned entities. *See, e.g., United States v. Esquenazi*, 752 F.3d 912, 929 (11th Cir. 2014) (noting that a company would be considered government-owned where it had been “overwhelmingly majority-owned by the state, had no [treasury] independent of the state, had a state-sanctioned monopoly for its activities, and was controlled by a board filled exclusively with government-appointed individuals”).

<sup>161</sup> *See* Minzner, *supra* note 118, at 2143 (“Quite naturally, large penalties will get the most attention and the greatest efforts at compliance.”). As a result, companies’ compliance programs will be reactive to the most recent, and likely largest, penalties meted out by the government.

<sup>162</sup> Williams, *supra* note 134.

international corporations by the DOJ, as well as expanded interpretation of the requisite knowledge for criminal liability. In addition, the corporate enforcement actions to date, as well as the tone set by the regulators in recent memoranda<sup>163</sup> and speeches,<sup>164</sup> signal that individuals will not escape investigation or liability for internal controls violations.

A. *Corporate Criminal Liability for Internal Controls Violations  
Absent Bribery Violations*

Although the SEC has brought civil charges against companies and individuals with internal controls violations in FCPA matters since 1996, the DOJ first brought criminal charges against a company for an internal controls violation in 2008.<sup>165</sup> Since the *Siemens* prosecution in 2008, the DOJ has increasingly charged internal controls violations, in conjunction with the SEC.

As noted above, to be held criminally liable, one must “knowingly” circumvent or fail to implement a system of internal accounting controls.<sup>166</sup> The government, however, has taken a broad interpretation of the knowledge requirement, and has interpreted the knowledge requirement as including “corporate knowledge.”<sup>167</sup> For example, the government has already begun to expand liability of parent corporations

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<sup>163</sup> See Memorandum from Sally Quillian Yates, Deputy Attorney Gen., U.S. Dep’t of Justice, Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015), <http://www.justice.gov/dag/file/769036/download>. The “Yates Memo,” as it has come to be known, stresses six areas of focus for the DOJ and SEC in investigating individuals for corporate wrongdoing. They are as follows: (1) corporations will be eligible for cooperation credit only if they provide DOJ with “all relevant facts” relating to all individuals responsible for misconduct, regardless of seniority level; (2) both criminal and civil DOJ investigations will focus on investigating individuals “from the inception of the investigation”; (3) criminal and civil DOJ attorneys should be in routine communication with each other, notifying civil counterparts when conduct giving rise to potential individual liability is discovered; (4) the DOJ will not agree to a corporate resolution that provides immunity for potentially culpable individuals unless there are extraordinary circumstances present; (5) the DOJ will have a clear plan to resolve open investigations of individuals when the case against a corporation is resolved; and (6) civil attorneys, in addition to criminal attorneys, should focus on individuals and take into account issues such as accountability and deterrence, as well as ability to pay fines. *Id.*

<sup>164</sup> Press Release, U.S. Dep’t of Justice, Assistant Attorney General Leslie R. Caldwell Delivers Remarks at the Second Annual Global Investigations Review Conference (Sept. 22, 2015), <http://www.justice.gov/opa/speech/assistant-attorney-general-leslie-r-caldwell-delivers-remarks-second-annual-global-0> (clarifying and elaborating on the Yates Memo).

<sup>165</sup> *Siemens* Complaint, *supra* note 22.

<sup>166</sup> 15 U.S.C. § 78m(b)(5) (2012).

<sup>167</sup> See, e.g., Complaint at 12–13, SEC v. Nature’s Sunshine Prods., Inc., No. 09-cv-0672 (D. Utah July 31, 2009) [hereinafter *Nature’s Sunshine Prods. Complaint*] (using control person theory to impute corporate knowledge upon executives).

for the acts of their subsidiaries, even in cases where the parent corporation has no knowledge of the subsidiaries' corrupt actions, such as in *Oracle*.<sup>168</sup>

In a recent FCPA criminal enforcement action, *United States v. Weatherford International Ltd.*, the DOJ alleged in its criminal information that Weatherford knowingly failed to establish an effective system of internal accounting controls designed to detect and prevent corruption, including FCPA violations.<sup>169</sup> In particular, the DOJ alleged that Weatherford did not establish sufficient controls related to (a) anti-corruption due diligence on third parties, joint ventures, and acquisitions; (b) gifts, travel, and entertainment expenses; (c) employees' ethics and compliance violations; and (d) foreign subsidiaries' activities.<sup>170</sup> The DOJ stated in its criminal information that Weatherford, despite being a large and complex company with substantial FCPA risk, did not have a dedicated compliance officer or compliance personnel, nor did it have any anti-corruption training.<sup>171</sup> Weatherford, for all intents and purposes, had taken measures to effect FCPA compliance. Because the case settled with a DPA, one may never know if the government could have met its burden of proving knowledge and intent to violate the internal controls provision of the statute, yet this is an important fact to consider.

Also in 2013, the DOJ charged Total S.A. with a myriad of FCPA violations, including internal controls violations.<sup>172</sup> Specifically, the DOJ

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<sup>168</sup> The same can be said of a more recent enforcement action against Ralph Lauren Corporation. Although settled as an NPA, and heralded as a victory for the defense and a roadmap for companies under government scrutiny, Ralph Lauren Corporation paid \$882,000 to resolve the allegations. In that matter, however, there was no evidence that the parent corporation was aware of the payments made by its Argentinian subsidiary. See Press Release, U.S. Dep't of Justice, Ralph Lauren Corporation Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay \$882,000 Monetary Penalty (Apr. 22, 2013), <http://www.justice.gov/opa/pr/2013/April/13-crm-456.html>; Press Release, U.S. Sec. & Exch. Comm'n, SEC Announces Non-Prosecution Agreement with Ralph Lauren Corporation Involving FCPA Misconduct (Apr. 22, 2013), <http://www.sec.gov/news/press/2013/2013-65.htm>.

<sup>169</sup> Deferred Prosecution Agreement at 10–12, *United States v. Weatherford Int'l Ltd.*, No. 13-cr-733 (S.D. Tex. Nov. 26, 2013) [hereinafter *Weatherford DPA*]. Weatherford entered into a deferred prosecution agreement for its FCPA anti-bribery provision and internal control provision violations. Weatherford paid the DOJ a criminal fine of \$87.2 million in November 2013. See Press Release, U.S. Dep't of Justice, Three Subsidiaries of Weatherford International Limited Agree to Plead Guilty to FCPA and Export Control Violations (Nov. 26, 2013), <https://www.justice.gov/opa/pr/three-subsidiaries-weatherford-international-limited-agree-plead-guilty-fcpa-and-export>.

<sup>170</sup> *Weatherford DPA*, *supra* note 169, at 4–5.

<sup>171</sup> *Id.* at 5. Although Weatherford had an anti-corruption policy, it was only available in English and not translated into any other languages. *Id.*

<sup>172</sup> Deferred Prosecution Agreement, *United States v. Total, S.A.*, No. 1:13-CR-239 (E.D. Va. May 29, 2013). Total entered a DPA for its FCPA related charges. *Id.*

alleged that Total “knowingly circumvented and knowingly failed to implement a system of internal accounting controls sufficient to provide reasonable assurances that transactions and dispositions of Total’s assets complied with applicable law.”<sup>173</sup> In support of this allegation, the DOJ stated that Total:

(a) failed to implement adequate anti-bribery compliance policies and procedures; (b) failed to maintain an adequate system for the selection and approval of consultants; (c) failed to conduct adequate audits of payments to purported consultants; (d) failed to establish a sufficiently empowered and competent corporate compliance office; (e) failed to take reasonable steps to ensure the company’s compliance and ethics program was followed; (f) failed to evaluate regularly the effectiveness of the company’s compliance and ethics program; (g) failed to provide appropriate incentives to perform in accordance with the compliance and ethics program; (h) concealed the consulting agreements’ true nature and true participants; (i) performed no due diligence concerning the named or unnamed parties to these agreements; and (j) lacked controls sufficient to provide reasonable assurances that the consulting agreements complied with applicable laws.<sup>174</sup>

Like Weatherford, Total settled the investigation through a DPA, which did not require the government to prove any of its allegations.<sup>175</sup> Of course, if Total had taken absolutely zero steps toward compliance, a criminal charge for knowing violations of the internal controls provision would be appropriate. Yet, Total is a multinational corporation whose actions, as described above in the criminal information, were no different than the majority of other multinational oil companies working in Iran during that time.

As discussed above in Part III, the requirements for satisfying internal controls provisions are fairly nebulous. Nevertheless, the list of compliance steps that both Weatherford and Total were alleged to have *failed* to take arguably gives some parameters about what the government expects with regards to compliance programs. This is an alarming precedent, albeit only suggestive because the cases settled without going to trial. Nonetheless, it is clear that the DOJ is getting in

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<sup>173</sup> Information at 13, *Total, S.A.*, No. 1:13-cr-239.

<sup>174</sup> *Id.* at 13–14. The SEC’s cease and desist order against Total included the same facts and allegations. Total, S.A., Exchange Act Release No. 69654, Accounting and Auditing Enforcement Release No. 3461, 2013 WL 2326682 (May 29, 2013).

<sup>175</sup> There was speculation for some time that Total would be the first company to hold the SEC and DOJ to their respective burdens of proof and go to trial. See Mike Koehler, *Friday Roundup*, FCPA PROFESSOR (Aug. 3, 2012), <http://www.fcprofessor.com/friday-roundup-45>.



the game of strong-arming defendants for violations of internal controls provisions despite evidence of existing compliance programs.

B. *Individual Liability for Internal Controls Violations*

Of course, internal controls charges are not limited to corporate actors, but also can be levied against individuals.<sup>176</sup> Like all of the FCPA enforcement actions to date, there has not been any enforcement action against an individual that is based *solely* on a violation of the internal controls provision. Rather, these violations are often charged in conjunction with other related charges of either the anti-bribery or books and records provisions.<sup>177</sup> Nevertheless, there is a valid concern that the government might hold individuals, particularly executives, liable for internal controls violations without any bribery occurring, and potentially without any violation of the books and records provision.

By way of example, in 2009, the SEC took a novel and aggressive approach against executives at Nature's Sunshine Products for violations of internal controls.<sup>178</sup> These executives were not directly involved in any other FCPA violation but were implicated for their alleged knowledge of improper payments made by subordinates to Brazilian customs officials.<sup>179</sup> The SEC charged the executives based on control person liability, alleging that they failed to (1) adequately supervise their personnel, (2) ensure accurate books and records were kept, and (3) ensure that proper internal controls were being maintained. In charging the executives under the control person liability theory,<sup>180</sup> the SEC did not allege that the executives had personal

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<sup>176</sup> See, e.g., SEC v. Peterson, No. 12-cv-2033 (E.D.N.Y. 2012) (former Morgan Stanley executive charged with FCPA violations and Investment Advisor fraud); SEC v. Turner, No. 1:10-cv-01309 (D.D.C. 2010) (former business director at Innospec, Inc. and Iraqi agent charged with FCPA violations); SEC v. Benton, No. 09-cv-03963 (S.D. Tex. 2009) (former officer of Pride International, Inc. charged with FCPA violations relating to bribes paid to foreign officials in Mexico and Venezuela); Hatoum, Exchange Act Release No. 74112, Accounting and Enforcement Release No. 3620, 2015 WL 271257 (Jan. 22, 2015) (former employee of PBS&J International, Inc. charged with FCPA violations).

<sup>177</sup> See, e.g., United States v. Peterson, No. 12-CR-224 (E.D.N.Y. 2012); Complaint, SEC v. Sharef, No. 11-cv-9073 (S.D.N.Y. Dec. 31, 2011).

<sup>178</sup> *Nature's Sunshine Prods. Complaint*, *supra* note 167.

<sup>179</sup> *Id.* at 7–9.

<sup>180</sup> Under the control person liability theory, in a majority of circuits, the government is not required to plead that the control person has culpable knowledge. See Zachary S. Brez et al., *Control Person Liability*, 5 Bloomberg L. Rep. (BNA) 17 (2011). Rather, a control person can raise lack of knowledge as an affirmative defense. *Id.* Although not the thrust of this Article's argument, control person liability can affect a number of seemingly uninvolved corporate players. For instance, directors may have a risk of liability under control person theory. This is because they have a duty to "attempt in good faith to assure that a corporate information and

knowledge of the payments, but instead alleged knowledge due to their supervisory position.<sup>181</sup> The executives each agreed to pay \$25,000 civil penalties.<sup>182</sup> Prior to *Nature's Sunshine Products*, the government had not asserted control person liability in FCPA enforcement actions, nor has the government brought an enforcement action under control person theory since that notable case.

Nevertheless, the precedent exists in *Nature's Sunshine Products* that the government may use the mere fact of an individual's supervisory role to impute knowledge of corporate malfeasance, or in a less sinister allegation, that the individual should have known that controls were insufficient. Given the moving target of what is considered "sufficient controls," particularly after the *BHPB* case in 2015,<sup>183</sup> the government has the ability to drastically overenforce and overcriminalize the internal controls provision as it applies to individuals, such as executives or directors.

#### CONCLUSION

The FCPA is a complex and intriguing statute, the enforcement of which has evolved drastically since its passage in 1977. Recent enforcement actions have put the spotlight on corporate internal controls, and seem to forecast that the SEC in particular will aggressively pursue internal controls violations in the absence of foreign bribery. This trend is troubling because it cuts against the original intent of the law. It results in penalties that are not foreseen in the statute, and a

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reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards." *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996). Indeed, Delaware case law makes clear that director liability exists if there is a "sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists." *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 364 (Del. 2006). Taking the logic from the *Oracle* and *Mead Johnson* cases, where parent corporations were charged for actions of the subsidiaries (of which the parent corporations were unaware), it is not a stretch to assume the government may expand individual liability to independent directors, audit committees, or other corporate executives who may be unaware of any illegal payments or accounting methods. Despite the threat of possible government enforcement, the government has yet to levy an internal controls charge against an individual who was not directly involved in malfeasance related to the FCPA's anti-bribery or accounting provisions, or was in control of those directly involved, but instead is merely aware of the lack of internal controls in the company for which he or she is an independent director.

<sup>181</sup> *Nature's Sunshine Prods.* Complaint, *supra* note 167.

<sup>182</sup> SEC Charges *Nature's Sunshine Products, Inc.* with Making Illegal Foreign Payments, Litigation Release No. 21162 (July 31, 2009).

<sup>183</sup> *BHP Billiton Ltd.*, Exchange Act Release No. 74998, 2015 WL 2393657 (May 20, 2015).

general overenforcement and overcriminalization of the statutory provision. Overenforcement and overcriminalization have a negative deterrent effect, and likely will do more harm than good in terms of fulfilling the statutory purpose of eradicating foreign bribery, and in ensuring companies are undertaking reasonable steps to comply with the statute and establish robust internal controls.