BRIBERY & ANTI-CORRUPTION

STAYING AHEAD OF THE CURVE

What Directors Need to Know In an Era of Expanding FCPA Enforcement

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This article contains information regarding the following topics: STRATEGY + LEADERSHIP + RISK MANAGEMENT

When word circulated last year that a main character on the daytime drama, The Young and the Restless, was arrested for violating the "Foreign Practices Corrupt Act," it was a watershed moment. Although anti-corruption experts snickered at the error, we also recognized that there was perhaps no more obvious sign that the U.S. Foreign Corrupt Practices Act ("FCPA"), once the bailiwick of a small, guild-like group of Washington prosecutors and defense lawyers, had entered the mainstream.

If the soap opera moment isn't convincing, consider these statistics:

Corporate FCPA fines and penalties totaled approximately $2.7 million in 2002 and $1.8 billion in 2010.

The Department of Justice and Securities and Exchange Commission resolved six FCPA enforcement actions in 2002 and 71 in 2010.

The FCPA was discussed in 462 news articles in 2000, and 4518 in 2010.

Measured by total fines and penalties, eight of the top ten FCPA settlements since 1977 were entered into in 2010.

The era of heightened FCPA enforcement is by no means at an end.

The government is not the only external source of pressure on companies. Following disclosure of an FCPA issue, shareholder derivative actions alleging a breach of fiduciary duty are a near certainty. Although to date these cases have typically been dismissed or settled out of court, they are an expensive and potentially significant threat. Other plaintiffs, including competitors, former employees and foreign governments, have also recently turned to antitrust, civil RICO and competition rules to seek redress for damage caused by corrupt activity.

Given the increased risks and costs of FCPA liability, directors must be knowledgeable about how their company is addressing FCPA risk. It can be daunting, however, to figure out how to stay ahead of the curve in such a fast-moving area.

Rather than get wrapped up in the complexities, Board members can prepare to meet this challenge by returning to the fundamentals. In evaluating FCPA risk, the fundamentals are:

1. *What does the company produce and sell (which typically determines the level of government regulatory involvement)?*

2. *Where are those products sold (high or low risk countries)?*

3. *To whom are they sold (government or private customers)?*

4. *How are the products sold (direct sales or through third parties)?*

In compliance, the fundamentals come in the form of the "seven elements" of effective compliance set out in Chapter Eight of the 2010 U.S. Federal Sentencing Guidelines Manual ("Guidelines"). The Guidelines provide that "the organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program." A closer look at several of these elements provides a framework for directors to discharge their oversight responsibility with regard to FCPA compliance.

CONTINUING EDUCATION:
Ensuring the Board Knows What Questions to Ask, and How to Evaluate Answers

The first question is whether the Board is equipped to evaluate what it hears from management. The Guidelines state that the organization "shall take reasonable steps to communicate periodically . . . its standards and procedures . . . to [the governing authority] by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities."

FCPA training should be on the Board's calendar. Whether in-house or outside FCPA counsel conducts these training sessions will vary. Shifts in FCPA policy and expectations often are announced through enforcement actions, and you may get caught short if you wait to read about the settlements in the papers. If in-house counsel cannot readily explain what's in the enforcement pipeline, consider going to outside FCPA counsel. The Board should be conversant in the company's FCPA risk profile, current anti-corruption enforcement trends, and compliance best practices to be able to critically evaluate the information it receives, as well as management's regard for, anticipation of, and response to FCPA issues.

CHIEF COMPLIANCE OFFICER "ACCESS" TO THE BOARD

Once the Board is trained, the next question is how often the Board, or a Board committee, meets with the Chief Compliance Officer ("CCO") to discuss the compliance program. The Guidelines Commentary explains that the CCO "should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness" of the program.

If the Board doesn't meet with the CCO, or if such a meeting only occurs at the CCO's request, add the CCO to the calendar and make it mandatory. Optional access is likely to be used only when a problem arises; in that case, the Board has arguably failed to discharge its "reasonable oversight" responsibility and left itself and the company exposed to liability.

If the Board meets with the CCO, topics should include updates on key program elements. For example, is there a complete inventory of the company's third party relationships? Have they passed through due diligence? How is FCPA training conducted, for whom, and how often? As discussed below, the briefing should cover concerns identified through reporting mechanisms or audits, and how they are being addressed. The level of detail should be commensurate with the company's corruption risks.

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PERIODIC TESTING OF PROGRAM EFFECTIVENESS

The Guidelines provide that companies should periodically test the effectiveness of their ethics and compliance program. If a company has embedded processes to test its program, it is more likely to detect gaps and weaknesses before those weaknesses result in a violation that will give rise to liability for the company. Any company on the back end of an enforcement action will tell you that they would have preferred to spend the money on prevention, rather than on the cure. Nonetheless, some companies still view FCPA compliance audits as a "nice to have" or mistakenly assume that standard Sarbanes-Oxley audits cover the necessary ground (they don't).

COMPLIANCE PROGRAM READINESS IN THE DODD-FRANK ERA

The Guidelines provide that an effective program must "have and publicize a system . . . whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation." In the wake of passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, hotlines have become a hot topic. Early reports suggest the SEC may reject the notion that a whistle-blower should not be eligible to recover the sizeable rewards available under the Act unless they have first used the company's own reporting mechanisms, and the company has failed to respond appropriately. Regardless of what the regulations say in the end, however, the Guidelines remain the same.

Dodd-Frank presents an opportunity for the Board to engage management on the subject of the reporting mechanisms in place. What are they? How often are they used? What kinds of issues are being reported? What is the process for responding to concerns? How is the process documented? These questions should already be covered by the company's compliance auditing, but they are worth separate discussion in light of new incentives for whistle-blowers to take their complaints elsewhere.

MERGERS & ACQUISITIONS DUE DILIGENCE

The Guidelines call for a company to "periodically assess the risk of criminal conduct" to tailor its compliance program to its risk. The Commentary explains that the nature and prior history of a business informs this assessment. A merger or acquisition by definition introduces a new "prior history," if not a different "nature of the business." Thus, an effective program requires assessment of the compliance risks posed by the transaction. These transactions often move quickly and management, perhaps rightly, is focused on getting the deal done. M&A transactions, however, are fertile ground for FCPA enforcement officials and civil litigants. Still, some continue to question the need for compliance due diligence. The Board can play a critical risk management role by ensuring that the transaction agreements expressly provide for full and cooperative due diligence, and by overseeing that process.

Currently, companies face aggressive FCPA enforcement, litigious shareholders, rising compliance and disclosure expectations, and a struggling economy. By focusing on the fundamentals and pursuing the right questions, Boards of Directors can help ensure companies not only meet these challenges, but stay ahead of the curve.

Author Biography

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