Chapter 14

The SEC's Enforcement of the Foreign Corrupt Practices Act*

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§ 14:1 Background

The Foreign Corrupt Practices Act of 1977 (FCPA) was adopted by Congress to combat the widespread use of corporate funds for questionable and illegal foreign and domestic payments. The existence of such payments and "off the books" slush funds raised serious questions for the SEC about the integrity and accuracy of the financial statements of U.S. companies and whether the disclosure obligations at the core of U.S. securities laws were being undermined. The FCPA addressed the issue by making it illegal for a U.S. "issuer" or "domestic concern" to pay, offer, or promise a bribe to a foreign government official, political party, or party official for the purpose of influencing an official act in order to obtain or retain business. Section 30A of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C.A. § 78dd-1. Although these antibribery provisions are frequently the focus of discussions concerning the FCPA, the FCPA also added broad reaching accounting provisions to the federal securities laws. These provisions require issuers to (i) keep accurate books and records, and (ii) maintain a system of internal ac-

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counting controls adequate to ensure that the company's assets are properly accounted for. Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, 15 U.S.C.A. §§ 78m(b)(2)(A) and 78m(b)(2)(B). Unlike the antibribery provisions of the FCPA, the accounting provisions are not focused exclusively on foreign or international business transactions. Thus, the SEC has brought hundreds of enforcement cases since the adoption of the FCPA, charging U.S. issuers with violations of the FCPA's books and records and internal control provisions where the underlying conduct or transactions occurred solely within the United States with no foreign connection.

§ 14:2 SEC's authority and nature of the SEC's FCPA investigations

The SEC has authority for civil enforcement of the FCPA's antibribery and accounting provisions. The SEC's enforcement authority is limited to "issuers" of U.S. registered securities or companies required to file reports with the SEC, as well as the officers, directors, employees, shareholders, and agents of such companies. It should be noted that foreign domiciled issuers are within the SEC's authority, provided that the foreign domiciled issuer has securities registered in the United States. *See Montedison* discussion *infra* at § 14:15.

Ensuring the accuracy of financial disclosure by issuers with U.S. registered securities is one of the SEC's top enforcement priorities. For this reason, the SEC's FCPA investigations tend to focus broadly on the overall integrity of the issuer's financial statements and not simply on the narrow issue of whether an FCPA prohibited payment was made. In other words, although the SEC is clearly concerned with determining who authorized and/or paid the bribe, that is only the start of its inquiry. SEC investigators will also try to determine who falsely recorded the bribe in the company's books and records, who lied or otherwise hid the bribe from the outside auditors, why the issuer's internal controls failed to identify the bribe, whether the bribe resulted in false public disclosures by the issuer, and whether senior management knew or should have known of the bribe or the related improper accounting.

Although certain regions of the world and certain industries have been identified as "high risk" for illicit payments, the SEC does not focus its FCPA enforcement geographically or on particular lines of business. Leads for possible investigations have appeared in the financial or industry press, complaints to the government from business competitors, or even from whistleblowers within the company accused of paying the bribe. The fact that much of the conduct related to an illicit foreign payment will often occur outside U.S. territory makes these cases difficult for the government to investigate effectively. The simple fact that many of the relevant records may not be maintained in English will, by itself, dramatically increase the government's cost and the speed at which it can conduct an inquiry.

The need to obtain information from foreign entities, both government and private, makes it very likely that the SEC staff will seek a Formal Order of investigation early in an FCPA investigation. The Formal Order provides the SEC staff with the power to issue administrative subpoenas to compel testimony and the production of relevant financial or other documents. The document subpoena in an FCPA matter is likely to be quite comprehensive, seeking all documents related to the transaction involving the alleged illicit payments, as well as all of the issuer's accounting records that might have been impacted by the booking of the payment. The SEC staff will also seek depositions from all employees and other persons (*e.g.,* auditors, agents, etc.) who may have knowledge of the illicit payments or who may have been involved in recording the payments in the issuer's books and records or financial statements.

Because administrative subpoenas may only be validly served within the United States, they are of limited use in obtaining documents or testimony from individuals residing overseas or companies with no U.S. presence. The SEC staff will typically take the position that a U.S. company (including financial institutions) with foreign opera-

tions has custody or control over documents at the foreign affiliate and should, thus, produce the documents pursuant to a subpoena served in the United States on the U.S. company. The SEC has agreements, or memorandums of understanding (MOUs), with securities regulators in approximately thirty different countries that provide the SEC an alternative means of requesting information from persons or entities outside the range of the SEC's subpoenas. In addition, the SEC will be able to seek information pursuant to the mandatory, multilateral cooperation provisions of the Organization for Economic Cooperation and Development Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention).

The nature of the covered conduct—bribes involving foreign governments and how they are accounted for—virtually guarantees that the SEC's investigation of an FCPA matter will be protracted, disruptive, and expensive for the issuer.

§ 14:3 SEC's cooperation with the department of justice

The Department of Justice (DOJ) shares responsibility with the SEC for enforcing the FCPA. The DOJ is authorized to prosecute violations of the FCPA criminally and may also bring civil actions where appropriate. In addition to actions against issuers and related persons, the DOJ, unlike the SEC, is also authorized to bring actions against "domestic concerns" (*e.g.,* private companies) and associated individuals. It should be noted that the accounting provisions of the FCPA do not apply to companies that are not issuers.

The shared responsibility for FCPA enforcement means that the SEC and the DOJ will communicate regularly and cooperate closely on FCPA investigations and/or FCPA policy issues. It should be assumed that any information provided to one agency will promptly be shared with the other. The SEC has a practice of promptly notifying criminal prosecutors when its civil investigations indicate that the misconduct at issue is sufficiently egregious to be prosecuted criminally.

In FCPA matters involving issuers and/or affiliated persons, where both agencies have jurisdiction, there is no specific procedure in place for determining which agency will conduct the investigation or whether the agencies will conduct simultaneous investigations of the same conduct. As in most federal securities law matters that create the potential for both civil and criminal enforcement, the SEC may choose to defer its inquiry, or at least coordinate its investigation closely with the DOJ, if a preliminary review indicates a strong likelihood that the DOJ's investigation is likely to result in a significant criminal prosecution. This result is not required by rule or even protocol. It is simply an implicit recognition by the SEC staff that the investigative tools available to the DOJ (most notably the grand jury and mutual legal assistance treaties with foreign governments) gives the DOJ an effective means of conducting such investigations not directly available to the SEC. In addition, the SEC certainly recognizes that the potential for jail time and substantial criminal fines attracts greater public attention and, thereby, provides a greater deterrent than that provided by civil remedies.

This is not meant to suggest that the SEC is likely to broadly defer to the DOJ on FCPA matters. The SEC's fundamental concern about the integrity of issuer financial disclosure means that its cases will often have a broader and somewhat different focus than the DOJ's FCPA cases. *See Triton* discussion *infra* at § 14:14 As noted above, the SEC is concerned not only with the fact that a bribe was paid, but rather with what the payment of the bribe says about the quality of the issuer's internal controls, accounting records, and public disclosures. On a more pragmatic level, the beyond a reasonable doubt standard of proof applicable in a DOJ criminal FCPA case, means that a DOJ prosecutor will have an extremely difficult evidentiary burden to satisfy. In contrast, the SEC's civil actions must establish the same elements of the FCPA violation only by a preponderance of the evidence. In other words, there will be particular cases where difficulties in satisfying the criminal standard of proof will tend to support the SEC bring-

ing the case as a civil matter. The SEC's broad approach to enforcing the internal control, accounting, issuer reporting, and disclosure aspects of an FCPA violation may also result in the filing of simultaneous actions. The DOJ's action focused on the illicit payment violation, and the SEC's action focused on the broader accounting and public disclosure concerns.

§ 14:4 SEC's sanction powers

The SEC has the option of pursuing an FCPA case either as a civil injunctive action in federal court or as a cease-and-desist proceeding in front of an administrative law judge. The serious nature of an illicit payments violation and the fact that fines against issuers and their employees are only available in a federal court action suggests that most, if not all, of the SEC's illicit payments cases are likely to be filed in federal court. Of course, the SEC always has the option of bifurcating its enforcement action, seeking the imposition of the civil penalty in a federal court action, and simultaneously obtaining a cease-and-desist order in an administrative proceeding. This option is traditionally used by the staff only in settled cases. Indeed, this is precisely the approach taken by the staff in its December 2000 and January 2002 settlements of the *IBM* and *BellSouth* cases, respectively. *See* §§ 14:9 and 14:13. It is also common, in an SEC investigation, for the most serious violators to be charged in a federal court action, while less culpable participants in the same matter are simultaneously charged in an administrative action.

Fines for illicit payments violations are not part of the SEC's general fining authority but are separately provided for in § 32(c) of the Exchange Act. Section 32(c) authorizes a civil penalty of not more than $11,000 for a violation by an issuer or any officer, director, employee, or agent of an issuer. However, because an illicit payments scheme will almost invariably include other violations of the securities laws (*e.g.,* books and records, internal controls, etc.), each of which are subject to the SEC's general fining authority under § 21(d)(3) of the Exchange Act, fines against issuers are likely to be significantly greater than $11,000. The SEC is authorized to seek fines against individuals from $6,500 to $110,000 per violation, and against issuers from $60,000 to $600,000 per violation. In a settled matter, the amount of the fine is a matter of negotiation with the SEC staff, subject to approval by the SEC. In the SEC's FCPA cases against Triton Energy and IBM, the issuers each agreed to fines of $300,000. The fines against BellSouth ($150,000), Chiquita ($100,000), and American Bank Notes ($75,000) have been significantly less. Indeed, the *Baker Hughes* case was settled with no fine against the company. In *Triton,* the two Triton Indonesia employees directly involved in the illicit payments agreed to fines of $50,000 and $35,000. *See* § 14:14.

Historically, an issuer that self-reported an FCPA illicit payments problem was unlikely to avoid being the subject of an SEC enforcement action. Although the SEC claims not to grant civil immunity, it is sometimes possible to obtain a limited reduction in charges and often a significant reduction in sanctions through cooperation with the staff's investigation and by promptly implementing appropriate remedial measures. Clearly, the SEC staff views an issuer's self-reporting of a problem as a significant factor in framing its ultimate enforcement recommendation. The SEC staff also considers, in assessing cooperation, the volunteering of information, particularly information not otherwise available to the staff; timely production of documents and witnesses; waiver of attorney-client and work-product privileges; bona fide, independent internal review of the problem; providing internal review findings to the staff; appropriate action taken against employee wrongdoers (*e.g.,* "housecleaning"); corrective disclosure and restatement of financials, if necessary; and adoption of new internal controls and procedures to prevent recurrence.

In a marked change from prior SEC practice, the *Baker Hughes* case demonstrates how exemplary cooperation may substantially benefit the corporate entity in an FCPA action brought by the SEC. Clearly, the SEC believed that it had a compelling illicit payments case. It filed a contested action alleging illicit payments against the former chief

financial officer (CFO) and the former controller of Baker Hughes, and the settled administrative cease-and-desist action brought against Baker Hughes described the illicit payments made. Nevertheless, the SEC limited the order's findings to violations of the internal control and books and records provisions of the FCPA, and as noted above, Baker Hughes was also the first issuer to avoid an SEC civil penalty in an FCPA action.

§ 14:5 Recent SEC activity in FCPA enforcement

For the last several years, the SEC has spoken of an increase in FCPA enforcement activity and noted that there were a number of new cases in the "pipeline." Those cases began flowing out of the pipeline in 2003 in record numbers. Recent FCPA cases brought by the SEC are discussed below.

§ 14:6 Recent SEC activity in FCPA enforcement—American Rice

According to the SEC's litigation release on this matter, former officers of American Rice, Inc., David Kay and Douglas Murphy, engaged in illicit payments to Haitian officials in exchange for reductions in import taxes on American Rice's products to Haiti.

> [I]n advance of certain rice shipments to Haiti between January 1998 and October 1999, Kay directed an American Rice employee to prepare false shipping records that underreported the tonnage of rice on the relevant vessels. Haitian customs officials used the false records to clear the American Rice vessels through customs. After the vessels cleared customs, Kay allegedly directed American Rice employees in Haiti to pay cash bribes to certain customs officials. To hide the payments, Kay then directed American Rice's controller in Haiti to improperly record the bribery payments as routine business expenditures.

SEC Litig. Rel. No. 18925 (Oct. 7, 2004), http://www.sec.gov/litigation/litreleases/lr18925.htm. The bribes resulted in tax reductions for American Rice in the amount of $1.5 million. Murphy, American Rice's president, "knew about the bribery scheme, but took no action to stop the payments." *Id.*

The DOJ, working jointly with the SEC, investigated the matter and ultimately decided to bring criminal charges against the two officers, while the SEC instituted a civil action in federal court against the officers as well as a third individual who, the SEC alleges, aided and abetted Kay and Murphy in violating the FCPA. In October 2004, Kay and Murphy were convicted by a federal jury in Houston for violating the FCPA and obstruction of justice. They were to be sentenced on January 6, 2005. *Id.*

The case demonstrates the agencies' willingness to bring, and ability to prosecute successfully, ***criminal*** charges against violators of the FCPA. It also demonstrates the SEC's draconian stance on potential FCPA violations, as both those who perpetrate illicit payments and those who simply condone them will be subject to civil and/or criminal prosecution.

§ 14:7 Recent SEC activity in FCPA enforcement—ABB, Ltd

ABB, Ltd., based in Switzerland, allegedly "made illicit payments totaling over $1.1 million to government officials" around the world in order to receive favorable treatment for ABB's global subsidiaries, thereby violating the FCPA. SEC Litig. Rel. No. 18775 (July 6, 2004), http://www.sec.gov/litigation/litreleases/lr18775.htm. The SEC filed a settled enforcement action in which ABB consented to a final judgment, without admitting or denying the allegations, of a $5.9 million disgorgement penalty and a $10.5 million fine. *Id.*

Notably, as a company based in Zurich, Switzerland, ABB was not covered by the FCPA until April 2001 when it became a reporting company. The Litigation Release alleged that $865,726 of the payments were made after ABB became a reporting company, *id.,* meaning that some of the payments were made while ABB was not subject to the FCPA. Furthermore, the Litigation Release noted that, while the SEC believed that ABB violated both the accounting and antibribery provisions of the FCPA,

> [i]n determining to accept ABB's settlement offer, the Commission considered the full cooperation that ABB provided to the Commission staff during its investigation. The Commission also considered the fact that ABB brought this matter to the attention of the Commission's staff and the U.S. Department of Justice. Based in part upon ABB's cooperation, the Commission determined to allow ABB's $10.5 million civil penalty obligation to be deemed satisfied by two of its affiliates' payments of criminal fines totaling $10.5 million in a parallel criminal proceeding brought by the U.S. Department of Justice [involving guilty pleas and criminal fines on the part of two ABB subsidiaries].

Id.

§ 14:8 Recent SEC activity in FCPA enforcement—Schering-Plough Corporation

On June 9, 2004, Schering-Plough Corporation consented to an administrative cease-and-desist order under § 21C of the Exchange Act and paid a $500,000 civil penalty for violations of § 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act for making improper payments to a charitable organization affiliated with a foreign official of the Polish government. The order also required Schering-Plough to retain an independent consultant to review the company's FCPA policies and procedures and to implement any changes recommended by the consultant. *SEC v. Schering-Plough Corp.,* Case No. 1:04CV00945 (PLF) (D.D.C.) (June 9, 2004); *In the Matter of Schering-Plough Corp.,* Rel. No. 34-49838 (June 9, 2004); *see* SEC Litig. Rel. No. 18740 (June 9, 2003), http://www.sec.gov/litigation/litreleases/lr18740.htm.

The SEC alleged that a Polish subsidiary of Schering-Plough, between February 1999 and March 2002, made approximately $76,000 in total payments to the Chudow Castle Foundation, which was headed by an individual who also served as the director of the Silesian Health Fund, a Polish government body. The SEC further alleged that these payments were made to induce the health fund director to influence the purchase of Schering-Plough's pharmaceutical products by hospitals within the health fund. SEC Litig. Rel. No. 18740. While the SEC acknowledged that the payments were made to a bona fide charity, the SEC, nevertheless, found that they were made to improperly influence the director, noting that (i) sales of two Schering-Plough oncology products increased disproportionately compared with sale of those products in other regions in Poland, and (ii) a Schering-Plough manager viewed the payments as "dues" required to be paid for assistance from the director.

The SEC also criticized Schering-Plough's policies and procedures for detecting possible FCPA violations because it did not require employees, prior to March 2002, to conduct any due diligence before making promotional or charitable donations to determine whether any government officials were affiliated with proposed recipients. As a result, Schering-Plough's Polish subsidiary failed to consider whether payments to the foundation might constitute an improper payment to obtain or retain business from the Silesian Health Fund.

The SEC also criticized Schering-Plough's failure to act when faced with red flags that "should have alerted" the company of the FCPA issues, including

(1) the foundation was not a health care-related entity and internal company policies provided that donations generally were to be made to health care institutions or related to the practice of medicine;
(2) the size of the payments to the foundation in relation to the company's budget for such donations;
(3) the structuring of the payments, which allowed a Schering-Plough subsidiary manager to exceed his authorization limits; and
(4) the director's relationship with the Polish government.

§ 14:9 Recent SEC activity in FCPA enforcement—BellSouth Corporation

On January 15, 2002, BellSouth Corporation consented, on a neither admit nor deny

basis, to the imposition of a $150,000 civil penalty and an administrative cease-and-desist order for violations of bookkeeping and internal control provisions, Section 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, for improperly recording payments made by BellSouth's Venezuelan and Nicaraguan subsidiaries. *SEC v. BellSouth Corp.,* Civ. Action No. 1:02-CY-0113 (N.D. Ga.) (Jan. 15, 2002); *In re BellSouth Corp.,* Rel. No. 34-45279 (Jan. 15, 2002). *See* SEC Litig. Rel. No. 17310 (Jan. 15, 2002), http://www.sec.gov/litigation/litreleases/lr17310.htm.

The SEC's actions stem from illicit payments made by two South American subsidiaries of BellSouth—Telcel, C.A. and Telefonia Celular de Nicaragua, S.A. The SEC alleged that Telcel senior management, based in Venezuela, authorized payments totaling approximately $10.8 million to six offshore entities and subsequently booked the disbursements as legitimate corporate expenditures. The SEC further alleged BellSouth could not determine to whom the payments were made or why they were made.

With respect to the payments made by Telefonia (BellSouth's Nicaraguan subsidiary), the SEC alleged that between October 1998 and June 1999, the company "improperly recorded payments to the wife of the Nicaraguan legislator who was the chairman of [a] legislative committee with oversight of Nicaraguan telecommunications." SEC Litig. Rel. No. 17310. Prior to the alleged improper payments, BellSouth acquired a 49 percent stake in Telefonia and an option to purchase an additional 40 percent ownership interest. At the time of its initial investment in Telefonia, BellSouth was unable to acquire a larger ownership interest because of restrictions imposed under Nicaraguan law.

The SEC alleged that after BellSouth's Telefonia investment, Telefonia "retained the wife of the Nicaraguan legislator to provide various regulatory and legislative services, including lobbying for repeal of Nicaraguan's foreign ownership restriction." *Id.* While she had prior professional experience, the SEC noted that she had no legislative experience. The SEC alleged that a former in-house attorney with BellSouth International, an indirectly wholly owned subsidiary of BellSouth, approved the retention of the legislator's wife even though the attorney lacked sufficient experience or training with FCPA issues. The SEC further alleged that while the legislator's wife was retained to endeavor to repeal the foreign ownership restriction, the legislator drafted a proposed bill repealing the restriction and sought support from others on the committee. Moreover, the legislator presided over a hearing during which BellSouth International advocated for relief from the foreign ownership restriction.

Telefonia subsequently terminated its relationship with the lobbyist, making a $60,000 payment to her for consulting services and severance payments. Three months later the committee referred the proposed amendment to the Nicaraguan legislature, which subsequently voted to repeal the foreign ownership restriction. Shortly thereafter, BellSouth exercised its option and purchased an additional 40 percent interest in Telefonia. *Id.*

The SEC's administrative order explicitly noted that the SEC considered BellSouth's level of cooperation with the SEC's investigative staff the remedial measures undertaken and enhancements made by BellSouth to its FCPA compliance program in accepting BellSouth's offer of settlement.

§ 14:10 Recent SEC activity in FCPA enforcement—Chiquita Brands

On October 3, 2001, the SEC announced the issuance of a settled cease-and-desist order against Chiquita Brands International, Inc., in which the SEC found that Chiquita violated the books and records provisions, § 13(b)(2)(A), and the internal control provisions, § 13(b)(2)(B), of the Exchange Act in connection with payments made to a Colombian customs official. The SEC simultaneously filed a settled complaint in federal court that required Chiquita to pay a civil penalty of $100,000. *SEC v. Chiquita Brands Int'l, Inc.* Civ. Action No.1: DICV02079 (D.D.C.) (Oct. 3, 2001); *see* SEC Litig. Rel. No. 17169 (Oct. 3, 2001), http://www.sec.gov/litigation/litreleases/lr17169.htm.

Chiquita's violations relate to the conduct of its wholly owned subsidiary Banadex, which is headquartered in Medillin, Colombia. Chiquita's Colombian operations consisted of, among other things, a number of banana farms located throughout the country and an import/export port facility located in Turbo, Colombia. Banadex owned and operated the Turbo facility, which was licensed by the Colombian government as a location where goods could be stored pending inspection by customs officials. In 1995, the Colombian government issued a decree requiring all current license holders to submit renewal applications. Banadex learned of the decree through CEA, a Colombian entity licensed by the government to act as an intermediary between corporations and the customs officials.

In 1995, Banadex management was advised that renewal of its customs license was in jeopardy because of two prior citations for failure to comply with customs regulations. Banadex's chief administrative officer authorized Banadex' s CEA agent to make a payment to Colombian customs officials to obtain the license renewal and directed Banadex's security officer and controller to make and process the payment. The CEA agent advised Banadex that the citations would be overlooked and the renewal granted for a payment equivalent to approximately $30,000. Banadex agreed to make the payment in two installments—$18,000 in advance and the remainder after renewal. Both payments were made by Banadex's security officer from a company account used for discretionary expenses. The initial payment was falsely reflected in the company's books and records as a maritime donation, and the second payment was falsely reflected as relating to a maritime agreement.

The SEC found that the inaccurate entries to conceal the payments to the customs officials made in the documents recording the payment and in the general ledger violated the FCPA's requirement that Chiquita maintain books and records which accurately reflected Banadex's transactions and disposition of assets. The SEC further found that Chiquita violated the internal control provisions by failing to maintain a system of internal accounting controls to ensure that Banadex's books and records accurately and fairly reflected the disposition of Banadex's assets.

§ 14:11 Recent SEC activity in FCPA enforcement—Baker Hughes

According to the SEC's litigation release on this matter, see SEC Litigation Release No. 17126 (Sept. 12, 2001), http://www.sec.gov/litigation/litreleases/lr17126.htm, in March 1999, two senior officers of Baker Hughes Inc., James W. Harris and Eric L. Mattson, were approached by an Indonesian tax official. The official offered to reduce a tax assessment on an Indonesian company beneficially owned by Baker Hughes in exchange for a $75,000 bribe. The net worth of the reduction in taxes to Baker Hughes was approximately $2.9 million. Baker Hughes's agent in Indonesia, KPMG-Siddharta Siddharta Harsono (KPMG-SSH), offered to execute the transaction and conceal the payment by falsifying some accounting records.

In addition to Harris and Mattson, Baker Hughes's general counsel and FCPA adviser were also made aware of proposed illicit transaction. Both the general counsel and the FCPA adviser warned that acceptance of the proposal would raise serious FCPA issues and that "under no circumstances should Harris or Mattson enter into [the transaction]." *Id.* Ignoring this counsel, Harris and Mattson paid the bribe through KPMG-SSH, thereby violating the accounting and antibribery provisions of the FCPA.

On September 11, 2001, the SEC instituted a civil action in federal court against Mattson and Harris, and a separate civil action against KPMG-SSH, alleging violations of the FCPA. With respect to KPMG-SSH, the defendants consented, without admitting or denying the SEC's allegations, to a final judgment that "permanently enjoined both defendants from violating and aiding and abetting the violation of the antibribery provisions of the FCPA and the internal controls and books and records provisions of the Exchange Act." *Id.* With respect to Mattson and Harris, the district court dismissed the

SEC's claims. The SEC appealed, but on July 14, 2004, the Fifth Circuit Court of Appeals dismissed its appeal, concluding the litigation. *See* SEC Litig. Rel. No. 18863 (Sept. 1, 2004), http://www.sec.gov/litigation/litreleases/lr18863.htm.

With respect to Baker Hughes, the SEC instituted a settled administrative proceeding, and Baker Hughes consented to the SEC's cease-and-desist order without denying or admitting the allegations of the accounting provisions of the FCPA. SEC Litig. Rel. No. 17126. As recounted above, what is notable about this settlement is the fact that Baker Hughes was, largely because of its cooperation with the SEC's investigation, spared the requirement of paying a fine and the charging of violations of the antibribery provisions of the FCPA, despite the fact that the SEC believed that such violations had occurred.

§ 14:12 Recent SEC activity in FCPA enforcement—American Bank Note Holographics, Inc

On July 18, 2001, the SEC filed actions in the U.S. District Court for the Southern District of New York "against current and former senior officers and directors of American Banknote Corporation (ABN) and/or American Bank Note Holographics, Inc. (ABNH) for violations of the antifraud, periodic reporting, record keeping, internal controls, and lying to auditors provisions of the federal securities laws." SEC Litig. Rel. No. 17068, http://www.sec.gov/litigation/litreleases/lr17068.htm.

According to the SEC, senior officers Morris Weissman and Joshua Cantor of ABN and ABNH, respectively, engaged in a systematic fraudulent scheme to inflate the revenues and net income of ABNH and ABN. The complaint alleges that in late 1998, Weissman and Cantor violated the antibribery provisions of the federal securities laws by causing ABNH to pay $239,000 to a Swiss bank account for the purpose of influencing or affecting the acts or decisions of one or more Saudi Arabian government officials, or the Saudi Arabian government, to assist ABNH in obtaining or retaining business with that government. *Id.* ABNH employed agents who were responsible for seeking out new business in various regions of the world. These agents were generally compensated on a commission basis for any business they generated for the company. In late 1998, one of ABNH's agents informed an ABNH employee of an opportunity to bid on a contract to produce holograms for the Saudi Arabian government. In an effort to obtain the contract, Weissman and Cantor authorized and directed an ABNH employee to wire $239,000 to a Swiss bank account for the benefit of one or more officials of the Saudi Arabian government. The employee wired the money as instructed and ABNH accounted for this payment as a consulting fee. This $239,000 payment comprised nearly 40 percent of the contract's value.

The SEC complaint against Weissman and Cantor sought an injunction, an order prohibiting them from acting as an officer or director of a public company, that they disgorge certain compensation and trading profits, and that they pay civil penalties. The SEC also "settled an administrative cease-and-desist proceeding against ABNH pursuant to which ABNH . . . consented to an order requiring it to cease and desist from committing, or causing any violation, and any future violation, of the antifraud, antibribery, periodic reporting, record-keeping and internal controls provisions of the federal securities laws." *Id.* As part of its settlement, ABNH consented to pay a $75,000 penalty for its violations of the FCPA's antibribery provisions.

Simultaneous with the SEC action, the U.S. Attorney's Office of the Southern District of New York announced an indictment against Weissman. In addition, Cantor was expected to plead to a four count information charging that he conspired to commit securities fraud, falsified corporate books and records, provided false statements to auditors, and violated the FCPA.

§ 14:13 Recent SEC activity in FCPA enforcement—IBM

On December 21, 2000, the SEC announced the filing of a settled cease-and-desist

proceeding against International Business Machines Corporation (IBM), for violation of the FCPA's books and records provisions. SEC Litig. Rel. No. 16839, http://www.sec.gov/litigation/litreleases/lr16839.htm. At the same time, the SEC filed a settled complaint in federal court pursuant to which IBM agreed to pay a $300,000 civil penalty for the same violation. *SEC v. International Bus. Machs. Corp.,* Civ. Action No.1:00CV03040 (JR) (D.D.C. Dec. 21, 2000).

According to the SEC's litigation release on the matter, in carrying out the contract certain, "former senior management of IBM-Argentina, S.A. (IBM-Argentina), a wholly owned subsidiary of IBM, caused IBM-Argentina to enter into a subcontract with Capacitacion Y Computacion Rural, S.A. (CCR). . . . [In] 1994 and 1995, IBM-Argentina paid CCR approximately $22 million under the subcontract, of which at least $4.5 million was transferred to several bank directors by CCR." SEC Litig. Rel. No. 16839. The Order further found that IBM-Argentina's former senior management provided IBM-Argentina's procurement department with fabricated documentation, including a backdated authorization letter and a document that stated incomplete and inaccurate reasons for hiring CCR. According to the Order, IBM-Argentina recorded the payments to CCR in its books and records as legitimate third-party subcontractor expenses. This false information was incorporated into IBM's 1994 Form 10-K which was filed with the SEC on March 23, 1995.

The Order noted that under the FCPA, IBM was responsible for ensuring that its wholly owned foreign subsidiary complied with the FCPA's books and records provisions and that IBM violated such provisions by failing to ensure that IBM-Argentina's books and records accurately reflected its transactions and disposition of assets in connection with the CCR subcontract.

§ 14:14 Recent SEC activity in FCPA enforcement—Triton Energy

In 1997, the SEC instituted settled civil and administrative proceedings against Triton Energy Corporation and six former employees, including the former CEO and CFO, alleging violations of the antibribery, books and records, and internal control provisions of the FCPA. *SEC v. Triton Energy Corp.,* Civ. Action No. 1:97 CV00401 (RMU) (D.D.C.) (Feb. 27, 1997). Triton was the first illicit payments case brought by the SEC since *SEC v. Ashland Oil* in 1986. *See* SEC Litig. Rel. No. 11150 (July 8, 1986).

The Triton case involved the activities in Indonesia of Triton Indonesia (TI), a wholly owned subsidiary of Triton, a Texas based company registered with the SEC with stock listed on the NYSE. The facts of the Triton case are not remarkable but, for that very reason, the case is a reminder that there are certain red flags as to which companies, and their senior managers, should be particularly sensitive. These red flags include operating in a country that is high risk for bribery; operating in an industry (extraction of natural resources) that is high risk for bribery; operating a joint venture with a foreign government entity; entering into consulting and agency relationships with persons acting as intermediaries with the foreign government; employing as intermediaries persons who also have control over financial expenditures of or financial reporting by the foreign venture; payments to foreign agents which are unusually large given the prevailing rates in the local economy and the nature of the services provided; and making bonuses for employees in foreign operations contingent on reaching unduly aggressive operating result targets, particularly when the ability to reach such targets was within the discretion or control of a foreign government authority.

In 1988, TI assumed a contract with the Indonesian government to operate the Enim oil field on the island of Sumatra. Pertamina, the Indonesian state oil company, assured compliance with the contract by performing periodic audits of TI's operations, including determining the amount of TI' s operating costs that could be recovered from the government. BPKP, the audit branch of Indonesia's ministry of finance, also periodically audited TI to ensure that TI was paying all required taxes to the Indonesian government

The SEC's investigation disclosed that in 1989 and 1990, two senior officers of TI, working through an agent, arranged and authorized numerous payments to Indonesian government officials to obtain favorable decisions on disputed audit issues. These same TI officers, with the help of other TI accounting employees, concealed the illicit payments by falsely documenting and recording them as legitimate business expenses, *e.g.,* purchase of seismic data or repairs to oil field equipment. Indonesian companies controlled by the agent were the counterparties to these sham transactions. TI also recorded other false entries in its books and records, including, for example, falsely documenting and recording cash payments totaling $1,000 per month to clerical employees of Pertamina for the purpose of expediting payment of monthly crude oil invoices.

While the illicit foreign payments were ongoing, Triton's CEO and CFO received a memo from the company's internal auditor describing the payments to the Indonesian auditors, and the falsification of TI's corporate books and records. The CEO ordered the memo destroyed and neither the CEO nor the CFO took steps to investigate the serious issues raised in the memo.

Triton and the two senior officers of TI agreed to settle a civil injunctive action which charged them with violating the illicit payment provisions and charged Triton with violating the internal controls and books and records provisions of the Exchange Act. Triton agreed to pay a civil fine of $300,000 and the individuals paid fines of $50,000 and $35,000.

Triton's CEO and CFO settled an administrative action in which they were charged with causing Triton's violations of the FCPA's illicit payments provision and books and records provisions. Two of TI's accounting employees settled administrative actions charging them with falsifying TI's books and records.

§ 14:15 Recent SEC activity in FCPA enforcement—Montedison

Montedison, S.p.A., headquartered in Milan, is one of Italy's largest public companies, involved in the agro-industry, chemical, and energy industries. Montedison's American Depository Receipts (ADRs), each of which represents ten shares of stock, have been listed on the NYSE since 1987 and registered with the SEC under § 12(b) of the Exchange Act. Montedison was required to file annual reports, including audited financial statements, with the SEC on Form 20-F.

In November 1996, the SEC filed a civil injunctive/penalty action against Montedison in a U.S. district court in Washington, D.C. *SEC v. Montedison, S.p.A.,* Civ. Action No. 1:96 CV02631 (HHG) (D.D.C. Nov. 21, 1996). The SEC's complaint alleges that Montedison attempted to conceal the payment of hundreds of millions of dollars in bribes to Italian politicians and other persons by falsely describing the payments on its books and records and in its financial statements. The complaint charged Montedison with violating the FCPA's books and records and internal controls provisions, as well as the antifraud and reporting provisions of the Exchange Act. Although the case involved bribes, it was not charged as an FCPA illicit payments case. The bribes arguably fell outside the terms of the FCPA because they were apparently paid to domestic, not "foreign," government officials. It is also uncertain whether the bribes would have satisfied the interstate commerce element of an FCPA illicit payments charge.

The SEC's complaint alleged that Montedison's management misappropriated and/or paid as bribes to Italian politicians almost $400 million during the period 1988 through 1991. In order to hide this conduct, the company's assets were materially overstated in its books and records and financial statements filed with the SEC over the same four-year period. According to the complaint, from 1988 through 1993, millions of dollars in bribes and questionable payments were made by Montedison's offshore affiliates and various accounts in Switzerland for the benefit of unnamed third parties. In 1993, these payments, totaling approximately $272 million, were aggregated on Montedison's books as a fictitious loan to Exilar International SA. Later in 1993, Montedison determined

that the phony loan was uncollectible and took a $272 million writedown for its 1992 fiscal year.

In what was referred to in the Italian press as the "Enimont Affair," Montedison also purchased and booked real estate in and around Rome at vastly inflated prices in order to disguise numerous bribes paid to Italian politicians. These fraudulent entries resulted in additional writedowns on Montedison's 1993 fiscal year financial statements of approximately $126 million.

Montedison's internal controls were so deficient that neither the company nor its auditors were able to reconstruct precisely what occurred and who was responsible.

On March 30, 2001, the SEC and Montedison entered into a settlement pursuant to which the company was ordered to pay a civil penalty of $300,000 for violating the antifraud, financial reporting, and books and records provisions of the federal securities laws. The settled order did not impose injunctive relief.

§ 14:16 Message from the SEC's cases

Recent history demonstrates that the SEC is clearly committed to bringing illicit payments cases. Although the cases are difficult for the agency to investigate and prove, the SEC's reach is broader than one might think and is getting broader all the time. The cases *Montedison, IBM,* and *Chiquita* demonstrate that the SEC approaches these cases aggressively and creatively. The issue is not just whether the issuer's conduct violates the FCPA's specific statutory prohibition against bribery, but rather whether the conduct can be addressed by any of the weapons in the SEC's arsenal. Thus, foreign and domestic issuers need to be sensitive to the FCPA's books and records and internal control provisions, as well as the Exchange Act's general antifraud provisions. In *Montedison,* the SEC brought a federal civil action alleging fraud against the issuer, even though the payments at issue were arguably not FCPA illicit payments. In *IBM* and *Chiquita,* the parent companies were held responsible for the false booking of a transaction by their foreign subsidiaries, even though the SEC did not allege that the amount of the false entries was material to the parent companies' consolidated financial statements or that the parent companies knew, or even should have known, of the false entries.

The SEC's *Triton* case stands as a reminder to senior management and corporate boards that the SEC will go beyond active wrongdoers and bring enforcement proceedings against those corporate officials who had the responsibility and opportunity to deal with the misconduct but failed to do so. The SEC's administrative case against Triton's former CEO and CFO is based squarely on the failure of those individuals to take meaningful action when the likelihood of FCPA violations was brought to their attention.

The *Triton* case also demonstrates that the FCPA will be construed broadly to address the problem of illicit payments. Some have argued that the FCPA's prohibition against paying a bribe to "obtain or retain business," should be construed narrowly as only covering the obtaining or renewal of a business relationship (*e.g.,* to obtain or renew a contract). The SEC, and for that matter the DOJ, take the position that the prohibition covers bribes paid during the course of the relationship to obtain tangible benefits for the Issuer.

§ 14:17 The future of SEC activity in the FCPA area

One could reasonably ask why the SEC has brought relatively few FCPA illicit payments cases since the statute was adopted in 1977. Recent published reports of investigations, as well as recent enforcement activity, would suggest that it is not due to complacency or a lack of interest by the SEC in vigorous FCPA enforcement. There appear to be a number of plausible explanations. First, illicit payment violations are not the type of events that can be easily discerned from an issuer's financial statements or that can be brought to light from any type of traditional government surveillance. Second, even when a potential violation is identified, the government, and particularly

the SEC, has historically had a limited ability to gather all of the relevant evidence that is frequently located outside the United States. Finally, the complexity of the offense, *e.g.,* the need to prove that the use of an instrumentality of U.S. interstate commerce was involved, made it quite difficult to prove an illicit payments violation.

International implementation of the OECD Convention should benefit the SEC's efforts to enforce the FCPA in each of these areas. By outlawing bribery on a broad international scale, the OECD Convention will open channels of communication and forums for lodging complaints that did not previously exist. One obvious result should be that more potential violations will be brought to the attention of U.S. regulators. The OECD Convention directly addresses the issue of gathering evidence from foreign jurisdictions by its inclusion of a mandatory, multilateral cooperation provision. Thus, the absence of "dual criminality" can no longer be used to create an impossible hurdle for U.S. investigators conducting an illicit payments investigation. Finally, the heavy burden of satisfying all of the elements of an illicit payments case was substantially reduced when Congress, as part of its implementation of the OECD Convention, amended the FCPA to drop the interstate commerce requirement for FCPA prosecutions of U.S. nationals. A U.S. national can now be prosecuted for an act of bribery committed anywhere in the world even though the bribery was carried out without the use of any aspect of U.S. interstate commerce.