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FCPA Update

A Global Anti-Corruption Newsletter

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Should the Supreme Court's Ruling in *McDonnell* Influence SEC and DOJ Enforcement Under the FCPA?

On June 27, 2016, the U.S. Supreme Court held in *McDonnell v. United States* that a conviction under the U.S. domestic bribery statute requires the payment at issue to have been made in an effort to influence a "decision or action" on a "question, matter, cause, suit, proceeding or controversy" involving the "formal exercise of governmental power."[1] In light of that ruling, the Supreme Court found that gifts, loans and other benefits provided to the former governor of Virginia, though "distasteful" and "tawdry," did not necessarily constitute bribery, because the prosecution had not tied them to the formal exercise of government power.[2]

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1. *McDonnell v. United States*, No. 15-474, slip op. (June 27, 2016).

2. *Id.* at 28.

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The ruling understandably raises the question whether bribery of foreign officials under the FCPA similarly arises only in the context of the formal exercise of power – potentially offering insight into the vexing issue of when gifts, entertainment or other benefits that are purely designed to build stronger relationships with government-official customers may be appropriate so long as no request for government action is then pending. *McDonnell* also raises the very real question whether the same benefits received by McDonnell and his wife would constitute an FCPA violation had they been offered to a foreign government official, and if so, whether it is incongruous for the U.S. government to make actions by U.S. companies that are legal with respect to U.S. government officials, illegal with respect to foreign government officials. Or should the Supreme Court's ruling in *McDonnell* give rise to a "rule of reason" that informs the enforcement decisions of the SEC and DOJ?

The Supreme Court's McDonnell Decision

In *McDonnell*, a Virginia businessman provided the Virginia governor, Bob McDonnell, and his wife with loans and gifts having a total value of over $175,000.[3] The gifts included flights on a private jet, rounds of golf, designer clothes, a Rolex, a loaner Ferrari, a $10,000 wedding gift for their daughter and a $50,000 loan. The businessman hoped Virginia's public universities would perform clinical studies of a nutritional supplement his company had developed. During the period when these gifts were being provided, McDonnell had arranged meetings for the businessman with subordinates, hosted events at the Governor's Mansion to which the businessman could invite guests, and contacted government officials to recommend that they meet with the businessman and his business associates.[4]

The U.S. government charged that McDonnell's and his wife's receipt of the gifts had prompted McDonnell, as governor, to take "official action" in violation of the so-called "honest services" fraud provisions of the U.S. Code and the Hobbs Act.[5] The jury instructions for both the honest services fraud and Hobbs Act violations against McDonnell were based on language borrowed from the U.S. Code's domestic anti-bribery provisions.[6] The bribery statute, in turn, prohibited McDonnell from "corruptly" demanding, seeking, receiving or accepting "anything of value" in return for being "influenced in the performance of any official act."[7] An "official act" is

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3. *Id.* at 8.
4. *Id.* at 10-11.
5. 18 U.S.C. §§ 1343, 1349 (honest services), 1951(a) (Hobbs Act).
6. 18 U.S.C. § 201.
7. 18 U.S.C. § 201(b)(2).

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defined as "any decision or action on any question, matter, cause, suit, proceeding or controversy" that may be pending before a public official or that may "by law be brought before" a public official in their "official capacity." [8]

A federal jury convicted McDonnell on all counts and the U.S. Court of Appeals for the Fourth Circuit affirmed. The Supreme Court, however, overturned the verdict, finding that the jury had been improperly instructed on the requirements for a finding of bribery. According to Chief Justice John Roberts, speaking for a unanimous Court, "setting up a meeting, calling another public official, or hosting an event does not, standing alone, qualify as an official act."[9] An official act, according to the Court, requires both that (i) a question, matter, cause, suit proceeding or controversy be pending before a government official or be one

"The [*McDonnell*] ruling understandably raises the question whether bribery of foreign officials under the FCPA similarly arises only in the context of the formal exercise of power . . . ."

that by law may be brought before the official; and (ii) the public official made a decision or took an action on the issue or agreed to do so.[10] The Supreme Court found, however, that "a typical meeting, telephone call, or event arranged by a public official" did not meet either of those two requirements.[11] As the Court observed, "conscientious public officials arrange meetings for constituents, contact other officials on their behalf, and include them in events all the time." The Court warned that the Government's position in the case "would likely chill federal officials' interactions with the people they serve and thus damage their ability effectively to perform their duties."[12]

The outcome in *McDonnell* was in many ways presaged by the Supreme Court's 1999 ruling in *United States v. Sun-Diamond Growers of Cal.*, in which the Court made clear under the federal anti-gratuity statute, which uses language nearly

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8. 18 U.S.C. § 201(a)(3).
9. *McDonnell v. United States*, slip op. at 14 (internal quotation marks omitted).
10. *Id.* at 14.
11. *Id.* at 14-15 (first requirement); *Id.* at 20 (second requirement, relying on *United States v. Sun-Diamond Growers of Cal.*, 526 U.S. 398 (1999)).
12. *Id.* at 22-23.

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identical to the domestic bribery statute and uses the exact same definition of an "official act," that prosecutions must rely on more than a mere desire to "build a reservoir of goodwill that might ultimately affect one or more of a multitude of unspecified acts, now and in the future."[13] The Sun-Diamond Court held that there must be some connection to an "official act" and not merely a gift given because of the government official's position.[14] *McDonnell* can fairly be read as an extension of *Sun-Diamond*, which Chief Justice Roberts cited approvingly in his *McDonnell* opinion. Where *Sun-Diamond* distinguished gifts meant to build relationships from illegal gratuities[15], *McDonnell* expanded the scope of permissible, non-bribe activity to encompass a wide range of gift-giving where there was no *quid pro quo* involving official action. This was true, according to *McDonnell,* even though the government official, as had been hoped by the gift-giver, made helpful telephone calls and introductions.

Potential Implications of *McDonnell* for FCPA Enforcement

The history of FCPA enforcement is replete with numerous instances where the provision of gifts and entertainment to foreign government officials has led to findings of bribery and attendant sanctions. The SEC and DOJ Resource Guide, for example, notes that a $12,000 birthday trip for a government official, or $10,000 in meals and entertainment are sufficient to give rise to an FCPA violation.[16] And while the Resource Guide finds the provision of a crystal vase for the wedding of a government official to be an acceptable token of esteem or gratitude,[17] there can be little doubt that a $10,000 wedding gift like the one provided to McDonnell's daughter would raise serious concerns within the SEC and DOJ under the FCPA. The provision of $175,000 worth of gifts, dinners and loans to a foreign government official almost certainly would lead to a significant investigation and likely would result in an enforcement proceeding under the FCPA. A natural question is whether the *McDonnell* ruling is likely to have any impact on future DOJ and SEC cases arising under the FCPA.

McDonnell's focus on whether the gifts were received in connection with an "official act," makes the critical issue in any case whether there was a *quid pro quo* involving official action. This emphasis is somewhat different than typical gift and

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13. *United States v. Sun-Diamond Growers of Cal.*, 526 U.S. 398 (1999).
14. *Id.* at 405-06.
15. *See*, *e.g.*, Sean Hecker, Bruce E. Yannett, Steven S. Michaels, and Noelle Duarte Grohmann, "Corrupt Intent, Relationship Building, and *Quid Pro Quo* Bribery: Recent Domestic Bribery cases," *FCPA Update*, Vol. 3, No.2 (Sept. 2011), http://www.debevoise.com/~/media/files/insights/publications/2011/09/fcpa%20update/files/view%20the%20update/fileattachment/fcpa_update_sept_2011.pdf.
16. A Resource Guide to the U.S. Foreign Corrupt Practices Act, at 16 (2012), http://www.justice.gov/criminal/fraud/fcpa/guidance/.
17. *Id.* at 17.

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entertainment cases under the FCPA, where the value of the gift sometimes appears most critical, so long as the payment is to an official who is in a position to influence a Company's business. In *McDonnell*, despite the high value of the gifts and the desire of the payor to benefit his business, the Court found that there were no bribes. The question under the FCPA is whether that statute is sufficiently similar to the domestic bribery statute that a corrupt *quid pro quo* also is required, even in the face of high value gifts to a foreign government official.

The language at the core of the FCPA tracks the language at issue in *McDonnell*. Like the domestic bribery statute, the FCPA requires that a bribe be "corruptly" given "to a government official to influence "any act or decision of such foreign official in his official capacity" or to induce the foreign official "to do or omit to do any act in violation of the lawful duty of such official." This language is strikingly similar to the language of the domestic bribery statute, which forbids anyone "to induce [a] public official…to do or omit to do any act in violation of the lawful duty of such official." The parallels are close enough that a court trying to harmonize the FCPA with the domestic bribery statute could reasonably impose the same two requirements that the Court highlighted in *McDonnell* – that the payment relate to a question, matter cause, suit proceeding or controversy pending before a government official or that by law may be brought before the official; and that the public official made a decision or took an action on the issue or agreed to do so. If a court were to take this approach, it seems likely that in the FCPA context, paying foreign officials in the expectation that they will set up meetings or take other routine steps similar to those in *McDonnell* would be an acceptable in the absence of an expectation that the recipient of the payment will engage in an official act.[18] A gift to a government official that had relationship building as its sole purpose, and that was undertaken at a time when no request for government action was pending or expected in the near term might therefore fall on the acceptable side of the ledger – even where the gifts and entertainment may be relatively expensive, such as an invitation to a major golf event, the Olympics[19] or a soccer championship.

The FCPA, however, also has other important provisions that do not have parallels in the federal domestic bribery law and that could undercut an argument in favor of applying the *McDonnell* analysis. For example, the FCPA contains expansive language prohibiting giving anything of value to a foreign official for the purpose of "securing any improper advantage."[20] Securing an advantage can take many

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18. *See* 15 U.S.C. § 78dd-1(a)(1)(A)(ii); 18 U.S.C. § 201.
19. *In re BHP Billiton Ltd. and BHP Billiton Plc*, SEC Admin. Pro. 3-16546 (May 20, 2015).
20. 15 U.S.C. § 78dd-1(a)(1)(A)(iii).

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forms and may or may not implicate "official action" by a government official. An argument could perhaps be made that the word "improper" incorporates some type of corrupt *quid pro quo* inducement in exchange for advantageous treatment by the government official, but such an argument is not clearly supported by the *McDonnell* ruling. The FCPA also makes it illegal to try to induce a "foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality." Using influence, once again, may or may not implicate an "official action" – although it may be possible to argue that the requirement of influence over an "act or decision" of the government or instrumentality is tantamount to an "official action" requirement. A plausible argument therefore may be available that *McDonnell* supports finding a corrupt *quid pro quo* requirement in this provision as well.

The different and unique provisions of the FCPA create the possibility for the SEC and DOJ to argue that the statute is sufficiently different from the domestic bribery law to warrant a broader interpretation and application than the Supreme Court has recognized in *McDonnell* and *Sun-Diamond*. But such a result is incongruous at the very least. It is difficult to make sense of an interpretation of that law that permits gift and entertainment associated with relationship-building in the domestic context, but that prohibits it overseas, or that requires a clear *quid pro quo* between the payment and official action in the domestic sphere, but eschews such a requirement when the same conduct is directed towards a foreign official.

In an environment where few cases against corporate defendants are litigated and where foreign bribe recipients are not subject to prosecution under the FCPA,[21] the SEC and DOJ may have little incentive to curtail their pursuit of an expansive interpretation of the FCPA based upon an untested legal theory and analogies to Supreme Court precedent. But the Supreme Court has now made it clear in two domestic cases that the government should be wary of trying to impose an unbounded interpretation of the federal bribery laws. Some of the Court's reasons for doing so, such as the fear of a "chilling effect" arising from criminalizing public officials' everyday behavior,[22] apply equally to domestic and foreign bribery. Indeed, much of the reasoning employed by the Court for a narrower interpretation of domestic anti-bribery statutes would seemingly apply to the FCPA as well: foreign officials need to engage with their constituents just as domestic officials do,[23]

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21. Although other federal laws, such as statutes criminalizing wire fraud and conspiracy, may lead to such prosecutions.

22. *McDonnell v. United States*, slip op. at 28.

23. It would moreover be in the interest of the United States to encourage foreign officials to engage with foreign investors, as the FCPA, as interpreted, would act as a disincentive to foreign investment.

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and the frequently complained of vagueness in domestic anti-bribery statutes is equally problematic in the FCPA context – maybe even more so, given the limited number of litigated cases under the FCPA and the greater variance of business practices abroad. As Justice Scalia noted at the conclusion of the unanimous ruling in *Sun-Diamond*, when it comes to interpreting statutes in the field of bribery, a statute "that can linguistically be interpreted to be either a meat axe or a scalpel should reasonably be taken as the latter."[24] While the ruling in *McDonnell* does not in itself compel a narrow, scalpel-like reading of the FCPA that might make companies feel more confident about gift and entertainment expenses incurred in pure relationship building activities where no government action is on the near horizon, the ruling should perhaps prompt the SEC and DOJ to consider whether to themselves impose a "rule of reason" in the FCPA context that limits application of the law to situations in which gifts and entertainment expenses are viewed as problematic only where there is a clear *quid pro quo* tie to official government action. More realistically, it may be necessary for Congress to intervene to assure that domestic bribery laws and the FCPA are appropriately harmonized in a way that avoids incongruously imposing stricter standards overseas than are imposed at home.

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24. *Sun-Diamond Growers of Cal.*, 526 U.S. at 412.

UK Proposes New Offense of Failure to Prevent Tax Evasion

Last year, as part of its efforts to clamp down on corporate corruption, including tax evasion, the UK government announced its intention to introduce a new corporate offense of failure to prevent the criminal facilitation of tax evasion. The proposed legislation seeks to discipline internationally known corporations whose names are used by rogue employees and other associates when assisting clients in setting up schemes to cheat the public exchequer.

Following the Panama Papers disclosures and ahead of its May 2016 Anti-Corruption Summit, the UK government announced that it was accelerating the timetable for consideration of the legislation, and HM Revenue & Customs published a revised draft of the proposed offenses together with draft guidance on the offense for public consultation.[1] This consultation finished on July 10, 2016. In the materials published, the government states that "[*t*]*his consultation is not seeking feedback on the policy of introducing a new corporate criminal offence*"; the UK government appears therefore to have made its mind up and the likelihood is that this proposed offense will indeed become law.

Key Provisions of the New Offense

The new offense is broadly modelled on section 7 of the Bribery Act 2010 (failure of commercial organisations to prevent bribery; the so-called "corporate offence"). Crucially, and reflecting the Bribery Act, the proposed legislation covers acts that occur in both the UK and abroad, and the predicate tax evasion offense can be to the detriment of the UK as well as foreign exchequers. Also borrowing from the Bribery Act "corporate offence", the proposed legislation would introduce a defence of having in place appropriate "prevention procedures" (or of showing that none were reasonably required).

Under the draft legislation, a "relevant body" – defined as a body corporate or partnership wherever incorporated or formed – will be guilty of an offense if a person associated with it facilities a tax evasion offense.

"Associated person" is defined very widely, and includes natural and legal persons performing services for, or on behalf of, the relevant body. Such individuals may be employees, agents, contractors or subsidiaries. Whether a person is 'associated' with

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1. HM Revenue & Customs, Tackling tax evasion: legislation and guidance for a corporate offence of failure to prevent the criminal facilitation of tax evasion (17 April 2016), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517020/Tackling_tax_evasion-legislation_guidance_corporate_offence_of_failure_to_prevent_criminal_facilitation_tax_evasion.pdf.

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the relevant body is determined by reference to the relevant circumstances, and not only by reference to the legal relationship between the associated person and the relevant body.

For a corporation to be liable under the new offense, it is not necessary for it to have profited from the actions of the associated person. In reality, however, it is likely that most corporations who are ultimately prosecuted under the draft legislation (once it is in force) will have done so.

The extraterritorial reach of the proposed legislation is notable. First, corporations who provide UK tax advice or financial planning services to UK entities or individuals need to be aware that they risk criminal liability if any of their staff or other associates facilitate the evasion of UK tax. Second, UK corporations or corporations with branches or places of business in the UK risk criminal liability if their staff or other associates facilitate the evasion of tax payable anywhere in the world. Corporations based anywhere in the world also risk liability if their staff or other associates facilitate the evasion of the tax payable anywhere in the world from UK territory.

Looking at the proposed offenses in a little more detail:

(i) *Failure to prevent the facilitation of UK tax evasion offenses*:

Section 2 of the draft legislation states that a relevant body is guilty of an offense if a person associated with the relevant body commits a UK tax evasion facilitation offense when acting in the capacity of a person associated with that relevant body.

The guidance makes it clear that any fraudulent conduct, the intent of which is to divert funds from the public revenue, constitutes the common law offense of cheating the public revenue and is therefore a UK tax evasion offense. It is not necessary that any tax is, as a matter of fact, successfully evaded for an offense to be committed. All that is required is for an associated person to knowingly be involved in, or take steps with a view to, fraudulently evading UK tax. This may be done by aiding, abetting, counselling or procuring the commission of the offense.

The draft legislation provides a defense for corporates that have "*in place such prevention procedures as it was reasonable in all the circumstances to expect* [the relevant body] *to have, or that in all the circumstances, it was not reasonable to expect* [the relevant body] *to have any prevention procedures in place*." Guidance is provided as to what constitutes 'relevant prevention procedures' and is discussed in further detail below.

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(ii) *Failure to prevent the facilitation of foreign tax evasion offenses*: Under section 3 of the draft legislation, a relevant body is guilty of an offense if a person associated with it commits a "foreign tax evasion facilitation offence" when acting in the capacity of a person associated with it.

This offense applies to any corporate that is incorporated or formed under the law of "*any part of the UK*," or carries on a business or other undertaking from an establishment in the UK, or the foreign tax evasion facilitation offense takes place in the UK.

"[T]he proposed legislation expands the scope of the 'failure to prevent' basis for corporate criminal liability, introduced in the Bribery Act, to a second category of wrongdoing."

Corporate liability for a failure to prevent a foreign tax evasion facilitation offense, requires dual criminality on two levels. First, in relation to the predicate "foreign tax evasion offence," it must be shown both that the conduct constituted an offense of evading tax in the jurisdiction affected, and would have constituted an offense "*of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of that tax (assuming that there was an offence of that kind in the United Kingdom in relation to that tax)*." It is for good reason that the UK government asks for suggested wording in respect of this definition in the consultation document; as drafted it is not entirely clear what the dual criminality element requires. However, the likely intention is that the court will be asked to assume that the foreign tax existed in the UK, then to ask itself whether the conduct at issue would have amounted to the criminal evasion of that tax had it occurred in the UK.

Second, the conduct of the associated person in facilitating the foreign tax evasion offense must be both an offense in the jurisdiction affected, and would constitute such an offense if the predicate tax evasion offense had related to UK tax.

The same reasonable prevention procedures defence is available as under the Section 2 offense.

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(iii) *Relevant prevention procedures*:

As noted above, the draft legislation provides a defence for corporations that can prove that they had appropriate prevention procedures in place. "Prevention procedures" are defined in the draft act as "*procedures designed to prevent persons associated with the relevant body from committing* [UK or foreign] *tax facilitation offences*".

The guidance acknowledges that although what constitutes "reasonable prevention procedures" will differ for each organisation, there are likely to be common elements. It also states that to be "reasonable", prevention procedures should be proportionate to the risks that the organisation faces. Examples given in the guidance include:

i. a specific commitment of the relevant body to prevent the involvement of those acting on the corporation's behalf in the criminal facilitation of tax evasion;

ii. a clearly articulated risk assessment on which the corporate's procedures are based;

iii. monitoring and enforcing compliance with its procedures; and

iv. a clear pathway for reporting wrongdoing by persons associated with the corporation.

The procedures put in place to implement an organisation's preventative policies "*should be designed to mitigate identified risks and to prevent criminal conduct by those providing services to or on behalf of the organisation*". The guidance includes examples of the types of topics that preventative procedures may encompass depending on the nature of the particular risks faced:

i. involvement of the corporation's top level management;

ii. due diligence into persons associated with the corporation;

iii. how the corporation will communicate its policies to persons associated with it;

iv. disciplinary and enforcement action taken against persons breaching the corporations policies; and

v. monitoring, review and evaluation of the corporation's preventative policies and procedures.

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Next Steps and Comments

As mentioned above, the consultation on the draft legislation closed on July 10, 2016 and the responses to the consultation are likely to be published in the autumn, together with near final draft of the legation. It is intended that this new offense will be included in the Criminal Finances Bill to be passed later this year.

In the absence of a general overhaul of the English law on corporate criminal liability which makes it very difficult to prosecute corporations for crimes committed on their behalf, the proposed legislation expands the scope of the "failure to prevent" basis for corporate criminal liability, introduced in the Bribery Act, to a second category of wrongdoing.

UK corporations and foreign corporations that do any business in the UK would be wise to start carefully to consider what procedures, if any, they may need to implement in the likely event that this proposed legislation becomes law. In some instances, significant changes to existing compliance procedures may be required. Based on the guidance, corporations may, in the first instance, wish to consider identifying all individuals that act for it, including agents, subcontractors and professional advisors that could be considered a 'person associated' with the corporate. A risk assessment may then need to be carried out to assess the likelihood of such associated persons being engaged in tax evasion. The range of individuals and entities a corporation may need to conduct this risk assessment on is wide and would include not only professional advisors, but also any companies to which the corporation outsources services.

Corporations may also need to amend existing contracts with third parties or provide information to third parties with a clear statement setting out the corporation's commitment to complying with all tax legislation. Corporates may also want to consider implementing a training program for its employees and 'associated persons.'

The current aim is for these proposals to be turned into law by the end of this year, with a view to it entering into force in 2017. Although the draft legislation can be expected to be further improved with a view to clarifying certain concepts, it can already be anticipated that, in particular, prosecutions in respect of facilitations of foreign tax evasion offenses will present considerable challenges. In its response to the first consultation on the proposed legislation, the UK government presented its proposed jurisdiction over corporations who fail to prevent the facilitation of foreign tax evasion offenses as a fall-back in the event that the jurisdiction concerned was

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"*unable to bring an action against that corporation due to corruption within that jurisdiction's legal system.*"[2] While a laudable ambition, those jurisdictions may also in many cases be the ones with less than clear rules to distinguish aggressive but legitimate tax planning from criminal tax evasion. One can therefore imagine that a UK prosecutor would experience considerable difficulties proving the latter.

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2. HM Revenue & Customs, Tackling offshore tax evasion: a new corporate criminal offence of failure to prevent the facilitation of tax evasion – Summary of Responses (December 2015), at paragraph 3.94, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483367/A_new_corporate_criminal_offence_of_failure_to_prevent_the_facilitation_of_tax_evasion_-_summary_of_responses__7011_.pdf.

Early Thoughts on the DOJ's Pilot Program, the Continued Breadth of the Accounting Provisions, and Possible Implications for Self-Reporting

On April 5, 2016, the Department of Justice ("DOJ") announced a pilot program designed to encourage self-reporting, full cooperation and remediation (the "Pilot Program").[1] In the interim, the Securities and Exchange Commission ("SEC") has brought four corporate enforcement actions: a "cease and desist" settlement with Analogic Corporation[2] ("Analogic"), another with Johnson Controls, Inc.[3] ("JCI"), and non-prosecution agreements with Akamai Technologies, Inc.[4] ("Akamai") and Nortek, Inc,[5] ("Nortek"). The DOJ has brought a parallel enforcement action in connection with only one of these - a non-prosecution agreement with BK Medical ApS ("BK Medical"), the Danish subsidiary of Analogic.[6] Meanwhile, it has reported "declinations" in connection with the other three SEC enforcement actions, with explicit reference to the Pilot Program in the letters announcing that it had closed its investigations.[7] As such, these four corporate enforcement actions offer the opportunity for an initial assessment of the meaning of "declination" under the Pilot Program and the possible benefits of self-reporting in the context of the Pilot Program, as well as the SEC's virtually strict liability interpretation of the FCPA's books and records and internal controls provisions.

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1. United States Department of Justice, "The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan and Guidance," April 5, 2016, https://www.justice.gov/opa/file/838386/download. See Paul R. Berger, Andrew M. Levine, Bruce E. Yannett and Philip Rohlik, "U.S. Department of Justice Issues New FCPA Guidance and Launches Pilot Enforcement Program," FCPA Update, Vol. 7, No. 9 (April 2016), http://www.debevoise.com/insights/publications/2016/04/fcpa-update-april-2016 (describing Pilot Program).
2. In the Matter of Analogic Corporation and Lars Frost, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Securities Exchange Act Enforcement Rel. No. 78113 ("Analogic Order"); Accounting and Auditing Enforcement Rel. No. 3784; Admin. Proceeding File No. 3-17305 (June 21, 2016), https://www.sec.gov/litigation/admin/2016/34-78113.pdf.
3. In the Matter of Johnson Controls, Inc., Order Instituting Cease-and-Desist Proceedings Pursuant Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Securities Exchange Act Rel. No. 78287 ("JCI Order"); Admin. Proc. File No. 3-17337 (July 11, 2016), https://www.sec.gov/litigation/admin/2016/34-78287.pdf.
4. United States Securities and Exchange Commission, Press Rel. 2016-109, "SEC Announces Two Non-Prosecution Agreements in FCPA Cases" (June 7, 2016), https://www.sec.gov/news/pressrelease/2016-109.html; Non-Prosecution Agreement (Akamai) (hereinafter "Akamai NPA"), https://www.sec.gov/news/press/2016/2016-109-npa-akamai.pdf;
5. Press Rel. 2016-109, *supra* n. 4; Non-Prosecution Agreement (Nortek) ("Nortek NPA"), https://www.sec.gov/news/press/2016/2016-109-npa-nortek.pdf.
6. In re BK Medical ApS, Non-Prosecution Agreement dated June 21, 2016, https://www.justice.gov/criminal-fraud/fcpa/cases/in-re-bk-medical-aps.
7. The DOJ's website has a specific page on "declinations" under the Pilot Program. https://www.justice.gov/criminal-fraud/pilot-program/declinations.

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The Analogic Settlement

On June 21, 2016, the SEC instituted a Cease-and-Desist Order against Analogic Corporation and the former CFO of its Danish subsidiary, Lars Frost, alleging violations of the books and records and internal controls provisions of the FCPA.[8] The allegations in the Order relate to the activities carried out by Analogic's Danish subsidiary, BK Medical, which sells ultrasound equipment. From 2001 to 2011, BK Medical allegedly issued fictitious inflated invoices to its distributors, retained the excess funds paid by the distributors, and later, "for reasons[] unknown to BK Medical," paid these funds to third parties identified by the distributors, including individuals in Russia and shell corporations in Belize, the British Virgin Islands, Cyprus, and Seychelles.[9] During the period, BK Medical allegedly paid approximately $16.1 million at the instruction of its Russian distributor and an additional approximately $3.8 million at the instruction of distributors in Ghana, Israel, Kazakhstan, Ukraine, and Vietnam.[10]

Also on June 21, 2016, BK Medical entered into a non-prosecution agreement with the DOJ, admitting that it knowingly and willfully falsified Analogic's books and records in violation of 15 U.S.C. 78m(b)(4).[11] In addition to the false records created as part of the scheme described in the Analogic Order, BK Medical also submitted false quarterly review checklists to Analogic's controller and false Sarbanes-Oxley subcertifications.[12]

According to the SEC, Analogic halted the payments upon discovery of the scheme, conducted an internal investigation, self reported its findings, "including an accounting of all the suspicious payments," and "thereafter generally cooperated with the Commission." It took a number of further remedial efforts, and agreed to pay approximately $7.67 million in disgorgement and approximately $3.81 million prejudgment interest. BK Medical's former CFO agreed to pay a civil penalty of $20,000. BK Medical also agreed to pay a civil penalty of approximately $3.4 million as part of its NPA with the DOJ and agreed to a three-year reporting period.[13] Without explicit reference to the Pilot Program, the DOJ assessed BK Medical's self-reporting, cooperation, and remedial measures. BK Medical received full credit for voluntary disclosure and remedial measures, but did not receive full cooperation credit "because . . . the Company did not disclose information that was known to

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8. Analogic Order, *supra* n. 2 at ¶¶ 22-25.
9. *Id.* ¶¶ 2, 9-11.
10. *Id.* ¶¶ 12-13.
11. *In the Matter of BK Medical ApS, supra* n.6 at NPA p.1 & Statement of Facts ¶¶ 15-18.
12. *Id.* at Statement of Facts ¶¶ 16-17.
13. *Id.* at 4 and Attachment C.

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the Company and Analogic about the identities of a number of the state-owned entity end-user of the Company's products, and about certain statements given by employees in the course of the internal investigation."[14] As a result, BK Medical received an aggregate discount of 30% off the bottom of the penalty under the U.S. Sentencing Guidelines.[15]

There are a number of unanswered questions arising from the BK Medical NPA. First, neither BK Medical nor Analogic was alleged to have violated the anti-bribery provisions of the FCPA. Were BK Medical considered an agent of Analogic (an issuer), the facts would arguably support a violation of 15 U.S.C. § 78dd-1(a)(3).[16] As to BK Medical, a Danish corporation, there is no allegation of activity "while in the territory of the United States."[17] Although it is often the case that part of the negotiations around the resolution of an enforcement action involve agreeing to

"[A]rguably none of the companies truly 'benefitted' from not being charged with a violation that they did not commit and it would seem that none of these cases can properly be called 'declinations,' at least in the traditional sense."

books and records rather than anti-bribery allegations, it is worth noting that, apart from the fact that BK Medical signed certifications for Analogic, no "use of the mails or any means or instrumentality of interstate commerce" is alleged in either the BK Medical NPA or Analogic Order. Moreover, although the criminal books and records provisions apply to corporate persons, it is odd, given the DOJ's recent guidance regarding individual enforcement actions, that the DOJ did not bring any action against the individuals who signed the SOX subcertifications.[18]

With regard to the Pilot Program, Analogic appears to have been significantly penalized for less than complete cooperation. The description of what Analogic did not provide is brief, involving a failure to disclose the identities of state-owned

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14. *Id.* at 1.

15. *Id.* at 2.

16. Providing "anything of value to … any person, while knowing that all or a portion of such money or thing of value will be offered … directly or indirectly, to any foreign official…"

17. 15 U.S.C. 78dd-3(a).

18. Memorandum of Deputy Attorney General Sally Quillian Yates, "Individual Accountability for Corporate Wrongdoing" (Sept. 9, 2015).

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end users and "certain statements given by employees." Analogic self-reported in 2011, five years prior to the resolution.[19] During those five years, it spent over $5 million on its investigation.[20] As noted by the SEC, its cooperation included "an accounting of all the suspicious payments."[21] The DOJ nevertheless deemed Analogic to have not disclosed "all relevant facts," even though the identity of state-owned end-users is not legally relevant to the books and records violation charged in the NPA. Although not referenced in the NPA, under the Pilot Program the maximum downward departure for a non-self-reporting company is 25%, while the maximum downward departure for a self-reporting company is 50%.[22] Thus, because of what was considered its less than complete disclosure, Analogic did not receive 80% of the benefit theoretically available to it for self-disclosure and paid a penalty $1.8 million greater than it had proposed to the DOJ.[23]

The So-Called "Declinations"

In addition to Analogic, the SEC brought three enforcement actions – against Akamai, Nortek and Johnson Controls – which did not involve parallel DOJ enforcement actions. However, each company received a letter from the DOJ announcing that the DOJ had closed its inquiries into the companies. These letters are available on the DOJ website under the "Declinations" section of the Pilot Program webpage.[24]

On June 7, 2016, the SEC entered into non-prosecution agreements ("NPAs") with Akamai Technologies, Inc. and Nortek, Inc., in connection with books and records and internal controls violations stemming from the respective Chinese subsidiaries of each company. Both companies paid relatively small amounts of disgorgement plus interest ($671,885 and $322,058, respectively)[25] and were not subject to any penalties or ongoing monitoring or reporting obligations.[26] Almost simultaneously, counsel for both companies received letters[27] from the DOJ announcing that it had closed its inquiry into the matters under investigation. These letters explicitly referenced the new FCPA Pilot Program.[28]

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19. Analogic Corp., Form 10-K, filed October 4, 2011 at 18.
20. Analogic Corp, Form 10-K, filed September 25, 2015 at 23; Analogic Corp. Form 10-K, filed September 30, 2013 at 21.
21. Analogic Order at ¶ 26.
22. Pilot Program, *supra* n. 1 at 8.
23. In its 2015 10-K, Analogic disclosed that it had proposed a settlement of $1.6 million, half of the actual settlement. Analogic Corp, Form 10-K, filed September 25, 2015 at 23.
24. https://www.justice.gov/criminal-fraud/pilot-program/declinations.
25. Akamai NPA at ¶ 4; Nortek NPA at ¶ 4.
26. Both companies agreed to cooperate with further investigations and refrain from public statements.
27. Both letters are available at https://www.justice.gov/criminal-fraud/pilot-program/declinations.
28. *Id.*

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Both companies promptly self-reported in early 2015, fully cooperated with the SEC and DOJ investigations, and engaged in remedial action, including the termination of employment of several employees of their Chinese subsidiaries.[29] In its press release, the SEC noted that the self-reporting and cooperation resulted in "expeditious resolutions,"[30] and the DOJ noted these factors as part of its decision to close its inquiries.[31]

The Statement of Facts in the Nortek NPA contains four short paragraphs of allegations relating to "Improper Payments and Gifts to Chinese Government Officials" by Nortek's Chinese subsidiary Linear China (Shenzhen) Co. Ltd. ("Linear").[32] Between 2009 and 2014, the managing director of Linear and several other senior employees made or approved over 400 payments and gifts to Chinese officials from numerous government departments, "including customs, tax, fire, police, labor, health inspection, environmental protection, and telecommunications."[33] The NPA goes on to allege that, "in some instances" (but apparently not all), these payments were falsely recorded in Linear's books.[34] According to the Nortek NPA, these payments were evidence of violations of the internal controls and books and records provisions, in particular because Linear made payments from multiple accounts that were not tested; there were "obvious red flags" including the number and size of meals and entertainment expenses; and Nortek "failed to establish procedures to ensure its Linear China employees were trained in anti-corruption compliance."[35]

The Statement of Facts in the Akamai NPA contains three paragraphs relating to "Bribes Paid to Chinese Government Officials."[36] According to the Akamai NPA, a regional sales manager at Akamai's Chinese subsidiary, Akamai (Beijing) Technologies Co., Ltd. ("Akamai China") "schemed" with a local third-party "channel partner," the use of which was required by Chinese regulations, to bribe employees of three end customers, two of which were state-owned entities. After the local partner took its cut, the regional sales manager kicked back funds and

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29. Nortek NPA, Exh. A (Statement of Facts) at ¶¶ 9-11; Akamai NPA, Exh. A (Statement of Facts) at ¶¶ 9-10.
30. *See* Press Rel. 2016-109, *supra* n. 4.
31. *See supra* n. 27.
32. Nortek NPA, Exh. A (Statement of Facts) at ¶¶ 3-6.
33. *Id.* at ¶ 5.
34. *Id.* at ¶ 6.
35. *Id.* at ¶ 7.
36. Akamai NPA, Exh. A (Statement of Facts) at ¶¶ 3-5.

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provided expensive gifts to employees of the end customers.[37] These payments totaled $155,500 over the three year period from 2013 to 2015, though only about a quarter of that ($38,500) went to employees of state-owned enterprises. The Akamai NPA also includes a version of the common concluding paragraph in FCPA enforcement actions, namely that "employees of Akamai-China routinely provided improper gifts and entertainment to employees of its end customers…" As is common in such concluding paragraphs, no specifics as to these gifts and entertainment are provided, except that these totaled $32,000 over the same three-year period.[38]

On July 11, 2016, the SEC announced a settlement with Johnson Controls, Inc., also relating to one of its Chinese subsidiaries.[39] JCI acquired its Chinese subsidiary from York International at a time that the Chinese subsidiary was subject to an SEC investigation.[40] As a result of the findings of that investigation, JCI addressed the recommendations provided by the monitor appointed in the York settlement,[41] "devoted additional resources to its compliance program, including hiring compliance personnel, conducting training and implementing risk-based procedures and controls."[42] It terminated the individuals involved in the misconduct in China and hired a new managing director of the Chinese business, reporting to JCI's global marine business in Denmark. It also limited its use of agents (the improper use of which was identified in the York settlement), and conducted specific FCPA training and audits of its Chinese subsidiary.[43]

Despite taking these steps, the JCI Order alleges that the new General Manager of the Chinese subsidiary and many of his employees continued to pay bribes and embezzle funds, using vendors instead of agents.[44] The General Manager and others specifically kept payments to these vendors to low dollar amounts (the average amount being only $3,400) so as not to trigger review by its Danish parent.[45] Between 2007 and 2013, the Chinese subsidiary made approximately $4.9 million in improper payments, which were discovered through anonymous hotline reports

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37. *Id.* at ¶¶ 3-4.
38. *Id.* at ¶ 5.
39. JCI Order, *supra* n. 3.
40. *SEC v. York International Corporation*, 07-cv-01750 (D.D.C.).
41. JCI Order at ¶ 5.
42. *Id.*
43. *Id.*
44. *Id.* at ¶ 6.
45. *Id.* at ¶ 9.

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at the end of 2012.[46] JCI self-reported, began an internal investigation, "provided thorough, complete, and timely cooperation," and under took a series of remedial measures, including firing employees, putting suspect vendors on a do not pay list, and closing down the offices of the relevant subsidiary.[47]

Despite having introduced the controls recommended by the monitor in the York proceeding, and despite the fact that its local employees concocted a scheme to make payments so as to avoid internal controls, the SEC found that JCI violated the books and records and internal controls provisions of the FCPA.[48] JCI was required to pay $11.8 million in disgorgement, $1.38 million in interest and a civil penalty of $1.18 million and submit to a one-year reporting requirement.[49]

"The disgorgement remedy applied in these cases (along with the civil penalty in JCI) is a form of strict liability for the acts of local employees of subsidiaries in high risk jurisdictions."

Not Declinations, Uncertain Benefits

The DOJ refers to its decisions with regard to Akamai, Nortek, and JCI as declinations, and the SEC, in its press release with regard to Akamai and Nortek, stated that because of prompt self-reporting and cooperation, the NPAs "stipulate that the companies are not charged with violations of the Foreign Corrupt Practices Act (FCPA)."[50] While a resolution that does not involve any alleged violation of the anti-bribery provisions of the FCPA is understandably preferable to almost any company, such an alleged breach would require a US nexus. No such allegation can be found in the admittedly sparse statement of facts in the NPAs, describing "bribes"[51] and a "bribery scheme"[52] in Akamai or Nortek, or in the lengthier allegations in the JCI Order. In all three cases, the misconduct is alleged to have

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46. *Id.* at ¶ 11.
47. *Id.* at ¶¶ 19-20.
48. *Id.* at ¶¶ 13-18.
49. *Id.* at 6-7.
50. SEC Press Rel. 2016-109, *supra* n. 4.
51. Nortek NPA, Exh. A (Statement of Facts) at ¶ 8.
52. Akamai NPA, Exh. A (Statement of Facts) at ¶ 6.

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occurred purely at the level of the Chinese subsidiaries.[53] Assuming, based on the lack of an allegation, that no such nexus existed, arguably none of the companies truly "benefitted" from not being charged with a violation that they did not commit and it would seem that none of these cases can properly be called "declinations," at least in the traditional sense.

Moreover, the books and records violations alleged against the companies represent the SEC's virtually strict liability interpretation of statutory provisions requiring "reasonable detail" and "reasonable assurances."[54] Both the Akamai and Nortek NPAs are explicit that the evidence for the books and records and internal controls violations consists of the illicit payments themselves,[55] and the JCI Order is clear that the local subsidiary went to great lengths to avoid detection.

Self-Disclosure and Enforcement Strategy

As any compliance professional working in a high-risk country will attest, corruption is endemic in much of the world. As even the Assistant Attorney General for the Criminal Division, Leslie Caldwell, recently admitted, "[i]n more than half of all countries it's very difficult to do business without being faced with the potential of a FCPA violation."[56]

None of the facts alleged in the Akamai and Nortek NPAs or the JCI Order is unusual. In all three matters, local employees are alleged to have made improper payments while actively concealing them from the parent companies and the auditors. In the JCI and Nortek matters, these payments were made with the knowledge or involvement of local management, making them easier to hide. Akamai involved a "Regional Sales Manager" of Akamai's Chinese subsidiary scheming with a third party to pay kickbacks to end customers as well as gifts and entertainment supplied by other "employees" of the Chinese subsidiary, who were not identified even by title.[57] Based on the allegations in the JCI Order, specifically the small size of the payments to vendors, JCI, like Akamai and Nortek, appears to have involved similarly small kickbacks to employees of end customers.

The Nortek NPA alleges payments of gifts and cash by executives and employees at Nortek's Chinese subsidiary to a plethora of low-level officials from almost every local government agency. Given that escaping anti-bribery violations was

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53. The use of these terms begs the question of the benefit of not being charged with violations of the anti-bribery prohibitions, in terms of collateral consequences, when the SEC explicitly alleges "bribery," rather than restricting its vocabulary to "illicit payments."

54. 15 U.S.C. § 78m(b)(2).

55. Nortek NPA, Exh. 1 (Statement of Facts) at ¶ 7; Akamai NPA, Exh. 1 (Statement of Facts) at ¶ 6.

56. Kara Scannell, "US redoubles efforts on foreign bribery cases," Financial Times, February 10, 2016, https://next.ft.com/content/cdb01524-cb8b-11e5-be0b-b7ece4e953a0.

57. Akamai NPA at ¶ 5.

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a supposed benefit of its self-disclosure, it is worth noting that the local agencies identified in the NPA are those that most commonly provide "routine governmental action," payments for which theoretically may be excepted from the anti-bribery provisions of the FCPA, depending on the circumstances.[58] Leaving aside the legal question, the allegations in the Nortek NPA are relatively mundane. Petty extortion by low-level Chinese bureaucrats is a well-documented, systemic problem, with even well-connected businessmen beset by "brazen bandits," descending "like whirring flies" on private businesses,[59] especially those with manufacturing plants.

These four resolutions ultimately do little to answer questions or provide further insight about what exactly should be self-reported. Analogic and BK Medical involved a complicated scheme (essentially the mirror image of the more common scheme of parking money with distributors) that was quickly self-reported. Because of apparently less-than-full cooperation (noted by the DOJ and not the SEC), Analogic lost much of the benefit it could expect from self-reporting, a reminder to companies that what they consider cooperation might not be enough from the regulators' point of view.

Akamai, Nortek and JCI are, if anything, more concerning. Each involved the aggregation of relatively low-dollar misbehavior by local employees of a subsidiary in a high-risk jurisdiction. Each also involved situations relatively common in such jurisdictions. The disgorgement remedy applied in these cases (along with the civil penalty in JCI) is a form of strict liability for the acts of local employees of subsidiaries in high risk jurisdictions. In any event, it remains important to continue monitoring FCPA resolutions by the DOJ, including under the Pilot Program, and the SEC in order to refine the perpetual calculus in whether to self-disclose to the US authorities and to cooperate fully in their investigations.

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58. 15 U.S.C. §§ 78dd-1(b), (f)(3).

59. *See* Wang Xiangwei, "Officialdom still a breeding ground for flies, rats and fleas," South China Morning Post, December 15, 2014, http://www.scmp.com/news/china/article/1662799/officialdom-still-breeding-ground-flies-rats-and-fleas (reporting on a speech to the Central Commission on Discipline and Inspection (CCDI) by Cai Xiaopeng, a retired bureaucrat turned businessman and former associate of CCDI Chairman and Politburo member Wang Qishan). *See also* Angela Meng, "When paying the taxman also requires paying bribes," South China Morning Post, April 3, 2014, http://www.scmp.com/news/china/article/1463391/when-paying-taxman-also-requires-paying-bribes.

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