

The Long Arm of the Law: Recent U.S. Enforcement of the Foreign Corrupt Practices Act by the Securities and Exchange Commission

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The US Foreign Corrupt Practices Act, passed in 1977, prohibits US corporations and other business entities and employees and agents of those entities from bribing foreign government officials. This outline reviews the pronounced increase in enforcement of the FCPA in recent years, and discusses some of the implications of the increased US activity for companies outside of the US and for government officials in those countries.

The FCPA divides enforcement responsibility between the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC). The Department of Justice is responsible for all criminal investigation and prosecution, as well as for civil investigation and prosecution of violations by corporations or other business entities that are not public companies. The SEC is responsible for civil investigation and prosecution of violations by publicly owned companies and their agents.

Before the FCPA was passed, the SEC brought several cases involving allegations of foreign bribery against public companies based on a fraud theory, arguing that bribes paid by public companies constituted an important undisclosed contingency and reflected on the integrity of company management in such a fashion that the payments should have been disclosed to investors. The FCPA eliminated the SEC's tenuous fraud theory and simply prohibited various kinds of payments or promises to pay foreign government officials. The legislation also required public companies to keep reasonably detailed, accurate books and records, and to have internal accounting controls sufficient to allow the company to see that assets are disposed of consistent with management direction and that financial records permit the preparation of proper financial statements. In 1998, the statute was amended, in conjunction with other amendments to conform US law to the OECD Convention, to cover the acts of US citizens and companies acting wholly beyond territorial US jurisdiction.

Renewed SEC Enforcement Interest. The US government's push for the passage of the OECD Convention paralleled a renewed interest in enforcement actions and investigations into FCPA issues, particularly from the SEC. The SEC brought only three foreign payments cases until the late 1990's, though during that period it brought hundreds of cases against US issuers charging violations of the books and records and internal accounting controls provisions. By contrast, the US Department of Justice, with the greater evidence-gathering tools available to criminal prosecutors, brought almost thirty foreign bribery actions during that period. Since 1996, though, the SEC has brought enforcement actions against five public companies for legal violations related to bribery of government officials, indicating once again that foreign bribery is an important enforcement priority for the SEC.

**SEC v. Montedison, SpA*. In 1996, the SEC alleged that Montedison, an Italian industrial conglomerate whose securities (in the form of American Depositary Receipts) are traded in the US, disguised hundreds of millions of dollars in payments that, among other things, were used to bribe politicians in Italy and other persons. The fraudulent conduct was disclosed only after new management was appointed when Montedison disclosed it was unable to service its bank debt. Virtually all of the former senior management at Montedison responsible for the fraud were convicted by Italian criminal authorities and were sued by the company. The Commission charged Montedison with committing fraud (its financial statements were misstated by hundreds of millions of dollars), and with violating the books and records and internal accounting controls provisions. All of the allegedly violative conduct occurred outside of the US. Five years after the case was filed, and after a change in corporate control at Montedison, the company settled with the SEC by consenting to pay a \$300,000 civil penalty.

**SEC v. Triton Energy*. In February 1997, the SEC alleged that Triton Energy Corporation, a US-domiciled public company, acting through the officers of a subsidiary, Triton Indonesia, made approximately \$450,000 in payments to an intermediary for the purpose of obtaining favorable treatment of a royalty agreement by Indonesian tax authorities. The illegal payments were falsely recorded on the subsidiary's records as for the purchase of services from the intermediary. Triton's liability apparently was premised not on direct participation in the wrongdoing, but in the parent company's failure to take adequate steps to prevent illicit foreign payments after certain warning signs came to the attention of management. Triton was enjoined from future violations of the books and records and internal accounting controls provisions and fined \$300,000. Two former officers of the subsidiary were enjoined from violating the anti-bribery provisions and fined \$50,000 and \$35,000 respectively. The SEC issued administrative orders prohibiting future misconduct from four additional employees in connection with the improper payments and the misbookings.

**In re IBM, Inc*. In December 2001, the SEC filed a settled administrative action against IBM, arising from a contract awarded to its wholly owned subsidiary, IBM-Argentina, to modernize and fully integrate the computer systems of a government owned bank, Banco de la Nacion Argentina ("BNA"). In connection with this contract IBM-Argentina's senior management circumvented IBM's established procurement review procedures and caused IBM-Argentina to enter into a \$22 million subcontract with a local company. Approximately \$4.5 million of that amount was subsequently diverted to certain BNA officials. The entire \$22 million was inaccurately recorded in IBM's books and records as legitimate subcontractor expenses. After discovering the matter, IBM brought it to the attention of the SEC. In resolving the matter, the SEC found that IBM violated the books and records provisions, and was ordered to pay a \$300,000 civil penalty.

**In re American Bank Note Holographics, Inc (ABNH)*. In July 2001, the SEC filed a settled action against ABNH related to a long-standing financial fraud conducted by former management of ABNH. In the course of conducting an internal investigation into financial irregularities, new management discovered that \$239,000 had

been paid to a Swiss bank account for the purpose of influencing the acts or decisions of Saudi Arabian government officials. The SEC alleged that the payments were falsely recorded in the company's records as consulting fees. The results of the internal investigation, including the illicit payment, were promptly reported to the SEC staff. ABNH consented to the entry of an administrative order finding that it violated the anti-bribery section of the FCPA, and ordering it to pay a \$75,000 civil penalty. Litigation is ongoing with respect to numerous settled with the Commission, agreeing to entry of an order finding that it violated Section 30A of the Exchange act and ordering it to cease-and-desist from further violations of that provision. ABNH also consented to pay \$75,000 penalty in a separate federal court action relating specifically to ABNH's violation of Section 30A of the Exchange Act. At the same time, the Department of Justice announced criminal actions against former officers of ABNH, charging violations of the anti-bribery provisions, among other things.

**In re Baker-Hughes, Inc.* Finally, on September 12, 2001, the SEC announced the filing of actions related to the alleged payment of \$75,000 by employees of Baker-Hughes Inc. for the purpose of influencing an Indonesian tax official responsible for reviewing a Baker-Hughes tax assessment. The SEC alleged that a chief financial officer and controller paid \$75,000 to the Indonesian affiliate of KPMG knowing that the payment was intended for a Indonesian Tax Official reviewing a Baker-Hughes tax assessment. The payment was inaccurately recorded in Baker-Hughes' books, records and accounts as a payment for professional services. In apparent recognition of the fact that Baker-Hughes uncovered the illicit payment, took strong corrective action, reported the incident to the staff, and cooperated fully with the staff's investigation, the SEC found that Baker-Hughes violated the books and records and internal accounting controls provisions, but did not order the company to pay a civil penalty. The SEC also filed the first-ever joint civil action with the Department of Justice against Baker-Hughes' Indonesian accounting firm, KPMG Siddharta Siddharta & Harsono, and a local partner at that firm for participating in the alleged bribery scheme. The SEC is litigating charges against two former Baker-Hughes officials.

Expansive SEC International Enforcement. The SEC's expansive international enforcement of the FCPA is not occurring in a vacuum. Indeed, the agency has aggressively pursued enforcement actions against foreign issuers whose securities trade in the US (*see, e.g., In re E.ON Ag* (Sept. 2000) (charging that E.ON Ag, a German company formerly known as Veba AG, violated US securities laws by not accurately disclosing the status of merger negotiations); *In re Sony Corporation* (August 1998) (charging that Sony, a Japanese corporation, violated US securities laws by failing to adequately disclose certain financial trends in business)). Likewise, the SEC recently charged two US persons with violating US securities laws by manipulating the market for four foreign company stocks through trades effected in four foreign markets. *See In re Angelo Ianonne, Andrew Parlin.*

Lessons for Foreign Companies and Foreign Officials. The SEC is capable of reaching deeply into the affairs of any foreign company engaged in improper payments or

corruption, so long as there is some connection, however tenuous, to the US. This is particularly the case for foreign companies whose securities are traded in the US, such as *Montedison*. The SEC's interest extends to the foreign operations of US issuers, even when the conduct in question involves foreign subsidiaries and foreign employees, as the *IBM* case demonstrates. Foreign agents and business partners, such as the Indonesian affiliate of KPMG in *Baker-Hughes*, should take no comfort that they are beyond the reach of US law merely by conducting their affairs in another country.

The books and records and internal accounting controls provisions are powerful and virtually open-ended charges available to US law enforcement authorities. US authorities are likely to take the position that the books and records of an issuer of securities, including foreign issuers whose securities trade in the US, include all of the books and records of subsidiary and affiliated companies. The likelihood of US law enforcement action under these provisions is limited only by the exercise of prosecutorial discretion and limited law enforcement resources. The cases leave open for question whether companies will receive any credit for self-reporting possible improprieties to the SEC.

The recent FCPA cases demonstrate that it considers itself an equal partner along with the Department of Justice in combating foreign bribery. In the *Baker-Hughes* case the SEC and Department of Justice filed a joint action charging the Indonesian KPMG affiliate and an Indonesian partner. In the *American Banknote* case the filing of a major SEC financial fraud action that included allegations of foreign bribery were coordinated with criminal charges filed by the Department of Justice.

The expansive international activity of the SEC is likely to continue. Each year brings greater cooperation among financial regulators through bi-lateral and multi-lateral agreements as well as informal working arrangements. The task of collecting evidence of foreign payments is difficult and time-consuming, but no longer insuperable. With the recent changes in the FCPA to include so-called nationality jurisdiction over US persons and US entities, we can expect to see even more cases in the future involving bribery and public corruption than we have seen in the past.