

Corporate Counsel

Anti-Corruption

Minimizing FCPA Risk on Two Fronts: Through Corporate Policy and Corporate Culture



Contributed by Alexandre H. Rene, Stephen L. Braga, and Anthony C. Biagioli, Ropes & Gray LLP

- **Managing FCPA risk is as much about corporate culture as it is about corporate policy.**
- **Companies can implement strategies to foster employee loyalty and internal reporting of violations.**

A common and justifiable refrain met the Securities & Exchange Commission (SEC)'s new whistleblower rules providing significant incentives for employees to disclose Foreign Corrupt Practices Act (FCPA), among other, violations to the SEC—that the rules would challenge internal corporate compliance programs to prevent, detect, and remediate FCPA and other violations. The resulting advice has been to double down on implementing effective policies, not only to detect and rapidly respond to violations once they occur, but to prevent them from occurring in the first place.

The advice is well-founded. Strong FCPA compliance controls—including comprehensive and understandable policies and effective training—are indispensable prerequisites to minimizing FCPA risk. Yet by themselves, they are insufficient. This is because the whistleblower incentives promise to alter the psychology

of employee reporting. In general, an employee who reports up the corporate chain may do so out of a desire to help the company root out corruption. And an employee who reports to the government instead of the company possibly does so out of concern about the seriousness of a violation management may be unable or unwilling to rectify. Yet with the promise of a reward of potentially millions or even tens of millions of dollars, the whistleblower rules risk compounding the incentives to report externally. The risk is that no corporate compliance policy, no matter how necessary and effective, can change that.

The lesson in light of the whistleblower rules is thus not simply that strong policies are critical, although they are. It is that minimizing FCPA risk is as much about corporate *culture* as about corporate *policy*. Just as important as strong policies is a business culture that encourages open communication from the bottom up—and which rewards employees for doing so. Without *both* defenses, companies remain at a significant risk of being swept into the net of the government's ever-expanding FCPA enforcement.

This article accordingly offers practical advice as to how companies might foster employee loyalty to the company and at least partially counteract the incentives to report potential issues outward. It focuses specially on empirical literature addressing whistleblower incentives. To incent internal reporting, the literature suggests that companies should facilitate bottom-up communication to promote employee voice, reduce excessive employee supervision, and, to the extent possible, decentralize company decision-making.

Dodd-Frank's Whistleblower Rules and New Incentives for Employee Reporting

The FCPA prohibits U.S. public companies from making or promising payments to foreign public officials to gain a business advantage, and the U.S. government is enforcing it. The year 2010 saw eight of the ten largest monetary settlements for FCPA

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violations, exceeding \$1.8 billion in total;¹ the SEC has a unit dedicated to FCPA matters;² and the government has targeted companies in industry-wide sweeps, including in the oil and gas, medical device and pharmaceutical industries.³ In a recent high-profile trial—one of the few cases in which a defendant did not simply plead guilty—a court ruled in favor of the government’s broad interpretation of the law, and then the jury convicted.⁴ The government’s ever-widening enforcement net has ensnared not just companies, but individuals—and some are going to prison.⁵

For companies and their management, a growing risk is that employee incentives to report potential FCPA violations to the government materially changed with the July 2010 passage of section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.⁶ The law permits whistleblowers to receive between 10 and 30 percent of collected monetary sanctions for voluntarily provided original information leading to covered enforcement actions recovering over \$1 million.⁷ Because FCPA penalties may exceed tens or even hundreds of millions of dollars, whistleblowers may easily recover tens of millions of dollars as a reward.⁸

On May 25, 2011, the SEC adopted rules implementing section 922. The rules took effect August 12, 2011.⁹ To be eligible for compensation, the individual must *voluntarily* provide *original information* to a *governmental* or *self-regulatory organization* relating to a *possible violation* of federal securities laws and *leading to a successful enforcement action* imposing *monetary sanctions* of more than *\$1 million*.¹⁰ The rules explain in considerable depth the significance of the above terms.¹¹

The risk to corporate compliance programs is abundantly clear: with the potential to recover tens of millions of dollars by reporting to the government, and the likelihood of receiving nothing by reporting a problem internally, employees may see no reason to utilize internal compliance policies, even those well-designed to investigate and remediate potential problems.

The SEC rules, in apparent recognition of the potential to undermine effective internal compliance processes, attempt to reduce the incentives to circumvent them in two ways. First, the rules provide that, in certain circumstances, providing original information to an internal compliance entity will be treated as if the whistleblower reported directly to the government—even if the company technically discloses first—if the individual provides information to the SEC within 120 days of reporting the information internally.¹² And second, when determining the size of the reward, the SEC will favorably consider that the employee first reported internally.¹³

Of course, given the extensive and time-consuming steps required to internally investigate a possible violation—e.g., initial interviews and planning, transaction testing and related analysis, document collection and review, and interviews with potentially significant employees—120 days is frequently insufficient to conduct a proper investigation. And even if the SEC offered only the *minimum* reward because the employee did not report internally first—and there is no evidence this would be the case—10 percent of a

reward of millions, tens of millions, or hundreds of millions of dollars could still be sufficient to incent the employee to bypass internal procedures.

The rules accordingly may place extraordinary strain on internal corporate compliance procedures.

Minimizing Risk on Two Fronts

– Effective Policies

In light of that potential, attorneys have offered clients universal advice, centered on the importance of implementing strong and effective compliance policies. It is undeniable that, with or without whistleblower incentives, effective policies and procedures are essential to minimizing FCPA risk.¹⁴ Such policies help prevent violations from occurring in the first place; detect violations when they occur; may help convince the Department of Justice (DOJ) to refrain from prosecution, possibly on a theory that a rogue employee surreptitiously flouted stellar compliance procedures; potentially help reduce a company’s sentence in the event of a conviction by reducing its sentencing score under the U.S. Sentencing Guidelines;¹⁵ and possibly set up an “adequate procedures” defense under the U.K. Bribery Act.¹⁶

– Corporate Culture

Faced with sizeable monetary incentives to report externally, however, corporate compliance policies, standing alone, do little to address what may be powerful external incentives to report possible violations. The academic literature does not appear to have directly addressed which factors contribute to internal reporting in the face of monetary incentives to report externally. One study assessed the comparative efficacy of various *legal* (not internal company) mechanisms to incentivize *external* reporting.¹⁷ Another addressed how to maximize internal reporting and employee rule-following, although it did not assess these mechanisms when an external reward was present.¹⁸ From this and related literature, lessons might be drawn for incenting internal reporting. It may not be precisely clear whether such incentives would be sufficiently strong when pitted against an external reward. But these strategies appear to be a company’s best bet to at least partially reduce the risk that an employee will report to the government, rather than up the corporate chain.

– 1. Offering Money to Promote Loyalty

A potentially obvious starting point is to find ways to increase employee loyalty and commitment to the company’s success, such as by offering employees stock options.¹⁹ Of course, if the external whistleblower incentive dwarfs the potential decline in the employee’s stock value—and, after a multi-million dollar FCPA settlement, it very well might—stock options alone may be ineffective. Yet they still may serve as part of a broader corporate program to promote employee investment and loyalty.

– 2. Incorporating Compliance Participation into Review and Bonus Structure

So too might making internal reporting of potential compliance issues an important component of an employee's review and even bonus.²⁰ This is not because the size of such a bonus could approach the magnitude of a potential SEC reward, but rather because it reinforces a broader company message about the importance of compliance. In addition, regardless of the bonus amount, employees could receive compensation from the company for reporting compliance concerns in the short term—not, for example, years later as in the case of a post-litigation whistleblower reward—which may further incent internal reporting.

– 3. Promoting Employee Voice and Responding to Expressed Concerns

A third, and possibly critical, effort companies can make to facilitate internal reporting is to encourage bottom-up communication and promote employee voice. One recent study found that an organizational emphasis on internal compliance and employee voice increased internal, and reduced external, reporting.²¹ Certain factors that affected external versus internal reporting—e.g., the conduct's possible harm to the organization or society—will exist regardless of a company's business culture. Yet some factors appear to be in management's control. In the study, positive reaction from management increased internal enforcement and reduced the likelihood of external reporting for certain misconduct.²² Similarly, important was communicating an expectation to report wrongdoing and that such reports would not trigger retaliation:

[O]ne of the most robust predictors of social enforcement was the perceived expectation to act. This factor was predictive of both external and internal enforcement, even when we control for all other factors. Its robustness demonstrates the importance of social and organizational norms and its independence from both organizational and social costs.²³

Combining these two findings suggests practical steps businesses can take to increase internal reporting. At a minimum, companies should continuously encourage internal reporting and provide positive feedback to employees who share even speculative compliance concerns. Compliance officers should personally assure reporting employees that the company takes their concerns seriously and is committed to investigating and, where appropriate, remediating. And companies must follow through.²⁴ Importantly, companies should not simply respond well to employee reporting (although responding well is critical). In addition, companies should *seek out* employees and proactively elicit employees' suggestions on improving compliance, including even speculative compliance concerns. This may entail brief but regular one-on-one meetings between compliance officers and employees at practicable intervals.²⁵ The goal is to integrate employees into the compliance process and acknowledge that they are trusted and essential participants.

– 4. Reduce Supervision and Empower Employees

A fourth possible step to promote internal reporting is to reduce excessive supervision and decentralize company decision making to permit lower-level employees to exercise discretion in their work and suggest innovations.²⁶ This reflects the degree to which broad features of a business culture may impact specific compliance goals. Some studies have shown that excessive supervision risks fostering mistrust and reduced motivation.²⁷ “The ‘embedded mistrust’ signaled by tight controls and commands creates an expectation of wrongdoing and cynicism about compliance.”²⁸ “Top-down surveillance [thus] crowds out other mechanisms of compliance that are generated through ethical development and self-monitoring.”²⁹

A tension, of course, exists between the oversight required to maintain an effective FCPA compliance policy and the reduced supervision suggested here. But just because there is an inherent degree of control and supervision required to effectively implement a strong FCPA policy, there seems no reason why such a requirement must permeate *every aspect* of an employee's work life. For example, just because an FCPA policy limits the gifts and meals that can be provided to government officials, or requires due diligence as to prospective agents, there seems considerable potential for employees to otherwise exercise discretion in their work. The reaction from businesses to the whistleblower rules should not be to simply lament the new incentives, or even to implement strong internal compliance policies and not go further. day-to-day interactions.

Winning the War on Both Fronts

The ultimate lesson for businesses is that broad decisions that shape company culture—even seemingly fundamental ones, like the degree to which companies promote employee voice or supervision on a corporate reporting structure—can be relevant to the seemingly unrelated task of detecting potential FCPA violations. The reaction from businesses to the whistleblower rules should not be to simply lament the new incentives, or even to implement strong internal compliance policies and not go further. Companies must in addition think hard about how their corporate culture shapes incentives to report internally. Doing so may maximize the chances of employee reporting up the in-house ladder, so that rather than responding to government inquiries before the company knows what occurred, companies can detect and root out wrongdoing at the outset.

Steve Braga is a Washington, D.C.-based government enforcement partner with Ropes & Gray. He has been representing individual and corporate clients in grand jury and other regulatory investigations, as well as in federal and state courts at both trial and appellate levels, for thirty years. Steve also regularly conducts internal investigations into, and advises corporate clients concerning, potential Foreign Corrupt Practices Act issues. He can be reached at stephen.braga@ropesgray.com.

Alex Rene is a Washington, D.C.-based government enforcement partner with Ropes & Gray. He has extensive experience representing

corporate entities and their executives in connection with litigation and investigations arising out of white collar criminal prosecutions, grand jury investigations, criminal antitrust investigations, and corporate compliance matters. As an Assistant U.S. Attorney, Alex prosecuted matters involving mail, wire and procurement fraud, money laundering, and violations of the Travel Act and Foreign Corrupt Practices Act (FCPA), among other offenses. He can be reached at alexandre.rene@ropesgray.com.

Anthony C. Biagioli is an associate in the Washington, D.C. office of Ropes & Gray and a member of the firm's government enforcement and antitrust practice groups. Anthony focuses his practice on representing corporate entities and their executives in government investigations related to the Foreign Corrupt Practices Act and federal antitrust and securities laws. He can be reached at anthony.biagioli@ropesgray.com.

¹ Elizabeth Fitzpatrick, *United States: Trends and Recent Developments in FCPA Enforcement*, Mondaq (Sept. 13, 2011).

² SEC Press Release No. 2011-192, Press Release, SEC, *Kara Novaco Brockmeyer Named Chief of FCPA Unit* (Sept. 27, 2011) (on file with author).

³ See Fitzpatrick, *supra* note 1.

⁴ Samuel Rubinfeld, *Lindsey Manufacturing Convicted: What Does It Mean?*, Wall St. J. Corruption Currents Blog (May 12, 2011, 6:19 AM) (noting that court embraced government's expansive definition of "foreign official" to include employees of state-owned enterprises). On December 1, 2011, the trial judge threw out the convictions and dismissed the indictment because of alleged prosecutorial misconduct; the government is appealing the ruling. See Edvard Pettersson, *Lindsey Manufacturing Wins Dismissal of Foreign Bribery Case*, Bloomberg (Dec. 2, 2011).

⁵ See, e.g., DOJ Press Release No. 11-1407, *Executive Sentenced to 15 Years in Prison for Scheme to Bribe Officials at State-Owned Telecommunications Company in Haiti* (Oct. 25, 2011) (on file with author) (announcing that former president of Terra Telecommunications Corp. was sentenced to 15 years in prison for role in scheme to bribe Haitian government officials at state-owned telecommunications company); DOJ Press Release No. 09-1217, *Connecticut Investor Frederic Bourke Sentenced to Prison for Scheme to Bribe Government Officials in Azerbaijan* (Nov. 11, 2009) (on file with author) (noting that investor was sentenced to one year and one day in prison for conspiring to bribe Azeri officials to rig auction to privatize state-owned oil company); see also DOJ Press Release No. 11-1626, *Eight Former Senior Executives and Agents of Siemens Charged in Alleged \$100 Million Foreign Bribe Scheme* (Dec. 13, 2011) (on file with author) (noting that executives allegedly bribed Argentine officials to obtain a \$1 billion contract with the Argentine government to produce national identity cards).

⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 922, 124 Stat. 1376, 1841-49 (2010) (codified at 15 U.S.C. § 78u-6) (among other provisions, strengthening anti-retaliation protections for whistleblowers by providing an express private right of action against retaliating employers).

⁷ See 15 U.S.C. § 78u-6(a)(1), (b) (2010).

⁸ See, e.g., SEC Press Release No. 2011-87, *SEC Charges Johnson & Johnson with Foreign Bribery* (April 7, 2011) (on file with author), (announcing that the company settled the SEC's charges by paying more than \$48.6 million in disgorgement and prejudgment interest to the SEC, and a \$21.4 million fine to settle DOJ criminal charges); SEC Press Release No. 2008-294, *SEC Charges Siemens AG for Engaging in Worldwide Bribery* (Dec. 15, 2008) (on file with author) (noting that Siemens paid \$350 million in disgorgement to settle the SEC's FCPA charges, and a \$450 million fine to settle DOJ criminal charges).

⁹ Securities Whistleblower Incentives and Protections, 17 C.F.R. §§ 240.21F-1 to -17 (2011).

¹⁰ *Id.* §§ 240.21F-1, -4. See generally Client Alert, Ropes & Gray LLP, *The SEC's New Whistleblower Compensation Rules* (June 2, 2011) (on file with author) ("Dodd-Frank and the whistleblower compensation rules also

establish who is not eligible for compensation including: (i) anyone who had a pre-existing legal or contractual duty to report the information to the governmental entity; (ii) attorneys who report privileged information, unless such reports are permitted under SEC rules or state bar rules; (iii) anyone who obtains the information through the commission of a crime; (iv) foreign government officials; (v) employees who learn the information through a firm's hotline; (vi) compliance and internal audit personnel, with some exceptions; and (vii) governmental employees and people who are criminally convicted in connection with the conduct they report.").

¹¹ See, e.g., 17 C.F.R. § 240.21F-4(b).

¹² *Id.* § 240.21F-4(b)(4)(v)(C).

¹³ *Id.* § 240.21F-6(a)(4)(i).

¹⁴ Effective policies explain the meaning of the FCPA and related anti-corruption laws, describe how employees should address issues they will likely encounter, and prescribe detailed due diligence steps to facilitate compliance.

¹⁵ An "effective compliance and ethics program" may result in a three-point reduction in an organization's culpability score. U.S. Sentencing Guidelines Manual § 8C2.5(f)(1) (2010). Prior to the November 2010 amendments to the Sentencing Guidelines, the involvement of a high-level person at the organization or a delay in reporting to the government generally precluded this reduction. U.S. Sentencing Guidelines Manual § 8C2.5f(2)-(3)(B) (2009). Currently, however, courts may subtract three points, despite the participation of a high-level person, if

(i) the individual or individuals with operational responsibility for the compliance and ethics program have direct reporting obligations to the organization's governing authority or an appropriate subgroup thereof (e.g., an audit committee of the board of directors);

(ii) the compliance and ethics program detected the offense before discovery outside the organization or before such discovery was reasonably likely;

(iii) the organization promptly reported the offense to appropriate governmental authorities; and

(iv) no individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.

See U.S. Sentencing Guidelines Manual § 8C2.5(f)(3)(C) (2010) (internal citation omitted).

¹⁶ Client Alert, Ropes & Gray LLP, *The UK Bribery Act 2010: Recent Guidance for Commercial Organizations* (April 7, 2011) (on file with author) ("By maintaining 'adequate procedures,' companies can ensure that they are not exposed to prosecution and liability by the acts of employees, consultants, suppliers, or other associated persons."). See generally *Bribery Act 2010, c. 23, § 7(1)-(2)* (U.K.) ("A relevant commercial organisation is guilty of an offence under this section if a person associated with [the commercial organisation] bribes another person . . . But it is a defence for . . . [the commercial organisation to prove that it] had in place adequate procedures designed to prevent persons associated with . . . [the commercial organisation] from undertaking such conduct." (internal parentheticals omitted)).

¹⁷ Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality*, 88 Tex. L. Rev. 1151 (May 2010). Feldman and Lobel surveyed more than 2,000 employees to assess the efficacy of anti-retaliation protection, affirmative reporting duties (e.g., suspected child abuse reporting by teachers), related liabilities for failure to report, and monetary incentives. They concluded that rewards may not be necessary, and may even be counterproductive, to incent reporting of morally outrageous conduct. For conduct that does not trigger moral outrage, high incentives (\$1,000,000) are better than low incentives (\$1,000), and low incentives may actually reduce reporting by diluting the moral dimension of the act and otherwise failing to motivate high levels of reporting. *Id.* at 1155.

¹⁸ Yuval Feldman & Orly Lobel, *Decentralized Enforcement in Organizations: An Experimental Approach*, 2 Reg. & Governance 165 (2008) [hereinafter, Feldman & Lobel, *Decentralized Enforcement*].

¹⁹ Orly Lobel, *Citizenship, Organizational Citizenship, and the Laws of Overlapping Obligations*, 97 Calif. L. Rev. 433, 469-70 (2009) ("Stock options increase employees' stake in the company and increase their commitment to the success of the firm."); Sharon Hanes, *Reverse Monitoring: On the Hidden Role of Employee Stock-Based Compensation*, 105 Mich. L. Rev. 1421, 1444 (2007).

²⁰ See, e.g., Lobel, *supra* note , at 469 ("A good example of a new workplace

feature designed to induce loyalty and identification with one's company . . . is the burgeoning system of . . . bonus-type compensation.").

²¹ See generally Feldman & Lobel, *Decentralized Enforcement*, *supra* note . Recall, however, that the authors did not test for effects when an external reward was present.

²² See *id.* at 175-78 ("[P]ositive reaction from management might have two benefits for the corporation: it is likely to motivate employees to report misconduct to management and to prevent employees from going outside the corporation.").

²³ *Id.* at 178.

²⁴ The visible, fair, and effective functioning of a company's internal compliance process may help shape whether employees believe they work in a procedurally just work environment, which may help further facilitate internal compliance. See, e.g., Lobel, *supra* note , at 495. Lobel notes that "a procedurally just work environment is conducive to employee rule abidance and ethical compliance" and that "[t]he goal of promoting organizational procedural justice is to encourage employees to report problems internally, while simultaneously enabling resolution and minimizing harm to the organization." *Id.* Importantly, "[a] good internal grievance procedure also signals to other workers that the organization cares about compliance." *Id.* at 495 n.385 ("This is not unlike the expressive function of the legal regime at large.") (citing Elizabeth S. Anderson & Richard H. Pildes, *Expressive Theories of Law: A General Restatement*, 148 U. Pa. L. Rev. 1503 (2000)).

²⁵ Group forum discussions of potential compliance concerns may be less effective and desirable, due to the possible reticence of employees to speak out in a group setting and the potential opportunity for would-be whistleblowers to collect sufficient information to make a meaningful report to the government.

²⁶ Lobel, *supra* note , at 469 (citing John P. Meyer et al., *Organizational Commitment and Job Performance: It's the Nature of the Commitment that Counts*, 74 J. Applied Psychol. 152, 155-56 (1989)).

²⁷ See Lobel, *supra* note 19, at 469 (citing Jennifer S. Lerner & Philip E. Tetlock, *Accounting for the Effects of Accountability*, 125 Psychol. Bull. 255, 259 (1999)).

²⁸ Lobel, *supra* note 19, at 469 (citing Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with Law*, 2002 Colum. Bus. L. Rev. 71, 98).

²⁹ Lobel, *supra* note 19, at 469 (quoting Robert B. Cialdini, *Social Influence and the Triple Tumor Structure of Organizational Dishonesty*, in *Codes of Conduct* 44, 57 (David M. Messick & Ann E. Tenbrunsel eds., 1996) ("When people perceive themselves performing the desirable monitored behavior, they tend to attribute the behavior not to their own natural preference for it but to the coercive presence of the controls. As a consequence, they come to view themselves as less interested in the desirable conduct for its own sake and they are more likely to engage in the undesirable action whenever the controls cannot register the conduct." (internal brackets and ellipsis omitted)).