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**FCPA****Smith & Wesson Settlement Raises FCPA Concerns for U.S. Businesses,  
May Establish a New Claim for an Insufficient Compliance Program**

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**O**n July 28, 2014, the Securities and Exchange Commission announced the settlement of charges under the Foreign Corrupt Practices Act against Smith & Wesson Holding Corp. for violations involving improper payments to Pakistani, Turkish and Indone-

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sian officials to secure minor firearm supply contracts.<sup>1</sup> Kara Brockmeyer, chief of the SEC Enforcement Division's FCPA Unit, described the action as a "wake-up call for small and medium-size businesses that want to enter into high-risk markets and expand their international sales."<sup>2</sup> Smith & Wesson agreed to pay more than \$2 million and to provide ongoing reporting about FCPA compliance to settle the charges, which included violations of the FCPA's anti-bribery, books and records, and internal control provisions.<sup>3</sup>

Such charges are typical of those brought in recent years against U.S. businesses operating in foreign jurisdictions that the SEC and U.S. Department of Justice view as posing significant corruption risk. However, the SEC's order is notable for several reasons, both with respect to the nature of the conduct and the scope of what the SEC seems to provide as a basis for its action. First,

<sup>1</sup> *Smith & Wesson Agrees to Pay \$2M to Settle SEC Probe Into FCPA Violations*, 12 CORP. L. & ACCOUNTABILITY REP. 879 (Aug. 1, 2014).

<sup>2</sup> U.S. SEC. & EXCH. COMM'N, Release No. 2014-148, *SEC Charges Smith & Wesson With FCPA Violations* (July 28, 2014), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542384677#.U-JxsnPD-Uk>.

<sup>3</sup> *Id.*

the bribes and contracts at issue appear to be relatively small. Additionally, the SEC offered an unusually detailed description of Smith & Wesson's failure to implement anticorruption controls specific to the conduct of third-party agents abroad. Moreover, the commission seemed to imply that the simple failure to have an adequate FCPA compliance program could constitute a securities violation.

### Recent Focus on High Value Corporate Targets

The SEC and DOJ's increasing focus on FCPA enforcement has been well publicized.<sup>4</sup> Although the number of enforcement actions brought by the SEC and DOJ has declined since its 2010 peak, FCPA enforcement has remained robust, with the SEC or DOJ bringing 27 corporate FCPA actions in 2013, and 23 such actions in 2012. Perhaps most notable among recent trends has been the increase in the average price of a corporate FCPA resolution, which, including DOJ and SEC fines, penalties, disgorgement and prejudgment interest, has increased fourfold from 2012 to 2013, with the 2013 average totaling more than \$80 million. Taken together, these trends suggest a narrowing of the government's enforcement strategy to fewer, but higher-priced actions.

### The Smith & Wesson Matter

The Smith & Wesson settlement breaks that trend. During the period that is the focus of the SEC's order, Smith & Wesson's international business accounted for only about 10 percent of the company's revenues—the SEC order itself notes that the company's international business was only in its “developing stages.”<sup>5</sup> The bribes identified by the SEC in its order were small compared to those that have been the subject of other recent FCPA enforcement actions, as were the benefits to Smith & Wesson. In one example cited in the SEC's order, Smith & Wesson retained a third-party agent in Pakistan in 2008 to help the company obtain a deal to sell firearms to a Pakistani police department. During the arrangement, Smith & Wesson employees authorized the agent to provide roughly \$11,000 in guns to Pakistani police officials as gifts and to make additional cash payments. Smith & Wesson ultimately won the contract with the Pakistani police to sell 548 pistols for a profit of just \$107,852.<sup>6</sup> The other bribes at issue appear to be not only small, they were all unsuccessful or the relevant contracts were subsequently canceled. The SEC's order also cites Smith & Wesson's authorization of illicit payments through third-party agents to secure firearm sales contracts in Indonesia, Turkey, Nepal and Bangladesh.<sup>7</sup> However, Smith & Wesson ultimately failed to secure contracts in those jurisdictions or canceled the contracts in light of the SEC's enforcement action.

<sup>4</sup> E.g., *More FCPA Cases in Pipeline, Brockmeyer Says; Some Administrative*, 12 CORP. L. & ACCOUNTABILITY REP. 851 (July 25, 2014).

<sup>5</sup> U.S. SEC. & EXCH. COMM'N, Securities Exchange Act of 1934 Release No. 72678, *In the Matter of Smith & Wesson Holding Corp.* (July 28, 2014).

<sup>6</sup> *Id.* at 3.

<sup>7</sup> *Id.* at 3–4.

Despite the small and unsuccessful nature of the bribes authorized, the penalties paid by Smith & Wesson still reached almost \$2 million.<sup>8</sup> To resolve the matter, Smith & Wesson agreed to pay \$107,852 in disgorgement, \$21,040 in prejudgment interest and a \$1.906 million penalty. Smith & Wesson also halted pending international sales transactions, consented to the implementation of a series of compliance improvements, terminated its *entire* international sales staff and will report to the SEC on its FCPA compliance efforts for a period of two years.<sup>9</sup>

### Scrutiny of Small and Mid-Sized Businesses Operating Abroad

As discussed, this action represents a significant shift from the SEC and DOJ's enforcement efforts in 2013, which focused on high-value targets and included two resolutions—those with Total, S.A. and Weatherford International Ltd.—that ranked among the 10 largest FCPA settlements ever and involved multi-million dollar payments to government officials.<sup>10</sup> As contrasted to the small, largely unsuccessful, and authorized-but-not-paid bribes described in the SEC's Smith & Wesson order, Total, S.A., was charged with utilizing intermediaries between 1995 and 2004 to make approximately \$60 million in improper payments to the chairman of a wholly owned subsidiary of the National Iranian Oil Company, to obtain the rights to develop oil and gas fields in Iran, resulting in \$153 million in illicit profits.<sup>11</sup> Similarly, Weatherford was charged with making corrupt payments through its subsidiaries and third-party representatives to obtain or retain business worth \$59.3 million in profits in Albania, Algeria, Angola, Congo, Iraq and another, unnamed Middle Eastern country.<sup>12</sup>

The Smith & Wesson matter therefore represents a potential extension of the SEC's “Broken Windows” strategy first announced by former Enforcement Division Director Robert Khuzami and reiterated by Chairman Mary Jo White—i.e., the resolution to pursue small infractions on the theory that minor violations lead to larger ones by fostering a culture where laws are

<sup>8</sup> U.S. SEC. & EXCH. COMM'N, Release No. 2014-148, *SEC Charges Smith & Wesson With FCPA Violations* (July 28, 2014), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542384677#.U-JxsnPD-Uk>.

<sup>9</sup> *Id.*

<sup>10</sup> U.S. SEC. & EXCH. COMM'N, Release No. 2013-252, *SEC Charges Weatherford International With FCPA Violations* (Nov. 26, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540415694#.U-J6aHPD-Uk>; U.S. SEC. & EXCH. COMM'N, Release No. 2013-94, *SEC Charges Total S.A. for Illegal Payments to Iranian Official* (May 29, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171575006#.U-J6G3PD-Uk>.

<sup>11</sup> U.S. SEC. & EXCH. COMM'N, Release No. 2013-94, *SEC Charges Total S.A. for Illegal Payments to Iranian Official* (May 29, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171575006#.U-J6G3PD-Uk>.

<sup>12</sup> U.S. SEC. & EXCH. COMM'N, Release No. 2013-252, *SEC Charges Weatherford International With FCPA Violations* (Nov. 26, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540415694#.U-J6aHPD-Uk>.

treated as toothless—to the FCPA space.<sup>13</sup> As highlighted by Ms. Brockmeyer’s quote above, Smith & Wesson serves as a warning that the SEC is expanding its FCPA enforcement efforts beyond high-value targets to small or mid-size businesses that previously slipped under the radar.

## Eye on Adequate Compliance Systems

The charges against Smith & Wesson are also notable for their seeming inclusion of an unusual basis for a charge: Section 13(b)(2)(B) of the Securities Exchange Act of 1934, for failure to establish an appropriate system of internal controls designed to address the bribery risk posed by the company’s use of third-party sales agents in foreign jurisdictions, as well as to have adequate FCPA-related training. The SEC may be seeking to expand its authority with this enforcement action to establish precedent that the mere failure of a public company to have an adequate anticorruption compliance program could constitute a securities law violation.

Past SEC and DOJ FCPA enforcement actions have included charges for internal control violations. These charges, however, have all focused on the failure to have a system in place to ensure that transactions are adequately described in the company’s records (e.g., bribes were listed as commissions or hidden in other charges). These cases are consistent with the terms of Section 13(b)(2)(B), which provides that every public company shall “devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that . . . transactions are recorded” accurately.

However, the Smith & Wesson order states as follows:

While the company had a basic corporate policy prohibiting the payment of bribes, it failed to implement a reasonable system of controls to effectuate that policy. For example, Smith & Wesson failed to devise adequate policies and procedures with regard to commission payments, the use of samples for test and evaluation, gifts, and commission advances. Further, Smith & Wesson’s FCPA policies and procedures, and its FCPA-related training and supervision were inadequate.

...

As a result of the conduct described above, Smith & Wesson violated Section 13(b)(2)(B) . . . .”

Thus, although it appears the alleged bribes were not accurately described in the company’s records, the SEC seems to base the internal controls violation in this case on the failure to have an appropriate anticorruption compliance system given the relevant risks.

To be clear, every company that engages in business outside the U.S. should establish a risk-based anticorruption program. The existence of such a program is often vital to convincing regulators, to the extent an issue

arises, to exercise their discretion and moderate their response to a company’s alleged misconduct. Additionally, it is well established under the U.K. Bribery Act that if a bribery situation arises, the failure of a company to have had an adequate anticorruption compliance system can constitute a *separate* violation from the bribe itself. There are also other unrelated circumstances—for instance, in the investment adviser and broker-dealer context—in which the SEC has statutory authority to bring a case against an entity for the simple failure to have an appropriate compliance system.

To date, however, the prevailing consensus has been that the SEC lacks the statutory authority to bring a case against a public company for the simple failure to have a sufficient anticorruption compliance system. It is difficult to understand how the SEC would have such statutory authority to bring such charges given the limited nature of Section 13, which is focused on the accuracy of books and records, other than as they might relate to a failure to have a system designed to address how payments are recorded.

## Conclusion

Large companies that operate in multiple jurisdictions are used to applying a risk-based approach to anticorruption compliance that incorporates variables that include geography, industry and the size of their international business. The Smith & Wesson settlement may change the calculus for U.S. companies both small and large by demonstrating that the SEC intends to scrutinize even minor transactions for corruption risk. The Smith & Wesson action further demonstrates the SEC’s willingness to examine the particular strategies employed by companies operating abroad—such as the use of third-party agents—and to compare those strategies to the company’s anticorruption policies, going line by line if necessary, to ensure that the policies and controls are crafted to address the individual risks posed by the company’s business model. It is concerning, however, that the SEC may be looking to start regulating public company compliance systems in the same manner that it does broker dealers, which at its extreme could lead to cases based on poor compliance systems without proof of any bribes.

As a precaution, companies and their counsel should take care to design internal controls and anticorruption policies tailored to their individual businesses with a particular focus on issues that the SEC has flagged as high-risk, such as the use of third-party sales agents. Companies should perform pre-contractual diligence on third-party agents, provide agents with compliance training, perform periodic assessments of the performance of agents and consider including audit rights in contracts with third-party agents who may interact with government officials in foreign jurisdictions. Critically, U.S. companies operating abroad should be diligent with respect to transactions both large and small, and should empower compliance and legal departments to ensure consistent enforcement of anticorruption policies in all foreign business.

<sup>13</sup> E.g., Mary Jo White, Chairman, U.S. SEC. & EXCH. COMM’N, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#.U-J73XPD-Uk>.