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FCPA

The Intent Element for Gatekeepers Under the FCPA: Is It All but Gone?



BY ASHEESH GOEL AND G. DAVID ROJAS

On May 19, 2014, Kara M. Stein, one of the commissioners of the U.S. Securities and Exchange Commission, gave a keynote address at Compliance Week in which she discussed the SEC’s targeting of

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corporate gatekeepers.¹ According to Commissioner Stein, the failure of gatekeepers to “disrupt or prevent misconduct” is becoming a “recurring theme.” Despite some criticism over charging chief compliance officers, Commissioner Stein defended the SEC’s actions, emphasizing that the CCOs were “assisting fraud, ignoring red flags, not asking the tough questions, and not demanding answers.”

The concept that a gatekeeper might be liable for missing red flags or failing to ask questions has not emerged out of a vacuum. Rather, the convergence of two trends in government enforcement, particularly in Foreign Corrupt Practices Act cases, has led to the prospect that gatekeepers—whether compliance officers, accountants, in-house counsel or internal auditors—may be responsible for misconduct of which they were not even aware.

First, the government has been turning to an alternative standard for establishing knowledge of misconduct. The FCPA prohibits certain entities from corruptly paying, or offering to pay, foreign officials with the purpose of influencing their decisions.² Inherent in the statute is a requirement of corruption: entities must *intend* to bribe foreign officials. Despite this element of intent, actual knowledge is not necessary for FCPA liability. The government alternatively may establish liability on the basis of an actor’s “willful blindness” to corruption. During the last few years, the SEC and the U.S. Department of Justice increasingly have used the willful blindness standard, rather than actual knowledge, in enforcement actions.

At the same time, the government has been enhancing its targeting of corporate gatekeepers under the FCPA. The government has long recognized the role of gatekeepers in FCPA enforcement. For instance, every SEC enforcement director during the last decade has

¹ Kara M. Stein, Commissioner, U.S. Sec. & Exch. Comm’n, Keynote Address at Compliance Week 2014 (May 19, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541857558>.

² 15 U.S.C. §§ 78dd-1(a)(1)(A).

remarked on the importance of gatekeepers as a mechanism for ensuring compliance.³ Nevertheless, the DOJ and SEC appear to be progressively focusing more on gatekeepers as enforcement targets. In a speech to the Annual Forum of the Australian Securities and Investments Commission on Mar. 24, 2014, SEC Chairwoman Mary Jo White warned the audience that gatekeepers who “fail to perform their duties and responsibilities” would be “held accountable.”⁴ On May 20, 2014, Andrew Ceresney, SEC enforcement director, highlighted the SEC’s “bolstered” focus on gatekeepers.⁵

These two parallel trends—the growing use of the willful blindness standard, together with the emerging focus on the role of gatekeepers in preventing misconduct—raise the question of whether corrupt intent is still relevant as an element under the FCPA.

Willful Blindness Standard

Definition

Under the FCPA, an actor’s willful blindness to potential violations may be sufficient to establish knowledge. In an FCPA criminal case against Frederic Bourke, co-founder of handbag maker Dooney & Bourke, the jury was instructed, “When knowledge of existence of a particular fact is an element of the offense, such knowledge may be established when a person is aware of a high probability of its existence, and consciously and intentionally avoided confirming that fact.”⁶ The FCPA’s legislative history indicates that the Act was intended to cover actors who exhibit “conscious disregard or deliberate ignorance of known circumstances that should reasonably alert one to the high probability of violations of the Act.”⁷

Recent Willful Blindness Cases in FCPA Context

The use of willful blindness to establish the FCPA’s knowledge requirement came to prominence in the DOJ’s case against Bourke for conspiracy to violate the FCPA. On Nov. 11, 2009, Bourke received a one-year

prison sentence, along with a \$1 million fine. According to evidence presented at trial, Bourke invested \$8 million in a company that paid hundreds of millions of dollars to government officials in Azerbaijan in an unsuccessful attempt to privatize the state oil company. The jury was instructed on the standard of willful blindness or conscious avoidance.⁸

The willful blindness standard continues to frame the issue of defendants’ knowledge in FCPA enforcement actions. On July 13, 2011, the SEC alleged certain executives of Armor Holdings, Inc. subsidiaries entered into a consulting agreement with a third-party intermediary, knowing or consciously disregarding that some portion of the consultant’s commissions would be used to bribe a United Nations official.⁹ The UN subsequently awarded an Armor Holdings subsidiary with a multiyear body armor contract. Armor Holdings agreed to pay approximately \$16 million to settle the DOJ and SEC cases.

On Jan. 9, 2014, the SEC charged Alcoa Inc. with violating the FCPA, alleging its subsidiaries retained a consultant to act as an intermediary for aluminum sales to a company primarily owned by Bahrain.¹⁰ According to the SEC, Alcoa’s subsidiaries knew or consciously disregarded that the consultant paid \$110 million in bribes to Bahraini officials. Alcoa agreed to pay \$384 million to settle the charges.

The government’s increasing use of willful blindness or conscious avoidance to bring FCPA cases underscores that mere ignorance is no excuse for FCPA misconduct.

Gatekeepers

Definition

In another emerging trend in FCPA enforcement, corporate gatekeepers are receiving heightened attention from the government. Gatekeepers are individuals who, in their execution of legal, compliance, finance, accounting or other professional functions, are in a “unique position to monitor and promote legal compliance.”¹¹ As former SEC enforcement director Linda Chatman Thomsen described, gatekeepers are professionals who are “generally motivated to be law abiding” under professional ethics and securities laws.¹² Chairwoman White defined the term to include personnel such as attorneys and auditors who “share the responsibility with regulators to protect investors.”¹³

Recent Gatekeeper Cases in the FCPA Context

An overview of recent cases brought by the government lends support to the notion that gatekeepers are becoming a priority of FCPA enforcement. For instance, the SEC charged Nature’s Sunshine Products, along with its former chief financial officer and its chief executive officer, on July 31, 2009, in a case involving al-

³ See, e.g., Stephen M. Cutler, then-Enforcement Director, U.S. Sec. & Exch. Comm’n, Speech by SEC Staff: Remarks at the University of Michigan Law School (Nov. 1, 2002), available at <http://www.sec.gov/news/speech/spch604.htm>; Linda Chatman Thomsen, *Introduction: Standing on the Shoulders of a Giant*, 1 BROOK. J. CORP. FIN. & COM. L. 1, 3 (2006); SEC Release No. 2011-120, SEC Suspends Trading in 17 Companies in Proactive Effort to Combat Microcap Stock Fraud (June 7, 2011), available at <http://www.sec.gov/news/press/2011/2011-120.htm>; Peter Rawlings, *Canellos: SEC Targeting Gatekeeper Negligence*, COMPLIANCE REP. (Feb. 11, 2013); Andrew Ceresney, Enforcement Director, U.S. Sec. & Exch. Comm’n, Financial Reporting and Accounting Fraud (Sept. 19, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370539845772>.

⁴ Mary Jo White, Chairwoman, U.S. Sec. & Exch. Comm’n, Perspectives on Strengthening Enforcement (Mar. 24, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541253621>.

⁵ Andrew Ceresney, Enforcement Director, U.S. Sec. & Exch. Comm’n, Keynote Address at Compliance Week 2014 (May 20, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541872207>.

⁶ U.S. v. Kozeny, 667 F.3d 122, 132 (2d Cir. 2011).

⁷ U.S. DEP’T OF JUSTICE AND U.S. SEC. & EXCH. COMM’N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 110 (2012).

⁸ *Kozeny*, 667 F.3d at 128–29, 132.

⁹ Complaint at 3–4, SEC v. Armor Holdings, Inc., No. 1:11-cv-01271 (D.D.C. July 13, 2011).

¹⁰ Alcoa Inc., Exchange Act Release No. 71261 (Jan. 9, 2014).

¹¹ Stein, *supra* note 1.

¹² Thomsen, *supra* note 3, at 3.

¹³ White, *supra* note 4.

leged payments to Brazilian customs officials.¹⁴ A Nature's Sunshine subsidiary allegedly made improper payments to the officials through a customs broker in order to circumvent new registration requirements, booked them as "importation advances" and purchased fictitious supporting documentation. The SEC argued that the CFO and the then-chief operating officer had supervisory responsibilities over books and records, internal controls and global distribution policies, and as "control persons," failed to adequately supervise their subordinates. Notably, the SEC did not allege that the executives had actual knowledge of the improper payments, the falsified documentation or the sale of unregistered products.

In one of the largest FCPA settlements of all time, Total, S.A., acknowledged in a deferred prosecution agreement failing certain gatekeeper functions. For instance, Total did not perform due diligence or audits of purported consultants.¹⁵ According to the government, Total's inadequate systems allowed the nature of the consulting agreements to remain concealed. On May 29, 2013, Total agreed to pay more than \$398 million.

On Apr. 9, 2014, Hewlett-Packard settled SEC and DOJ allegations that it ignored multiple red flags leading to millions of dollars in improper payments to government officials in exchange for lucrative public contracts.¹⁶ The government's allegations reflect failures by HP gatekeepers in permitting an HP subsidiary to engage a German agent in the face of red flags waved by the subsidiary's credit officer. Despite questionable subcontractors and flimsy support for the agent's €8 million markup, the HP subsidiary failed to conduct any meaningful diligence. The agent eventually paid out millions of dollars in bribes. Additionally, despite payments of more than \$2.5 million from another HP subsidiary to a third-party distributor for services to a Russian state-owned enterprise, HP gatekeepers did not maintain records reflecting what work was performed. HP agreed to pay \$108 million to settle the allegations.

In contrast, the government has declined to prosecute companies when it determined that gatekeepers served their function by creating and monitoring effective anti-corruption programs, even though a bad actor managed to evade the controls for some period of time. On Apr. 25, 2012, a managing director of Morgan Stanley was charged with bribing a Chinese official in exchange for steering business to Morgan Stanley funds. Nevertheless, the DOJ announced it would not bring an FCPA enforcement action against Morgan Stanley because its internal controls "provided reasonable assurances that its employees were not bribing government officials."¹⁷ On Oct. 7, 2013, Stephen Cohen, associate enforcement director at the SEC, suggested "[i]solated conduct combined with good compliance and internal controls make it less likely that we will bring an action at all."¹⁸

¹⁴ Complaint at 7-8, 12-13, SEC v. Nature's Sunshine Products, Inc., No. 2:09CV0672 (D. Utah July 31, 2009).

¹⁵ Deferred Prosecution Agreement at A-5, USA v. Total, S.A., No. 1:13 CR 239 (E.D. Va. May 29, 2013).

¹⁶ Hewlett-Packard Co., Exchange Act Release No. 71916 (Apr. 9, 2014).

¹⁷ U.S. DEP'T OF JUSTICE, Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA (Apr. 25, 2012), <http://www.justice.gov/opa/pr/2012/April/12-crm-534.html>.

¹⁸ Stephen L. Cohen, Assoc. Enforcement Director, U.S. Sec. & Exch. Comm'n, Remarks at SCCE's Annual Compliance

Willful Blindness as Applied to Gatekeepers

The government's increased focus on gatekeepers' failure to implement sufficient controls to identify red flags highlights the peril of turning a blind eye to potential FCPA violations. On Feb. 21, 2014, Commissioner Stein emphasized "greater individual accountability" would be sought for gatekeepers.¹⁹ Ceresney cautioned on Sept. 19, 2013, that gatekeepers such as audit committees have been subject to SEC actions for "failing to recognize red flags."²⁰ He also emphasized the SEC intended to continue to focus on audit committees, auditors and others who "shirk their responsibilities as gatekeepers to the securities markets."²¹

Furthermore, the SEC appears to be turning its focus toward gatekeepers of all kinds, including lawyers. Commissioner Stein cautioned that lawyers should not be "used as a shield against liability" for themselves or others.²² Moreover, she stated they must not be treated "differently from other gatekeepers," though they have been notably "absent from the list of [past] cases."²³

Gatekeepers and the Disappearing Corrupt Intent Requirement

The confluence of the rising use of the willful blindness standard and the increased attention to gatekeepers may lead one to question whether the requirement of corrupt intent still holds any relevance to FCPA actions. On Feb. 14, 2013, George Canellos, then-enforcement director, stated the SEC is "quite focused on the important role gatekeepers play."²⁴ When asked a hypothetical question about the liability of a gatekeeper who behaves honestly when violations occur, Canellos responded, "Honest but negligent makes for a negligence case, right?"²⁵ Canellos's statement and the government's application of the willful blindness standard to gatekeepers lead to a sobering conclusion: gatekeepers may be at personal risk purely because they failed to sufficiently investigate red flags. A government prosecutor may find that decision made the gatekeeper willfully blind of the wrongdoing, even without the FCPA's corrupt intent requirement, which has been fading over time.

Gone are the days when gatekeepers might hope to avoid liability because they did not participate in or have knowledge of FCPA wrongdoing. Modern gatekeepers must be particularly vigilant in identifying and investigating any hint or suspicion of impropriety, as that is what the DOJ and SEC expect. In A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT ("FCPA GUIDE"), the DOJ and SEC illustrate red flags gatekeepers would be wise to heed, such as "excessive commis-

& Ethics Institute (Oct. 7, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370539872783>.

¹⁹ Kara M. Stein, Commissioner, U.S. Sec. & Exch. Comm'n, Remarks at the "SEC Speaks" Conference (Feb. 21, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540830487>.

²⁰ Ceresney, *supra* note 3.

²¹ *Id.*

²² Stein, *supra* note 1.

²³ *Id.*

²⁴ Peter Rawlings, *Canellos: SEC Targeting Gatekeeper Negligence*, COMPLIANCE REP. (Feb. 11, 2013).

²⁵ *Id.*

sions to third-party agents or consultants,” “unreasonably large discounts to third-party distributors,” and third-party consultants that are “in a different line of business than that for which [they] ha[ve] been engaged.”²⁶ The FCPA GUIDE also presents myriad hypotheticals to assist compliance departments and in-house counsel in preparing adequate anticorruption programs, but those gatekeepers would be wise to look beyond the FCPA GUIDE and stay vigilant for any red flag that crosses their desk. Gatekeepers must keep a keen eye on their company, along with its employees and agents, as there is no doubt the government is keeping a keen eye on them.

²⁶ U.S. DEP’T OF JUSTICE AND U.S. SEC. & EXCH. COMM’N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 110 (2012).

Conclusion

Gatekeepers now more than ever find themselves at the center of the DOJ and SEC’s agenda for FCPA enforcement. Moreover, the government is increasingly eschewing the notion that liability under the FCPA requires actors to be aware of the existence of improper payments, relying instead on allegations they remained willfully blind to red flags that point the way to evidence of wrongdoing. In light of these continuing trends, it is essential that companies develop and maintain FCPA compliance programs that thoroughly address red flags and clearly communicate their anticorruption policies throughout the entire organization.