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Tom Fox's

FCPA

Year in Review

A Look Back at the Corruption Cases That Defined a Tumultuous 2020

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Introduction

2020 was a very significant year for every compliance practitioner and compliance program. Not only was it the year with the single highest Foreign Corrupt Practices Act (FCPA) fine ever and the largest year in total FCPA fines to date, but there were significant enforcement actions, fines and penalties assessed against corporations, coupled with a large number of individual prosecutions. Yet, perhaps most significantly, there were two noteworthy releases of information by the federal government that directly impacted compliance professionals.

On the enforcement front, the Department of Justice (DOJ) and Securities and Exchange Commission (SEC) had another record year of enforcement, surpassing last year's previous record. In total, the DOJ collected $374 billion. The Commodities Futures Trading Commission (CFTC) settled its first enforcement case against Vitol Trading for $28.7 million. The total of SEC and CFTC enforcement was $1.34 billion. Of course, we had the largest FCPA settlement of all time with the Goldman Sachs enforcement action, which will pay more than $2.9 billion as part of a coordinated resolution with criminal and civil authorities in the United States, the United Kingdom, Singapore and elsewhere.

But 2020 was not only a record-setting year for FCPA enforcement; it was a record-setting year for information about the FCPA and compliance programs from the DOJ and SEC. In June, the DOJ released its 2020 Update to the Evaluation of Corporate Compliance Programs – Guidance Document (2020 Evaluation). It should be mandatory reading for every Chief Compliance Officer (CCO), compliance practitioner and professional or any other person interested in the DOJ's latest thinking on what constitutes a best practices compliance program.

In the introduction, the DOJ stated,

> "Because a corporate compliance program must be evaluated in the specific context of a criminal investigation, the Criminal Division does not use any rigid formula to assess the effectiveness of corporate compliance programs. We recognize that each company's risk profile and solutions to reduce its risks warrant particularized evaluation. Accordingly, we make *a reasonable*, individualized determination in each case *that considers various factors including, but not limited to, the company's size, industry, geographic footprint, regulatory landscape and other factors, both internal and external to the company's operations, that might impact its compliance program.*" (all changes noted in italics)

This change makes clear that every policy will be evaluated on its own merits. Moreover, this point is further driven home by the addition to fundamental question #2 that prosecutors are required to ask: "'Is the program being applied earnestly and in good faith?' In other words, is the program *adequately resourced and empowered to function effectively*?"

By tying this new language to question #2, companies that want to cut back to a paper program and take away the ability of CCOs to effectively do their job will lose the credit going forward, as this language clearly references both monetary resources and headcount.

The final addition in the introduction adds the following language: "In any particular case, the topics and questions set forth below may not all be relevant, and others may be more salient given the particular facts at issue and the *circumstances of the company*." Here is an important part near and dear to my heart, as it clearly equates to "document, document, document." If you make changes to your program, if you lose headcount, if you are not allowed to have the most current tech solution, then be prepared to explain why your company cannot do so.

From the changes in the tactical information presented in the 2020 Update, it is clear that the DOJ expects a continually evolving compliance program. It once again demonstrated that the days of a paper program are dead. There are multiple references throughout the 2020 Update for using a variety of compliance tools to garner information and then incorporating that information back into your best practices compliance program on an ongoing basis so that your compliance program is a living, breathing program and not a static program dependent on policies and procedures.

The second release was the DOJ and SEC's updated *A Resource Guide* to the U.S. Foreign Corrupt Practices Act Second Edition (2020 FCPA Resource Guide). This was a most welcome update to the seminal and original FCPA Resource Guide, released in 2012 and widely recognized as the single best volume on the FCPA. Some of the key changes for the compliance professional include the following:

The biggest change is the addition of a new Hallmark, entitled "Investigation, Analysis and Remediation of Misconduct," which reads in full:

> "The truest measure of an effective compliance program is how it responds to misconduct. Accordingly, for a compliance program to be truly effective, it should have a well-functioning and appropriately funded mechanism for the timely and thorough investigations of any allegations or suspicions of misconduct by the company, its employees or agents. An effective investigations structure will also have an established means of documenting the company's response, including any disciplinary or remediation measures taken.
>
> In addition to having a mechanism for responding to the specific incident of misconduct, the company's program should also integrate lessons learned from any misconduct into the company's policies, training and controls. To do so, a company will need to analyze the root causes of the misconduct to timely and appropriately remediate those causes to prevent future compliance breaches."

There are many interesting aspects to this new Hallmark, not the least being that it begins with "the truest measure of an effective compliance program is how it responds to misconduct." This builds upon the language found in the Confidential Reporting and Internal Investigations hallmark, which stated, "once an allegation is made, companies should have in place an efficient, reliable and properly funded process for investigating the allegation and documenting the company's response." Now, beyond being properly funded, you must have a "well-functioning mechanism" for the "timely and thorough investigations of any allegations or suspicions of misconduct by the company, its employees or agents."

This clearly mandates that once an allegation or even suspicion comes to the attention of compliance, it must be properly triaged and your investigation protocol should kick in with a detailed and effective investigation that is completed in a reasonable time and provide a response to the investigative findings. Moreover, an investigation is not the ending point and should be followed with a robust root cause analysis.

The 2020 Resource Guide brings the top FCPA and compliance resource from the past decade into this one. 2020 was certainly a year of significance for the compliance practitioner and the compliance profession.

We also had the first Opinion Release in nearly six years, which itself may portend where anti-corruption enforcement is headed into 2025 and beyond. ◆

Chapter 1

The Enforcement Actions

2020 brought several significant and very large FCPA resolutions from the DOJ. These massive cases had multiple lessons from the compliance professional to review for their own compliance program. The year also saw several SEC enforcement actions which were significantly smaller in terms of the overall fines in penalties but in many ways were more focused on detailing the specific Accounting Provision violations and hence better learning tools. This chapter will take a look at these cases.

Alexion Pharmaceuticals

The same day that the 2020 Resource Guide was released, the SEC announced it had settled an FCPA enforcement action involving Alexion Pharmaceuticals Inc. (Alexion), which agreed to pay more than $21 million to resolve charges that it violated the books and records and internal accounting controls provisions of the FCPA. According to the SEC press release, the case was resolved via a cease-and-desist order (Order), in which Alexion "agreed to cease and desist from committing violations of the books and records and internal accounting controls provisions of the FCPA and pay $14,210,194 in disgorgement, $3,766,337 in prejudgment interest and a $3.5 million penalty."

Background

As with most recent FCPA enforcement actions announced by the SEC, this matter had some very interesting and useful information for the compliance practitioner.

The company engaged in bribery as a standard business practice in a wide variety of countries and through several wholly owned subsidiaries, including Alexion Ilaç Ticaret Limited Sirketi ("Alexion Turkey"), incorporated in 2010; Alexion Pharma OOO ("Alexion Russia"), incorporated in 2012; Alexion Pharma Brazil ("Alexion Brazil"), incorporated in 2009; and Alexion Pharma Colombia SAS ("Alexion Colombia"), incorporated in 2009. Alexion Colombia's books and records were consolidated into Alexion's financial statements.

According to the Order, Alexion engaged in bribery and corruption by making payments to foreign officials in order to influence them to provide favorable regulatory treatment for Alexion's primary drug, Soliris, and to approve Soliris prescriptions for individual patients. In addition, from 2011 to 2015, Alexion Russia made payments to foreign officials in order to influence the allocation of regional health care budgets for Soliris, increase the number of approved Soliris prescriptions and favorably influence the regulatory treatment of Soliris. The payments were made in a variety of ways, including through the use of a third-party consultant, honoraria and grants. Alexion Brazil and Alexion Colombia failed to maintain accurate books and records regarding third-party payments.

The Bribery Schemes

Alexion Turkey had a sales program called the Named Sales Program (NSP), which required each patient's application to be reviewed and approved by health care providers (HCPs) appointed to serve on commissions in Turkey's Ministry of Health, a separate set of approvals to pay for the prescription and recurring approvals thereafter to continue the patient on Soliris therapy. Alexion Turkey illegally paid HCPs employed at state-owned health care institutions for services, including research and educational events to get through this process.

This led Alexion Turkey to hire a consultant to facilitate the payment of bribes. It was accomplished by paying the consultant fees and alleged expense reimbursements. The consultant used this money as a slush fund to make bribe payments in the form of cash, meals or gifts to HCPs to secure favorable treatment for Soliris. Certain Alexion Turkey employees recorded these payments inaccurately in the books and records. In one of the most improbable scenarios recently seen in a FCPA enforcement action, one "Alexion Turkey manager directed that the description of the Consultant's claimed expenses should be written in pencil. The use of pencil would allow the description of the expenses to be easily changed or concealed." HCPs were paid over $100,000, and Alexion Turkey made some $7.5 million in ill-gotten gains as a result.

In Russia, Soliris was also sold through the NPS process and reimbursed through regional health care reimbursements. To obtain approval for these reimbursements, various regions were required allocate funds to Soliris from regional health care budgets. Alexion Russia paid HCPs employed at state-owned health care institutions for services, including research, consulting on specific topics and hosting educational events and activities. These payments were fraudulent and inaccurately recorded in the entity's books and records.

Moreover, certain state-employed HCPs also served in official roles at the regional and federal levels of the Russian government health care system. These HCPs provided expert opinions regarding the allocation of regional health care budgets and the regulatory treatment of Soliris. Alexion Russia made over $1 million in payments to these HCPs, which included funds paid to influence the HCPs to take positions favorable to Alexion Russia in connection with regional budget allocations, to increase the number of approved Soliris prescriptions and to favorably influence the regulatory treatment of Soliris. These payments were recorded inaccurately in their books and records as honoraria, educational expenses, business meeting expenses and scientific research. In Russia, more than $1.3 million was paid in bribes, and the resulting ill-gotten gains by the company exceeded $7.5 million.

Finally, there were bribery schemes involving Alexion Brazil and Alexion Colombia. They created or directed third parties to create inaccurate financial records concerning payments to third parties, including patient advocacy organizations (PAOs). In one instance, Alexion Brazil caused a PAO to pay for the manager's personal expenses for alcohol and personal travel. To fund this bribe, they had the corrupt manager submit a fictitious invoice, which was then reimbursed by Alexion Brazil. As the quid pro quo, the corrupt manager and an employee in Alexion Brazil submitted grant requests to Alexion's global grant review committee that misstated how the requested funds would be allocated to the different activities covered in the grant request.

In Alexion Colombia, a senior manager "directed a PAO to submit an invoice that falsely described that the funds would be used for 'legal support' services. This inaccurate invoice allowed Alexion Colombia to approve the payment locally instead of obtaining approval for the payment through the global grant process, as required by Alexion's policies." Both Alexion Brazil and Alexion Colombia failed to maintain accurate books and records of its financial transactions involving payments to third parties.

The Order went on to state, "notably, both subsidiaries failed to regularly maintain certain documents underlying a substantial number of financial transactions. Finally, when they were caught, Alexion allowed Alexion Brazil to destroy relevant documents demonstrating the fraud."

Data Analytics

Now I consider how the use of data analytics could prevent these types of corruption schemes from even getting off the ground.

Turkey

Alexion Turkey used the NSP to mask its corrupt payments to sell its Soliris therapy, illegally paying HCPs employed at state-owned health care institutions for services, including research and educational events to get through this process. Remember, Alexion Turkey hired a consultant to facilitate the payment of bribes, which were carried out by paying the consultant fees and alleged expense reimbursements.

How could data analytics have helped here? The most basic way would be to test the expenses charged back by the consultant against other similarly situated consultants. Such benchmarking is straightforward with a comparison of the fees and expenses charged back to the company for reimbursement. From there, a compliance professional could consider the HCPs the consultant had formal relationships with and test the number of products prescribed or sold through those HCPs.

According to the Order, each patient's application to begin Soliris therapy required review and approval by HCPs appointed to serve on commissions in Turkey's Ministry of Health, separate approvals to pay for the prescription and recurring approvals to continue the patient on Soliris therapy. The Order noted, "the Consultant passed a portion of these funds on to Turkish government officials, in the form of cash, meals or gifts, to secure favorable treatment for Soliris."

The compliance function could review the timing of the illegal payments, even if they were masked as legitimate business entertainment, for instance, to see if approvals were given at or near the time of such business entertainment or expenditure. Finally, "these HCPs were responsible for approving or denying patient prescriptions for Soliris and had influence over key regulatory matters, such as treatment guidelines and reimbursement criteria. Alexion Turkey paid these HCPs to influence them to approve patient prescriptions and support regulatory actions favorable to Soliris."

Once again, a simple correlation could be run to see if corrupt payments were made at or near the time that a *quid pro quo* was paid back to Alexion.

Russia

In Russia, the bribery scheme was a bit different. The Order noted,

"Certain state-employed HCPs also served in official roles at the regional and federal levels of the Russian government health care system. These HCPs provided expert opinions relied upon by decision-makers regarding the allocation of regional health care budgets and the regulatory treatment of Soliris. Alexion Russia senior managers believed that these HCPs had decision-making authority regarding regional health care budgets and regulatory decisions."

This is a variation of the key influencer bribery scheme used by Novartis in Greece (more on that later).

Yet once again, a very straightforward approach could be used. Simply correlate the dates of payments, entertainment or any other thing of value provided to these officials and the dates of their actions back which promoted Alexion products. You could even start with a chart listing dates of benefits provided to the corrupt HCP(s) and then date of benefit back to Alexion, regardless of what that corrupt act was for the company.

Alexion Russia paid HCPs employed at state-owned health care institutions for services, including research, consulting on specific topics and hosting educational events and activities. Here, in addition to the correlation of corrupt benefits provided to the HCPs with the benefits provided back to Alexion, the compliance professional could look at the overall spend on educational events and activities. Any sophisticated gift, travel and entertainment recordation system provider would be able to help you understand when the total amount paid looks suspicious.

Brazil and Colombia

In Alexion Brazil and Alexion Colombia, the local business units either created or directed third parties to create inaccurate financial records concerning payments to third parties. Recall the company causing a PAO to pay for a manager's personal expenses for alcohol and personal travel – the bribe funded by the corrupt manager submitting a fictitious invoice which was then reimbursed by Alexion Brazil. Then there was the other, the senior manager directing the PAO to falsely invoice for "legal support" services, which allowed "Alexion Colombia to approve the payment locally instead of obtaining approval for the payment through the global grant process, as required by Alexion's policies."

Any international corporation worth is salt will run data on its foreign business unit expenses. Even if corrupt payments are hidden in such apparently legitimate expenses, the power of data analytics is to identify anomalies for further investigation. This means that if legitimate expenses increase significantly as their payment is used to fund bribery, a robust but even high-level data analytics approach would uncover the "patterns in raked leaves" and allow a deeper-dive investigation.

The fact that compliance functions did not previously have access to this data or that it was seen as somehow outside the compliance function's remit simply no longer is valid. In the section entitled Data Resources and Access, the 2020 Update to the DOJ's Evaluation of Corporate Compliance Programs asked,

> "Do compliance and control personnel have sufficient direct or indirect access to relevant sources of data to allow for timely and effective monitoring and/or testing of policies, controls and transactions? Do any impediments exist that limit access to relevant sources of data and, if so, what is the company doing to address the impediments?

The clear import is that a compliance professional must have access to the data and then actually do something with it going forward. ◆

Herbalife

Herbalife Nutrition Ltd (Herbalife) recently concluded a long-running FCPA enforcement action with both the DOJ and SEC. Herbalife settled with the DOJ via a deferred prosecution agreement (DPA) and Information and with the SEC via a cease-and-desist order (Order). The documents all help to more fully fill out the picture of the corruption at the organization, which went for some 10 years, between at least 2006 and 2016 and was originally disclosed in the indictments of Jerry Li and Mary Yang in November 2019. The SEC also brought civil charges against Li at the time of his indictment, via a civil complaint.

Introduction

All in all, these documents provide a sordid tale of a company that did not give one whit about compliance, doing business ethically or even in a noncriminal manner. As for the reason, it was quite simple: According to the Information, by 2016, the Chinese business unit brought in some 20 percent of the company's worldwide sales, or approximately $860 million. Here, I explore the Herbalife enforcement action in depth, mine it for lessons learned and consider what, if anything, it might say about where FCPA enforcement might be headed.

According to the DOJ press release,

> "Herbalife… agreed to pay total penalties of more than $122 million to resolve the government's investigation into violations of the FCPA. The resolution arises out of Herbalife's scheme to falsify books and records and provide corrupt payments and benefits to Chinese government officials for the purpose of obtaining, retaining and increasing Herbalife's business in China. This includes a criminal penalty of over $55 million and approximately $67 million to be paid to the U.S. Securities and Exchange Commission (SEC) in a related matter."

Acting Assistant Attorney General Brian C. Rabbitt of the Justice Department's Criminal Division said in the press release, "By engaging in a decade-long scheme to falsify its books and records to conceal corrupt and other improper payments to Chinese officials and state-owned entities, Herbalife misrepresented important information made available to investors."

He went on to note, "the integrity of our financial markets depends on the timely and accurate disclosure of material information about companies' operations. Today's resolution reflects the department's ongoing commitment to combating international corruption and ensuring that investors can trust the accuracy of the financial statements of publicly traded companies."

According to Acting U.S. Attorney Audrey Strauss of the Southern District of New York,

> "As admitted in the deferred prosecution agreement entered into today, Herbalife approved the extensive and systematic corrupt payments to Chinese government officials over a 10-year period to promote and expand Herbalife's business in China. Moreover, in an effort to conceal this widespread corruption scheme, Herbalife maintained false accounting records to mischaracterize these improper payments as permissible business expenses. In addition to admitting its criminal conduct, Herbalife has agreed to pay combined penalties of more than $123 million. This case signifies this Office's commitment to ensuring that companies operating in the United States do not gain an unfair advantage through corruption and illegal bribes of foreign officials."

There is no doubt Herbalife was engaged in a fraud on the market and U.S. investors, as the company falsified its Sarbanes-Oxley (SOX) sub-certifications in connection with the company's quarterly and annual filings from at least 2008 until 2017. Furthermore, knowledge of the company's illegal action went right up to the top of the organization, including senior management.

The bribery scheme itself was incredibly straightforward. According to the DOJ press release,

> "Between 2007 and 2016, Herbalife knowingly and willfully conspired with others in a scheme to falsify its books and records and provide corrupt payments and benefits to Chinese government officials. Herbalife carried out the scheme for the purpose of obtaining, retaining and increasing Herbalife's business in China by, among other things, (1) obtaining and retaining certain direct selling licenses for its wholly-owned subsidiaries in China (Herbalife China); (2) improperly influencing certain Chinese governmental investigations into Herbalife China's compli-

> ance with Chinese laws; and (3) improperly influencing certain Chinese state-owned and state-controlled media for the purpose of removing negative media reports about Herbalife China."

Many of the numbers cited in the Information and Order are eye-popping. Per the Order,

> "Between 2012 and 2016, Herbalife reimbursed External Affairs employees for over $7.2 million in questionable External Affairs meal and gift expenditures in connection with Chinese officials and media, including state-owned media officials. Herbalife obtained approximately $58.7 million in benefit based on the conduct described above."

When a board member questioned this amount of spend, he was informed by the head of internal audit that "the findings are the typical issues in these audits" and are within "tolerance."

Most interestingly, Herbalife was not required to sustain a monitor. You must give credit to Herbalife's FCPA counsel for getting them one heck of deal. The most important thing in any negotiation with the DOJ is credibility. One can only surmise that Herbalife's FCPA counsel brought credibility through its interactions with the DOJ to bring the company the superior result it achieved.

Hedge fund guru Bill Ackman made a notoriously famous short-selling bet against Herbalife. He accused the company of being a pyramid scheme. Herbalife fought back ferociously, saying it was a legal multi-level marketing company. Pyramid schemes are illegal, while legal multi-level marketing is, well, legal. Ackman also said that Herbalife was the most well-run pyramid scheme in the world, implying that the fraud they perpetrated was far-reaching and extremely deceptive. It turns out Ackerman was right; an illegal scheme was underlying Herbalife, but that illegal scheme was an entire business unit based on bribery and corruption in China.

Bribery Schemes and Numbers

It was clear from the start of Herbalife's business relationship in China that the company was committed to illegal activity that it knew was in violation of the FCPA. As far back as 2007, the managing director for Herbalife China admitted they were illegally bribing Chinese government officials to obtain licenses to do business in China. According to the Order, there was the following conversation:

> "In a January 10, 2007 telephone call, Managing Director (serving then as the Director of Sales for Herbalife China) asked EA Director whether Herbalife China had 'taken care of' an official at Chinese Government Agency 1 ('Official 1'). Managing Director then asked, 'we have given the money to [Official 1], haven't we?' to which EA Director replied, 'of course we have.' Managing Director then stated, 'The money works well on him.'"

This was the basic state of how Herbalife did business in China for the next 10 years.

But it was more than simply the corruption of the Chinese business unit. Consider this exchange that the China MD had with a senior executive in the U.S. in 2007 about the limit of six meals for any specific government official per year. Once again from the Order:

> "MD told Senior Executive that this policy will put the onus on U.S. executives to approve any dinners in excess of six times per year, 'I can always write back to you folks and ask for approvals, but then it's like putting the onus back on you folks to answer future questions.'"

In other words, the China MD knew he was putting U.S. executives at risk by misrepresenting expense reimbursement requests.

However, the U.S. executive was no less culpable than the Chinese MD, as he advised lying on the expense reimbursement requests, stating: "I am sure there are a lot of government officials, you can put different names down … but I didn't tell you that." After Former MD explained that "with the license process, you know, it is tough for me to use all the names," Senior Executive responded, "how would anybody ever know?" Former MD said he understood, and Senior Executive told Former MD, "all an auditor is going to do is pick up your receipts, your expense report, oh he did Mr. X, Mr. A, Mr. B, Mr. C, Mr. D., and if he did a few of these guys a couple times, but that was it."

Bob Woodward is back in the news with his latest book "Rage," and it is a useful reminder that one must always follow the money. In the case of Herbalife, it was multiple millions paid out in bribes. The funding mechanism for this pot of money to pay bribes was fraudulent expense requests. In the first six months of 2012 alone, Mary Yang submitted "approximately $3.7 million for claimed meals, gifts and entertainment of government officials and media, including state- owned media officials." Normally, I would have the Bribery Box Score at this point, but Matt Kelly did such a great job in summarizing the submitted reimbursement requests from Mary Yang in the first six months of 2012, I'll cite his table.

Number of days reviewed	**184**
Meals expensed during that period	**239**
Average number of meals expensed that day	**1.3**
Total participants at meals	**4,312**
Average number of participants at each meal	**18**
Average cost per expensed meal	**$3,232**
Average share per person	**$179.55**

Kelly went on to somewhat dryly note, "in other words, Yang was supposedly eating at least one lavish meal with 17 other people **every day** — and twice on weekends! — for six months. I'm all for treating oneself from time to time, but obviously these numbers cannot be accurate."

Normally, such numbers would catch someone's eye in internal audit, compliance or the board. Unfortunately, Herbalife did not see fit to have a chief compliance officer (CCO) during this time frame, so no joy there. The internal audit report did make its way to the board of directors. One board member "emailed the audit committee and IA director, asking whether the high spending by [the] China EA was reasonable. Another board member responded: "please note, I have questioned this every year I have been on the board, and the company has defended its position that these are reasonable within FCPA guidelines.""

Yang was supposedly eating at least one lavish meal with 17 other people every day — and twice on weekends! — for six months. I'm all for treating oneself from time to time, but obviously these numbers cannot be accurate.

Rather amazingly, the "IA director responded that 'the findings are the typical issues in these audits' and are within 'tolerance.'" This response clearly portends that the head of IA was in on the scheme (or perhaps the most idiotic director of IA ever), as the company approved over $7.2 million in expense reimbursements from China from 2012 to 2016.

All of this demonstrates that the Herbalife FCPA enforcement action was not about some "rogue actors" in China or the ubiquitous "them." It was about a well-known bribery scheme existing in the organization for many years.

Penalty Calculation and No Monitor

With the lengthy and extensive bribery schemes – which apparently went to the very top of the organization – laid out in some detail, we consider now how Herbalife was able to obtain the truly superior result in its FCPA resolution. To recap, a fine and penalty of just over $133 million, a three-year DPA and no monitorship. Before this case, if I had been asked who I thought one of the top FCPA defense counsels was for a very serious case, I would have said Pat Stokes from Gibson, Dunn & Crutcher LLP. Now, let me echo that in double stereo. Stokes and his team obtained a truly superior result. Remember the bribery scheme was in play for at least 10 years, from 2006 to 2016, and the recalcitrant China business unit executives were with the company until 2017.

According to the DPA, the company did not self-disclose. I still wonder if the short-seller imbroglio involving Herbalife did not somehow lead to a government inquiry. Even with the lack of self-disclosure, the company "received full credit for its cooperation with the United States' independent investigation, which has included: making regular factual presentations to the United States and, after taking steps that the Company and its affiliates determined complied with applicable foreign data privacy, confidentiality and discovery laws, voluntarily making employees available for interviews in the United States; producing documents and information located outside of the United States; providing translations of foreign language materials; proactively disclosing certain conduct of which the United States was previously unaware; and providing to the United States all relevant facts known to it."

The company engaged in extensive remediation, taking actions including:

> "taking disciplinary actions against, and separating from, employees involved in the misconduct; enhancing its anti-corruption compliance program by, among other things, significantly increasing the personnel and resources devoted to compliance; bolstering the Company's annual risk assessment process; strengthening accounting controls for various forms of expenditures; implementing additional testing, monitoring and auditing procedures; and improving policies related to entertaining and giving gifts to foreign officials."

Under the FCPA Corporate Enforcement Policy,

> "if a company did not voluntarily disclose its misconduct to the Department of Justice (the Department) in accordance with the standards set forth above, but later fully cooperated and timely and appropriately remediated in accordance with the standards set forth above, the company will receive, or the Department will recommend to a sentencing court, up to a 25 percent reduction off of the low end of the U.S.S.G. fine range."

All of this led to a 25 percent discount of the low end of the range from the U.S. Sentencing Guidelines.

However, that is not the end of the story. Under the U.S. Sentencing Guidelines, a company can receive a reduction of two points on the base fee "if the organization fully cooperated in the investigation and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct," which Herbalife received. However, the company could have received up to a reduction of five points if it had self-disclosed, so its failure to do so cost the company somewhere around an additional $25 million in fines and penalties.

Also, of note in this settlement is the lack of a mandated monitor. Once again, one can only state that the Herbalife's defense counsel did a superior job in convincing the DOJ that a monitor was not needed for the company to complete its compliance program obligations under its DPA. The criteria for a monitorship are set out in the Benczkowski Memo. There are two broad criteria for the evaluation of the need for a monitor: "(1) the potential benefits that employing a monitor may have for the corporation and the public, and (2) the cost of a monitor and its impact on the operations of a corporation."

These two criteria are to be further evaluated by the following:

- whether the underlying misconduct involved the manipulation of corporate books and records or the exploitation of an inadequate compliance program or internal control systems;

- whether the misconduct at issue was pervasive across the business organization or approved or facilitated by senior management;

- whether the corporation has made significant investments in and improvements to its corporate compliance program and internal control systems; and

- whether remedial improvements to the compliance program and internal controls have been tested to demonstrate that they would prevent or detect similar misconduct in the future.

Additional considerations include:

- Whether the changes in corporate culture and/or leadership are adequate to safeguard against a recurrence of misconduct.

- Whether adequate remedial measures were taken to address problem behavior by employees, management or third-party agents, including the termination of business relationships and practices that contributed to the misconduct.

- In assessing the adequacy of a business organization's remediation efforts and the effectiveness and resources of its compliance program, Criminal Division attorneys should consider the unique risks and compliance challenges the company faces, including the particular region(s) and industry in which the company operates and the nature of the company's clientele.

In reading through these criteria, it would seem that Herbalife executives both manipulated the company's books and records and exploited a nonexistent compliance program. Senior management was clearly involved. However, this appears to have been tempered by a truly superior remedial program, including investments in a new compliance regime. While it is not clear how much of senior management is still around, perhaps there has been "high turnover" both at the board level and among senior management. Unfortunately, there is no analysis in the DPA of why a monitor was not required, so at this point, we can only speculate and tip our compliance hats to Stokes and his team.

Final Thoughts

Herbalife settled with the DOJ via a DPA and Information and with the SEC via a cease-and-desist order. The documents all help to more fully fill out the picture of the corruption at the organization which went for some 10 years between at least 2006 and 2016 and was originally disclosed in the indictments of Jerry Li and Mary Yang in November

2019. The SEC also brought civil charges against Li at the time of his indictment, via a civil complaint.

The Board

It was not clear whether the board of directors was in on the bribery scheme. I would say it does not appear so, because at least two board members asked questions about the gift, meals and entertainment spend coming out of the China business unit. From there, either senior management intentionally misrepresented the situation in China or they were so incompetent as to almost defy belief in their responses to the board. All of this can be summed up in this selection from the Order.

> "After receiving the March 2016 IA report, a member of Herbalife's board of directors emailed the audit committee and IA director asking whether the high spending by China EA was reasonable. Another board member responded: 'please note, I have questioned this every year I have been on the board, and the company has defended its position that these are reasonable within FCPA guidelines.' IA director responded that '**the findings are the typical issues in these audits**' and are **within 'tolerance**.'" [emphasis mine]

Let me just opine that there has never been an audit in the history of the world – ever – where a company "reimbursed External Affairs employees for over $7.2 million in questionable External Affairs meal and gift expenditures in connection with Chinese officials and media, including state-owned media officials" and it was ***typical*** or ***within tolerance***. But, more importantly, it points out that a board must engage in substantive oversight, not simply take management at its collective word, whether fraudulent or incompetent. Did the board of directors open itself up to a Caremark claim? At this point, we can only speculate, but I am sure such a filing has been made and the Delaware courts will have more to say about the ineptness of the Herbalife board.

The Gatekeepers

As the superior HBO series "Watchmen" reminded us, who watches the watchers? Herbalife did have controls in place that should have, if not prevented illegal actions, acted as tripwire and detected it. For instance, as early 2007, a control was in place that restricted dinners with a single government official to a maximum of six times per year. The China business unit executive recognized this would be a problem for those in the U.S. who had to approve any exceptions. The Order stated, "former MD told Senior Executive that this policy will put the onus on U.S. executives to approve any dinners in excess of six times per year."

There must always be a second set of eyes on my process to validate that process. If the entire organization is not corrupt, eventually someone will notice.

However, the corrupt U.S. senior executives had an even better idea: Lie on the expense reports. The Order stated,

> "senior Executive told Former MD that 'I am sure there are a lot of government officials, you can put different names down … but I didn't tell you that.' After Former MD explained that 'with the license process, you know, it is tough for me to use all the names,' Senior Executive responded, 'How would anybody ever know?'"

All of this led to fraudulent SOX 404 certifications in the China business unit, which of course were rolled up into the U.S. entity.

This is why multiple redundancies must be put in place. Think of the eyes of Dr. T. J. Eckleburg from "The Great Gatsby." There must always be a second set of eyes on my process to validate that process. If the entire organization is not corrupt, eventually someone will notice (even if its short sellers or regulators).

A Serious Matter Requires a Serious Legal Response

As I have said several times, Herbalife owes a huge debt to Pat Stokes and the team at Gibson Dunn. Jim McGrath said it best a long time ago when he continually reminded us that when a company is in a serious FCPA imbroglio, a serious legal response is required. In this case, it meant bringing in one of the top FCPA defense practitioners around, doing an extensive investigation, engaging in extraordinary remediation during the pendency of the investigation and then negotiating a superior settlement.

But it is more than knowing the law. It is working with the client so that they understand the posture in which they find themselves. Clearly, Herbalife put profits before all else – before doing business ethically or even obeying the law. So, the first thing defense counsel must do is to disabuse them of any notion that this is not an extremely serious matter. Defense counsel then has to engage in the investigation, root cause analysis and remediation, all under the watchful eye of the DOJ and SEC. Defense counsel must establish and maintain a credible relationship with both the DOJ and SEC so they feel like they can trust what is being presented to them.

FCPA Enforcement Going Forward

If there was ever a case that seemed appropriate for a corporate monitorship, it was Herbalife. The bribery scheme was in play for at least 10 years, from 2006 to 2016, and the recalcitrant China business unit executives were with the company until 2017. The company did not even have a CCO, yet no monitor was required. There was no real analysis in the DPA as to why or how the company avoided the monitorship. Perhaps it was superior negotiating.

The company received a 25 percent discount off the minimum of the U.S. Sentencing Guidelines for its investigation, remediation and cooperation. While others may decry it, there appears to be a greater emphasis by the DOJ and SEC for cooperation after either self-disclosure (although not present here) or subpoena from the government. All of this would seem to follow the direction the DOJ has been headed since the implementation of the FCPA Pilot Program in 2016, through the FCPA Corporate Enforcement Policy (and updates) in 2017 and the Evaluation of Corporate Compliance Programs and updates (since 2017).

There are now real incentives for companies to take advantage of these discounts and incentives the government is offering. Obviously, the first is to step forward and self-disclose, but if that is not an option, to extensively cooperate, investigate and remediate. ◆

Criminal FCPA Plea by Sargeant Marine

September saw an unusual FCPA enforcement action. According to the DOJ press release,

> "Sargeant Marine Inc. (Sargeant Marine), an asphalt company formerly based in Boca Raton, Florida, pleaded guilty today to conspiracy to violate the anti-bribery provisions of the FCPA and agreed to pay a criminal fine of $16.6 million to resolve charges stemming from a scheme to pay bribes to foreign officials in three South American countries."

Apparently never having received the Memo that the FCPA prohibited bribery of foreign government officials back in 1977, the company engaged in massive and ongoing criminal conduct from 2010 to 2018. "The company paid millions of dollars in bribes to foreign officials in Brazil, Venezuela and Ecuador to obtain contracts to purchase or sell asphalt to the countries' state-owned and state-controlled oil companies, in violation of the FCPA."

Introduction

Acting Assistant Attorney General Brian C. Rabbitt of the Justice Department's Criminal Division said, "With today's guilty plea, Sargeant Marine has admitted to engaging in a long-running pattern of paying bribes to corrupt officials in three South American countries to obtain lucrative business. Today's resolution, together with charges the department has brought against individuals involved in Sargeant Marine's illegal schemes, demonstrates the department's continuing commitment to holding companies and their executives responsible for international corruption."

Acting U.S. Attorney Seth DuCharme of the Eastern District of New York said, "Today's resolution is the result of a multiyear, multinational, collaborative effort to root out corruption perpetrated by an American company in three countries. We will continue to investigate and prosecute any company that corrupts foreign government officials in order to gain a competitive edge, as well as any of their executives and employees who participate in those efforts."

Assistant Director Calvin Shivers of the FBI's Criminal Investigative Division said,

> "Sargeant Marine Inc. attempted to get ahead of competitors by paying bribes to foreign officials in violation of the Foreign Corrupt Practices Act. As today's guilty pleas demonstrate, the FBI will relentlessly investigate those attempting to cheat the market, and we will bring them to justice."

The bribery and corruption were widespread throughout the region. Quoting from the DOJ Press Release, "According to the company's admissions, it engaged in an eight-year scheme to bribe foreign officials in Brazil, Venezuela and Ecuador. In Brazil, the bribery scheme involved corrupt payments to a Minister in the Brazilian government, a high-ranking member of the Brazilian Congress and senior executives at Petróleo Brasileiro SA (Petrobras) to obtain valuable contracts to sell asphalt. The bribery scheme was based around fake consulting agreements with bribe intermediaries. After receiving fake invoices, it then sent international wires from Sargeant Marine bank accounts to offshore bank accounts held in the names of shell companies controlled by the bribe intermediaries. The bribe intermediaries used a portion of the commissions to pay bribes to Brazilian government officials on Sargeant Marine's behalf, either by wire to the officials' offshore shell companies, or in cash in Brazil."

In Venezuela, Sargeant Marine "bribed four Petróleos de Venezuela, S.A. (PDVSA) officials in exchange for inside information, and for their assistance in steering contracts to purchase asphalt from PDVSA to a Sargeant Marine nominee. The Sargeant Marine co-conspirators used code names to hide the identities of some of the PDVSA officials receiving the bribes, referring to them simply as 'Oiltrader,' 'Tony' and 'Tony 2' in emails and texts. The inside information was called 'Chocolates.'"

The bribery scheme was paid for (yet again) by entering into fake consulting agreements with an intermediary and wiring commission payments into U.S. and offshore bank accounts controlled by the intermediary who then paid the PDVSA officials on behalf of Sargeant Marine.

In Ecuador, Sargeant Marine also admitted that it "bribed an official at the state-owned oil company EP Petroecuador (Petroecuador) to secure a 2014 contract to supply asphalt." Once again, "The company used the same tactics as in Brazil and Venezuela to conceal the bribe payments. In particular, it engaged a bribe intermediary with close ties to a decision-maker at Petroecuador and then paid commissions to the bribe intermediary pursuant to a sham consulting agreement. The intermediary used the commission payments to pay the bribes to the Petroecuador official on Sargeant Marine's behalf."

Perhaps equally interestingly, the DOJ announced it was unsealing "charges against, and the guilty pleas of, five of the individuals who played a major role in the bribery scheme, including Daniel Sargeant, a senior executive of the company; Jose Tomas Meneses, a Sargeant Marine trader; Luiz Eduardo Andrade and David Diaz, consultants who acted as bribe intermediaries in Brazil and Venezuela, respectively; and Hector Nuñez Troyano, a former PDVSA official who received bribes in connection with the Venezuela contracts. A sixth individual, Roberto Finocchi, also a Sargeant Marine trader, pleaded guilty in November 2017 for his role in the Brazil scheme."

The Bribery Schemes

The case was stunning in that apparently Sargeant Marine had incorporated the payment of bribes directly into its business strategy through the creation of multiple shell companies, use of corrupt third-parties and creation of related entities through which Sargeant Marine could launder its illegal bribe payments. The case is also noteworthy in that six individuals formerly employed by or associated with Sargeant Marine have previously pleaded guilty to FCPA violations.

The bribery and corruption were widespread throughout the Latin American region. According to the Information, Sargeant Marine engaged in an eight-year scheme to bribe government officials in Brazil, Venezuela, and Ecuador, as well as employees of the state-owned energy companies in those countries. In Brazil, the bribery scheme involved corrupt payments to a Minister in the Brazilian government, a high-ranking member of the Brazilian Congress and senior executives at Petrobras to obtain valuable contracts to sell asphalt.

A Brazilian consultant believed that a competitor of Sargeant Marine was winning contracts from Petrobras because that competitor was favored by a particular Brazilian politician and was likely paying bribes to that politician. In an effort to win that business from Petrobras for Sargeant Marine, the Brazilian consultant arranged a dinner with a Petrobras official and Brazilian politician, a powerful member of the Brazilian Congress at the time. At the dinner, Brazilian consultant told the Petrobras official and Brazilian politician that if they assisted Sargeant Marine with winning business from Petrobras, they would be paid bribes on the resulting contracts. Both the Petrobras official and Brazilian politician agreed to the scheme, and the Petrobras official directed his subordinates in the asphalt department to give business to Sargeant Marine.

To facilitate the bribery scheme and to conceal the bribe payments Sargeant Marine made to Brazilian government officials and the Petrobras official, several Petrobras officials and Brazilian politicians entered into a fake consulting agreement with a shell company controlled by corrupt Brazilian consultants. In total, Sargeant Marine and its affiliated companies, including Asphalt Trading and Sargeant Marine Affiliate, paid more than $5 million into offshore bank accounts held in the names of shell companies controlled by corrupt consultants.

The bribery scheme was similar in Venezuela. Prior to 2012, PDVSA refused to sell asphalt to Sargeant Marine or related companies. To circumvent this prohibition, SMI and Swiss Asphalt Company agreed that Swiss Asphalt Company would purchase asphalt from PDVSA at the request and direction of SMI and then resell that asphalt to Sargeant Marine at a small premium. To make this happen, Sargeant Marine agreed to offer and pay bribes to PDVSA Officials. To facilitate and conceal the bribe payments, Sargeant Marine and its co-conspirators entered into fake consulting contracts with corrupt Venezuelan consultants. Payments were then routed through offshore bank accounts to pay the bribes. Amazingly enough, Sargeant Marine started payments within the U.S. banking system.

But in Venezuela, it was more than the sale of asphalt. Here Sargeant Marine paid bribes to PDVSA officials in exchange for receiving nonpublic information from PDVSA and to secure a competitive advantage in obtaining and retaining business with PDVSA. To demonstrate (once again) the idiotic nature of both Sargeant Marine officers and employees and bribe payors in general, to facilitate the scheme and to conceal the scheme its participants, used the code word "Chocolates" to refer to the confidential information obtained through the corrupt bribery scheme. As Mrs. Gump continually reminded us, "Stupid is as stupid does."

A similar bribery scheme was used in Ecuador where bribes were paid to "secure an improper advantage in order to obtain and retain business with Petroecuador and win lucrative contracts with Petroecuador." Sargeant Marine created fake consulting agreements and fake invoices and made payments from the U.S. to offshore bank accounts controlled by corrupt third parties in Ecuador.

The Penalty

In addition to this rare corporate criminal plea, there have been six individuals, previously associated with Sargeant Marine, who have previously pled guilty. None have been sentenced, nor is there any information as to the individual facts they have pleaded.

Yet the Sargeant Marine FCPA enforcement action has several instructive points, which are largely laid out in the plea agreement. It has not yet been disclosed how Sargeant Marine came to the attention of the DOJ. From the Plea Agreement, we know that the company did not self-disclose. Yet the company did receive a 25 percent discount off the minimum range of the U.S. Sentencing Guidelines for both extensive cooperation and extensive remediation.

What type of cooperation engendered such a discount? From the Plea Agreement, the company conducted a thorough investigation, made witnesses available to the DOJ and proactively identified facts and issues to the DOJ that were uncovered in the investigation. The company provided to the

DOJ "all relevant facts known to it, including information about individuals involved in the misconduct," which assisted the DOJ in obtaining the six guilty pleas.

When it came to the remediation, the company's response was equally robust. It engaged in "extensive remedial measures," provided compliance training and made enhancements to the "internal controls and compliance program, including a new anti-corruption policy, a new employee manual and new third-party due diligence and onboarding procedures."

It is somewhat unusual for a company to withdraw from the jurisdictions where it engaged in illegal conduct, but this is a remedy that should perhaps be more often employed by the DOJ.

Certainly, it is worth noting that Sargeant Marine pulled out of doing business in Brazil, Venezuela and Ecuador. It is not clear if the company did so to curry favor – because the Sargeant Marine name was so besmirched in those countries that it had no hope of being commercially viable – or, in the case of Venezuela, because there was not only no business to be had, there was no way of getting money out of the country.

It is somewhat unusual for a company to withdraw from the jurisdictions where it engaged in illegal conduct, but this is a remedy that should perhaps be more often employed by the DOJ. For Sargeant Marine, given the scope and nature of their multiyear bribery and corruption schemes, it was clearly a smart business move to make. When you can engage in a remediation measure that is also a smart business move, it is one that more companies should consider.

Perhaps most astoundingly, the company was not required to sustain a monitor. It would appear that the message from the Benczkowski Memo has finally gotten out to companies, or at least the outside counsel who represents them. I do not personally know the Sargeant Marine counsel, but one can only assume they were able to persuade the DOJ that the company was earnest in its assertions of creating a culture of compliance at the company.

The other unusual component of this FCPA enforcement action was the final penalty assessed against Sargeant Marine. As calculated in the Plea Agreement, Sargeant Marine received a benefit from its bribery and corruption program of over $38 million in pecuniary gain. Based upon the U.S. Sentencing Guidelines, the range of fines was between $120 million and $240 million. As previously noted, Sargeant Marine did receive a fine reduction of 25 percent under the FCPA Corporate Enforcement Policy for its extraordinary cooperation and extensive remediation. That would have brought the fine down to $90 million.

However, the final penalty paid was $16.6 million. The reason? According to the Plea Agreement, "Based on that analysis, the Fraud Section and the Office determined that a criminal fine greater than $16,600,000 would substantially threaten the continued viability of the Company." Further, "The Defendant has represented and the Fraud Section and Office have independently verified that the Defendant has an inability to pay a criminal fine in excess of $16.6 million over eight months." The DOJ stated that it had "with the assistance of a forensic accounting expert, conducted an ability to pay analysis considering a range of factors in the Justice Department's Inability to Pay Guidance," accounting for factors including the sale of the corrupt joint venture, which received most of the ill-gotten gains, and the lack of financing available to Sargeant Marine.

It is clear that Sargeant Marine has no one to blame its financial situation on other than itself. It engaged in a multi-year deliberate campaign of bribery and corruption and now finds that it can no longer do business in the energy space because it was so corrupt. Why would any company ever trust Sargeant Marine again? Sort of like Wells Fargo, do you really think they got rid of all the corrupt management? Yet this FCPA enforcement action once again shows that not only will the DOJ work with a company that follows the prescripts of the FCPA Corporate Enforcement Policy, but also that it will work with a company in dire financial straits. The clear message for any board of directors is that if you want the best deal you can get, self-disclose, cooperate in the investigation, remediate fully and give up all the evidence needed to convict the guilty parties.

The Individual Guilty Pleas

We rarely have seen a single FCPA enforcement action generate so many individual criminal pleas. The Sargeant Marine case is an exception. To date, there have been six guilty pleas sustained. The single best resource for all things FCPA enforcement related is the Stanford Law School FCPA Clearinghouse, a collaboration with Sullivan & Cromwell LLC. The following information came from the reference material from the site, which detailed the following guilty pleas from individuals in this matter.

Daniel Sargeant was an executive and part owner of Sargeant Marine and its related companies from approximately 2006 through 2016. Sargeant's responsibilities included seeking, approving and overseeing contracts with Petrobras, Brazil's state-owned oil company and PDVSA, Venezuela's state-owned oil company.

Between approximately 2010 and 2018, Sargeant conspired to pay bribes to foreign officials in Brazil and Venezuela in order to secure contracts and other benefits for Sargeant Marine. In Brazil, Sargeant conspired to obtain and retain business with Petrobras by bribing employees and Brazilian politicians. As a result of the bribery scheme, Sargeant Marine secured contracts with a total value in excess of approximately $185 million. In Venezuela, Sargeant conspired to pay bribes to various PDVSA officials in order to, among other things:

a. purchase asphalt from PDVSA;

b. acquire inside, nonpublic information from PDVSA to obtain an improper advantage in the purchase and sale of asphalt; and

c. recover certain late fees, called demurrage fees, owed by PDVSA to a Swiss asphalt company related to Sargeant Marine.

On December 18, 2019, the DOJ filed a two-count Information against Sargeant alleging conspiracy to violate the anti-bribery provisions of the FCPA and conspiracy to commit money laundering. Sargeant pleaded guilty on the same date, but the plea agreement has not been released.

Jose Tomas Meneses worked as a trader at Sargeant Marine between 2012 and 2018. According to the documents in this case, between 2012 and May 2018, Meneses conspired to pay bribes to various officials at PDVSA, to purchase asphalt from PDVSA, to acquire inside, nonpublic information to obtain an improper advantage in the purchase and sale of asphalt and to recover certain late fees, called demurrage fees, owed by PDVSA to Swiss Asphalt Company, an entity related to Sargeant Marine.

On June 8, 2018, the DOJ filed a complaint against Meneses, and on August 2, 2018, the DOJ filed a single-count Information against Meneses alleging conspiracy to violate the anti-bribery provisions of the FCPA. Meneses pleaded guilty on the same date, but the plea agreement has not been released.

Hector Nunez Troyano was an employee at the Venezuelan state-owned oil company, PDVSA, between 2008 and February 2015. At PDVSA, Troyano was involved in the sale of asphalt. According to the documents in this case, between 2011 and 2018, Troyano was both a beneficiary and participant in two conspiracies to pay bribes to various officials at PDVSA. Troyano accepted bribes in the form of commissions for every barrel of asphalt purchased from PDVSA by an unnamed asphalt company. After resigning from PDVSA, Troyano acted as an agent to pay bribes on behalf of Sargeant Marine to officials at PDVSA.

On February 20, 2019, the DOJ initiated a case against Troyano, filing a single-count Information alleging conspiracy to commit money laundering. Troyano pleaded guilty on the same date, but the plea agreement has not been released.

David Diaz worked as an agent in Venezuela for Sargeant Marine and a second unnamed asphalt company. According to the documents in this case, between 2012 and 2018, Diaz engaged in two conspiracies to pay bribes to various officials at PDVSA. First, Diaz acted as an agent for the Swiss Asphalt Company to pay commissions to a PDVSA official for every barrel of asphalt purchased from PDVSA. Second, Diaz acted as an agent for Sargeant Marine to purchase asphalt from PDVSA, to acquire inside, nonpublic information to obtain an improper advantage in the purchase and sale of asphalt and to recover certain late fees, called demurrage fees, owed by PDVSA to a Swiss asphalt company related to Sargeant Marine.

On March 28, 2018, the DOJ filed a two-count Information against Diaz alleging conspiracy to violate the anti-bribery provisions of the FCPA. Diaz pleaded guilty on the same date, but the plea agreement has not been released.

Luiz Eduardo Andrade worked as an agent for Sargeant Marine in Brazil from approximately the end of 2009 through at least early 2016. Andrade's responsibilities included seeking contracts with Petrobras for Sargeant Marine and its related companies. Between 2010 and 2017, Andrade conspired to pay bribes to several Brazilian officials on behalf of Sargeant Marine and associated companies so that they could obtain and retain business with Petrobras. Andrade facilitated bribe payments to at least two Petrobras officials and two Brazilian politicians by using, among other things, U.S. and Swiss bank accounts and shell companies incorporated in the Marshall Islands.

On September 22, 2017, the DOJ filed a single-count Information in the Eastern District of New York against Andrade alleging a conspiracy to violate the anti-bribery provisions of the FCPA. According to the docket, Andrade pleaded guilty on the same day, but the plea agreement has not been released.

Roberto Finocchi worked as a trader for Sargeant Trading, Ltd. Co. and related companies from approximately 2006 through 2017. Between 2010 and 2017, Finocchi conspired with others to pay bribes to Brazilian government officials and Petrobras officials. The bribes were made through intermediary consultants and shell companies and were made in order to obtain business for Sargeant Marine and its associated companies.

On November 17, 2017, the DOJ filed a single-count Information against Finocchi alleging conspiracy to violate the anti-bribery provisions of the FCPA. Finocchi pleaded guilty on the same day, but the plea agreement has not been released.

One can only conclude that Sargeant Marine was one corrupt organization.

Final Thoughts on Sargeant Marine

Rarely do you see someone whose last name is in the company name running a bribery and corruption scheme. Nor do you often see six individual guilty pleas before the company actually pleads guilty. However, both are components of this FCPA enforcement action.

Given the pervasive nature of the corruption present at Sargeant Marine and the business model built on bribery, there are probably not any compliance program lessons to be garnered, as the company was one large criminal operation. Nevertheless, there are some broader lessons to be learned from the case. The first one is for the board of directors. It is not clear if the board has been sued for failing in their *Caremark* duties, but the board pretty clearly was not engaged. However, at some point, whether by hook or by crook, they did become engaged, and it's clear this was key, as the discount obtained under the FCPA Corporate Enforcement Program was a substantial 25 percent. It also demonstrates that companies should not wait until the DOJ comes knocking, but instead seriously consider self-disclosure in the self-interest of the organization. Every board now understands how much is lost by not self-disclosing.

There has been a large amount of commentary about the drop of the penalty from $90 million to $16.6 million due to the inability to pay. Dylan Tokar, in the Wall Street Journal Risk & Compliance Journal, summed it up with,

> "Facing a bribery probe, asphalt company Sargeant Marine Inc. claimed that a large criminal penalty would make it insolvent. So federal prosecutors knocked off more than $70 million. A discount of more than 80 percent off what could have been a fine of at least $90 million is the first-time prosecutors have applied the latest U.S. Justice Department guidance on inability-to-pay claims to a Foreign Corrupt Practices Act case, according to senior department officials. Sargeant Marine's case, which ended … with the Florida company agreeing to pay $16.6 million, illustrates how prosecutors may apply the guidance in future cases."

He concluded by noting even the trial judge overseeing the case was impressed: "In Sargeant Marine's case, Judge Eric Vitaliano for the Eastern District of New York presided over the hearing where representatives of the company entered a guilty plea on its behalf. The judge said he was impressed with the way prosecutors had thoroughly vetted Sargeant Marine's financials. The settlement included a significant penalty, he said, while allowing the company and its employees to be viable and productive."

This final statement brings up a critical question in corporate punishment: What is the purpose of a fine and penalty? Is it punitive, to punish wrongdoers? Is it deterrent, to stop others from engaging in the same or similar conduct? Is it something else? Should Sargeant Marine have been put out of business because it clearly employed a business model designed to engage in bribery and corruption? What about all the others in the company? Should they suffer the same fate as those who lost their jobs by putting the company out of business? There are no easy answers to these questions.

One thing is clear: If your business model was based on bribery and corruption, and the bribery and corruption is taken away, not only will you lose all that business – which, in the case of Sargeant Marine, was some $38 million over eight years – but chances are, your organization will never be able to replace that revenue stream. First, if you cannot compete in the open market (i.e., not paying bribes), it means your products and services do not meet market needs. Second, your organization is forever tainted as a company that had bribery and corruption baked into its DNA. Why would any organization ever do business with you going forward? The risks – legal, business and reputational – are simply too great. ◆

Vitol

The DOJ settled a multi-part enforcement action, partly involving the FCPA, with Vitol Inc. (Vitol), the U.S. subsidiary of Vitol Holding II SA. Vitol agreed to pay a combined $135 million to resolve matters. Interestingly, also included in the overall settlement was a disgorgement of more than $12.7 million to the Commodity Futures Trading Commission (CFTC) in a related matter and a penalty payment to the CFTC of $16 million related to trading activity. The FCPA component was settled via a DPA and criminal information (Information).

Market Manipulation Through Corruption

In a DOJ press release, Acting Assistant Attorney General Brian C. Rabbitt of the Justice Department's Criminal Division, said,

> "Over a period of 15 years, Vitol paid millions of dollars in bribes to numerous public officials – in three

> separate countries – to obtain improper competitive advantages that resulted in significant illicit profits for the company. Today's coordinated resolution with Brazil, along with our first coordinated FCPA resolution with the CFTC, underscores the department's resolve to hold companies accountable for their crimes while, at the same time, avoiding unnecessarily duplicative penalties."

Acting U.S. Attorney Seth D. DuCharme of the Eastern District of New York added,

> "Vitol paid bribes to government officials in Brazil, Ecuador and Mexico to win lucrative business contracts and obtain competitive advantages to which they were not fairly entitled. The United States Attorney's Office for the Eastern District of New York will continue to hold accountable companies and individuals that attempt to defy U.S. law to the detriment of honest competitors."

While the total amount of the criminal penalty was $135 million, the DOJ credited "$45 million – approximately one third of the total criminal penalty – against the amount that Vitol will pay to resolve an investigation by the Brazilian Ministério Público Federal for conduct related to the company's bribery scheme in Brazil."

Moreover, as a part of the DPA,

> "Vitol Inc. and Vitol S.A., another company within the Vitol group of companies, have agreed to continue to cooperate with the department in any ongoing investigations and prosecutions relating to the conduct, including of individuals; to enhance their compliance programs; and to report to the department on the implementation of their compliance programs."

If ever there were a question about energy traders and FCPA risk, this enforcement action answers it once and for all.

There were some interesting aspects of this enforcement for compliance practitioners to consider:

1. **Vitol paid bribes in violation of the FCPA in exchange for receiving confidential Petrobras pricing and competitor information.** During the 2011 to 2014 time period, the company admitted that it bribed at least five other Petrobras officials in exchange for receiving confidential pricing information that Vitol used to win fuel oil contracts with Petrobras.

2. **The nature of the parties:** Many energy traders have claimed over the years that the FCPA does not apply to their business. The Vitol case illustrates that nothing can be further from the truth. Energy traders routinely deal with those entities which have energy products to sell, namely energy companies. This means that a large amount of their business is with national energy companies such as Petrobras, Petróleos Mexicanos (Pemex) and EP Petroecuador. If ever there were a question about energy traders and FCPA risk, this enforcement action answers it once and for all.

3. **The CFTC's involvement:** In spite of the Trump Administration's attempt to get rid of the CFTC, it still exists as a viable government agency regulating anti-competitive behavior. According to the CFTC press release, the agency's involvement

> and enforcement action was for manipulative and deceptive conduct, "which spanned from 2005 to early 2020, involved foreign corruption and physical and derivatives trading in the U.S. and global oil markets, including attempted manipulation of two S&P Global Platts physical oil benchmarks."

Clearly, Vitol had adopted bribery, corruption and market manipulation as business strategies for some 15 years. The press release stated,

> "Vitol's fraudulent and manipulative conduct — including conduct relating to foreign corruption — defrauded its counterparties, harmed other market participants and undermined the integrity of the U.S. and global physical and derivatives oil markets. This case is brought in coordination with the Division of Enforcement's Corruption Task Force and is the first action brought by the CFTC involving foreign corruption."

The CFTC Order detailed,

> "Vitol committed fraud by making corrupt payments to employees and agents of [Petrobras] in exchange for confidential information, including confidential material involving Vitol's trading in physical oil and derivatives. This material included at times the specific price information — referred to internally at Vitol as the 'gold number' — at which Vitol understood it would win a supposedly competitive bidding or tender process."

The order further found that,

> "In August 2014 and July 2015, Vitol acted to manipulate two Platts fuel oil benchmarks for the purpose of benefiting Vitol's related physical and derivatives

> positions, including positions obtained while in possession of confidential information. By attempting to manipulate such benchmarks, Vitol was also attempting to manipulate futures, swaps and other derivatives and physical trades that price in reference to those benchmarks. If Vitol's actions had been successful, such conduct would have been to the detriment of market participants who held opposing positions — including Vitol's counterparties — or those who rely on the benchmarks as an untainted price reference for U.S. physical or derivative trades."

This entry of the CFTC into FCPA-related enforcement was clearly communicated by the CFTC in its 2019 Advisory on Violations of the Commodity Exchange Act Involving Foreign Corrupt Practices (Advisory). In this Advisory, CFTC's then Enforcement Director, James McDonald, said,

> "Combatting misconduct that affects our financial markets has truly become a team effort, and that is particularly true with respect to foreign corrupt practices. We at the CFTC will do our job as part of the team to identify this type of misconduct in our markets and hold wrongdoers accountable, working closely with our enforcement partners domestically and abroad."

Market Intelligence, Last Look & Rigged Bids

One thing about criminals is that they are usually quite clever. It has been quite some time since we have seen the traditional "bags of cash across the border" bribery scheme. This case has some interesting bribery schemes that every compliance professional should study and see if the schemes used by Vitol could appear in their organization. This makes a review of the enforcement action quite instructive.

The first key to this enforcement action was that Vitol bribery in Brazil was not to directly obtain contracts, but to do so indirectly through the illegal purchase of inside information, which would allow it to underbid its competitors through pricing and competitor information. During the 2011 to 2014 time period, Vitol admitted that it bribed at least five other Petrobras officials some $8 million in exchange for receiving confidential pricing information that Vitol used to win fuel oil contracts with Petrobras. The Information reported that Vitol reaped some $33 million in profits as a result of this inside information.

Market Intelligence and Last Look

The data obtained included

> "(i) 'market intelligence,' which included internal Petrobras import and export forecasts and other confidential information intended to benefit Vitol in trading with Petrobras; and (ii) 'last look' information, including confidential bid information that Petrobras received from Vitol's competitors, which Vitol used to determine the amount it would need to bid to win public tenders."

Apparently, obtaining the market intelligence was an approved business strategy of Vitol as this scheme began when

> "Vitol Trader 1 asked Vitol Brazil Executive to find a contact within Petrobras who could provide Vitol with confidential information regarding Petrobras's fuel oil import and export program. The information Vitol Trader 1 requested included information that was detailed in weekly internal Petrobras reports that contained Petrobras's production volume and quality, anticipated imports, shipping routes and cargo loading details… The bribe payments ranged from approx-

> imately \$5,000 per month in 2005 to approximately \$12,000 per month by in or about January 2014."

The Last Look scheme began in a different way as in 2006, "Brazilian Official 1 offered Vitol Brazil Executive 'last look' information on confidential competitive bids for fuel oil that Petrobras received from other companies, which would allow Vitol to match or beat the final bids submitted by Vitol's competitors."

Through this information, which was shared with Vitol traders across the globe, they developed what their traders called the "golden price," which was the number they had to hit to make the purchase or sale. Interestingly, here the bribes were built into the price structure, as "Vitol paid Brazilian Official 1 bribes in the amount of eight cents per barrel of fuel oil that Vitol purchased from Petrobras in winning tenders."

Finally, as the Information stated,

> "From at least in or about and between March 2006 and December 2014, Vitol paid for and received confidential 'last look' information for over 50 Petrobras tenders. In addition, on at least five occasions, Vitol also paid per barrel bribes to Brazilian Official 1 and three other Petrobras officials in connection with tenders outside of Brazil in which Petrobras was a Vitol competitor. In connection with these tenders outside of Brazil, Vitol paid bribes to Petrobras officials in the amount of eight cents per barrel if Vitol won the tender or four cents per barrel if Vitol did not win."

The funding of the bribes was not only equally creative, but equally well-known within Vitol. Sham contractors in Brazil were set up to invoice Vitol for nonexistent services. Payment of these fraudulent contracts were then made to known "doleiros" whose business is to both launder money and get illegally obtained funds out of Brazil. These doleiros then "converted the funds into Brazilian currency so that

Vitol Brazil Executive could deliver cash to" the corrupt Petrobras officials.

Fake Bids

In yet another bribery scheme, Vitol paid the bribes to Brazilian officials through intermediaries in exchange for receiving confidential pricing information that Vitol, at times, used to bid or offer on fuel oil contracts from Petrobras. With this confidential information, Vitol traders would then have "secret negotiations to establish corruptly agreed upon prices for Petrobras contracts that included bribes to the Brazilian officials and commissions to Brazil Consultant 1 and Brazil Consultant 2. After the prices were secretly agreed to pursuant to the corrupt scheme, the parties engaged in sham negotiations to make those negotiations appear legitimate" so that a paper trail was created if they were audited.

This corruption scheme had the following characteristics:

- In exchange for the bribe payments, Vitol received "confidential product and pricing information that allowed Vitol to determine its interest in pursuing a deal for that particular Petrobras cargo shipment."

- Thereafter, a corrupt intermediary, acting on behalf of Vitol, negotiated a final price between Vitol and Petrobras. The "delta" between the sale price and the purchase price would be used to pay commissions and bribes.

- They then facilitated a staged negotiation between Petrobras and Vitol for that particular cargo.

The fraudulent transaction went something like the following: "'Gentlemen, your email should be to [Vitol Trader 1] indicating +17, Geneva will counter at +15 and close @ +16.' Vitol consummated more than 30 transactions with

Petrobras in this or a similar manner in or about and between 2011 and 2014." The amount of the bribes was to be determined on a case-by-case basis.

According to the Information,

> "In or about and between 2015 and 2020, Vitol, through certain of its employees and agents, knowingly and willfully conspired and agreed with others to corruptly offer and pay more than $2 million in bribes to, and for the benefit of, officials in Ecuador and Mexico to secure an improper advantage in order to obtain and retain business in connection with the purchase and sale of oil products."

Ecuador Corruption

The corruption started in Ecuador in 2015, when Vitol agreed to pay bribes "for identifying business opportunities for Vitol and others with Petroecuador and, in some cases, using their influence to ensure Vitol received the benefit of those opportunities." This was expanded in 2016, when Ecuadorian officials began working on a prospective project related to the purchase of fuel oil from Petroecuador. In this scheme, the Ecuadorian national oil company would contract with Vitol "on back-to-back terms, thereby bypassing a competitive tendering process."

The scheme played out as follows: Vitol would pay bribes to Ecuadorian officials in exchange for the award of the fuel oil contract to Petroecuador for the benefit of Vitol. The bribe was baked into a "per-barrel commission for fuel oil provided to Vitol," and corrupt consultants retained by Vitol would use a portion of those funds to pay bribes to Ecuadorian officials on Vitol's behalf.

The bribes were funded in March through May 2018 by payments totaling approximately $2.64 million by Vitol to its corrupt consultant based upon fraudulent invoices. After the money was funded, Vitol instructed its corrupt consultant in tranches of $150,000 every 15 days to the corrupt Petroecuador officials. For these bribe payments, Vitol secured a $330 million contract for its corrupt acts.

Mexico Corruption

In Mexico, between 2015 and 2020, Vitol used a corrupt intermediary to make bribe payments to Mexican officials to receive inside information and obtain business. The Information provided the following example, "in or about 2018, Vitol paid bribes to a Mexican official at a wholly owned PEMEX subsidiary in order to receive confidential, inside information to help obtain a contract with the PEMEX subsidiary. To effectuate the bribe payments, Vitol caused two Mexican entities to execute sham consulting agreements with shell companies controlled" by the corrupt Intermediary.

Penalties

Vitol was assessed and agreed to pay a total monetary penalty in the amount of $135 million. The company and the DOJ agreed that of that total amount, Vitol would pay the United States $90 million. The DOJ credited the remaining amount of the total criminal fine against the amount the Vitol agreed to Brazilian authorities, up to a maximum of $45 million, so long as the company pays the remaining amount to Brazil pursuant to the company's separate resolution with Brazilian authorities that addresses the same underlying conduct related to Brazil as described in the DPA. Vitol also resolved an enforcement action with the CFTC via a cease-and-desist proceeding for conduct described in the DPA and other conduct. The total fine and penalty is $12.79 million in disgorgement relating to the conduct described in the DPA and a $16 million penalty relating to trading activity not covered in the DPA.

Vitol was able to obtain a discount under the FCPA Corporate Enforcement Policy in the full amount available to it, 25 percent, although the company did not self-disclose its conduct. However,

> "the Company received full credit for its cooperation and Vitol S.A.'s cooperation with the Fraud Section's and the Office's investigation, including: (i) making factual presentations to the Fraud Section and the Office; (ii) voluntarily facilitating the interview in the United States of a former foreign-based employee; (iii) producing to the Fraud Section and the Office, on a prompt basis, relevant documents, including documents located outside the United States, accompanied by translations of documents; and (iv) timely accepting responsibility and reaching a prompt resolution".

Apparently, there was adequate disclosure of the facts by Vitol as the DPA noted; the company provided to the DOJ all relevant facts known to them, including information about the individuals involved in the illegal conduct. Most importantly,

> "Vitol … engaged in remedial measures, including personnel changes; implementation of enhanced policies, procedures and internal controls relating to, among other things, anti-corruption, retention and management of commercial agents and other third parties, and gifts, travel and entertainment; internal investigations and risk assessments; and enhancements to training and internal reporting programs."

The company agreed to continue to enhance its compliance program and report to the DOJ on its progress. It is not clear what obligations Vitol agreed to in a Brazilian enforcement action.

Interestingly, under the Sentencing Guideline calculations, it appears that the failure to self-disclose cost Vitol $45 million in additional penalties. That amount is quite an incentive for companies to come forward and self-disclose.

Lessons Learned

Concurrent Crimes

While I have not detailed the CFTC Order, it bears noting that bribery and corruption in violation of the FCPA was not the sole crime engaged in by Vitol. A separate enforcement action was brought by the CFTC that required Vitol to pay more than $95 million in civil monetary penalties and disgorgement. The Order stated,

> "By attempting to manipulate such benchmarks, Vitol was also attempting to manipulate and would have distorted numerous futures, swaps and other derivatives and physical trades that price in reference to those benchmarks. This would be to the detriment of market participants that had opposite exposure (including Vitol's counterparties), or who looked to rely on the benchmarks as a fair price reference for physical or derivative trades, including U.S. futures contracts and swaps."

Every compliance practitioner needs to understand that corporate bribery and corruption can lead to other crimes as well. In the case of Vitol, it was "Section 6(c)(1) of the Act, 7 U.S.C. § 9 (2018), and Regulation 180.1, 17 C.F.R. § 180.1 (2020), prohibit the use or attempted use of any manipulative or deceptive device, untrue or misleading statements or omissions or deceptive practice, in connection with any swap or contract of sale of any commodity in interstate commerce, or for future delivery. Specifically, Regulation 180.1(a)(1)–(3)".

There has been another FCPA enforcement action that had concurrent illegal activity. Back in 2011, Bridgestone Corporation pleaded guilty to and agreed to pay a $28 million criminal fine for its role in conspiracies to rig bids and to make corrupt payments to foreign government officials in

Latin America related to the sale of marine hose and other industrial products manufactured by the company and sold throughout the world. It would seem that anti-competitive behavior can be a direct outcome of bribery and corruption.

Insider Information

Bribery and corruption are not always used to directly obtain or retain business. Vitol obtained confidential bid information from Petrobras on its competitors, which Vitol used to determine the amount it would need to bid to win public tenders. One scheme involved information Vitol obtained that detailed weekly internal reports containing Petrobras's production volume and quality, anticipated imports, shipping routes and cargo loading details.

A second scheme provided information on confidential competitive bids for fuel oil that Petrobras received from other companies, which would allow Vitol to match or beat the final bids submitted by their competitors. Through this information, which was shared with Vitol traders across the globe, they developed what their traders called the "golden price," which was the number they had to hit to make the purchase or sale.

Payment for these bribes was built into the price structure of eight cents per barrel of fuel oil that Vitol purchased from Petrobras in winning tenders. Finally, Vitol also paid per-barrel bribes to corrupt Petrobras officials in connection with tenders outside of Brazil in which Petrobras was a Vitol competitor. In connection with these tenders outside of Brazil, Vitol paid bribes to Petrobras officials in the amount of eight cents per barrel if Vitol won the tender or four cents per barrel if it did not win.

Antitrust Compliance Programs Needed

These bribery schemes make clear that compliance professionals not only need to be on the lookout for new and different ways to fund a bribe but corruption for indirect business development. These schemes also make clear why an anti-trust compliance program is equally necessary for any multinational organization to prevent, detect and remediate anti-competitive behavior. ◆

Novartis FCPA Enforcement Action

In late June and early July, there were two stunning bribery and corruption enforcement actions involving the Swiss pharmaceutical giant Novartis. The first one was announced on June 25: an enforcement action for Novartis' violations of the FCPA outside the United States. It involved the Swiss pharmaceutical company Novartis AG, its Greek subsidiary Novartis Hellas S.A.C.I. (Novartis Greece) and Alcon Pte Ltd.

The second matter pertained to bribery and corruption inside the U.S. and involved violations of the False Claims Act and violations of the Anti-Kickback Statute. July 1, 2020 brought a stipulation and order against Novartis Pharmaceuticals Corporation for its bribery and corruption in the U.S. There were two settlements for U.S. domestic corruption: The first settlement pertained to the company's alleged illegal use of three foundations as conduits to pay the copayments of Medicare patients taking Novartis's drugs, Gilenya and Afinitor; the second settlement resolved claims arising from the company's alleged kickbacks to doctors.

Introduction

Proving that the era of the large FCPA enforcement action is not over, the Swiss pharmaceutical company Novartis AG, its Greek subsidiary Novartis Hellas S.A.C.I. (Novartis Greece) and Alcon Pte Ltd., a unit of eye-care company Alcon Inc., agreed to pay about $347 million in fines to resolve claims to settle Novartis' long-standing FCPA enforcement action on June 25. Novartis Greece and Alcon Pte, a former subsidiary of Novartis AG and current subsidiary of Alcon Inc., agreed to pay $233 million in criminal penalties to resolve the DOJ investigation into FCPA violations. Novartis AG has also agreed to pay $112 million to the U.S. SEC in a related matter, the SEC cease-and-desist order (SEC Order). The resolution documents included:

- Alcon Pte Ltd DPA;
- Alcon Pte Ltd criminal information;
- Novartis Hellas S.A.C.I. DPA;
- Novartis Hellas S.A.C.I. criminal information.

What the Regulators Said

According to the DOJ press release, U.S. Attorney for New Jersey Craig Carpenito said, "the agreement we're announcing today shows that there will be a heavy price paid by companies that violate our laws, whether at home or overseas. Just as importantly, it includes a framework for compliance reforms that should ensure that these companies conduct their business legally moving forward."

This was punctuated by then-Assistant Attorney General Brian A. Benczkowski of the Justice Department's Criminal Division, who stated, "Novartis AG's subsidiaries profited from bribes that induced medical professionals, hospitals and clinics to prescribe Novartis-branded pharmaceuticals and use Alcon surgical products, and they falsified their books and records to conceal those bribes. The resolutions announced today reflect the paramount importance of effective compliance programs and the department's commitment to holding companies accountable when they fall short."

Going more into the weeds, Charles Cain, Chief of the SEC Enforcement Division's FCPA Unit, said in an SEC press release, "poor control environments are fertile soil for malfeasance," and "as illustrated by Novartis' misconduct, weaknesses in one part of the business can often serve as a harbinger of larger unaddressed problems."

The Schemes: The Big Picture

Novartis

Novartis got into trouble in multiple countries: Greece, Vietnam and South Korea. Novartis Greece admitted to bribing Greek physicians, employees of state-owned health care enterprises and public health ministers through a variety of schemes. According to the DOJ press release, "between 2012 and 2015, Novartis Greece conspired with others to violate the FCPA by engaging in a scheme to bribe employees of state-owned and state-controlled hospitals and clinics in Greece in order to increase the sale of Novartis-branded pharmaceutical products. Novartis Greece paid for those employees to travel to international medical congresses, including events held in the United States, as a means to bribe these officials in exchange for increasing the number of prescriptions they wrote for Lucentis, a prescription drug that Novartis Greece sold. Novartis Greece employees [who] traveled to the United States facilitated the provision of the improper benefits to publicly employed Greek health care providers."

The company "also admitted that between 2009 and 2010, Novartis Greece made improper payments to health care providers in connection with an epidemiological study that was intended to increase sales of certain Novartis-branded prescription drugs. The epidemiological study was used as a vehicle to make improper payments to the health care providers in order to increase sales of certain Novartis-branded prescription drugs, and Novartis Greece employees recognized that many participating health care providers believed that they were being paid in exchange for writing prescriptions of Novartis products and not for providing data as part of a clinical study."

Alcon

Alcon Pte, an eye-care unit of Novartis, from 2011 through 2014 "knowingly and willfully conspired with others to cause Novartis AG to maintain false books, records and accounts, as a result of a scheme to bribe employees of state-owned and state-controlled hospitals and clinics in Vietnam. The false books and records resulted from a scheme in which Alcon Pte, Ltd. made corrupt payments through a third-party distributor to employees of state-owned and state-controlled hospitals and clinics in Vietnam in order to increase sales of intraocular lenses. Intraocular lenses are artificial replacement lenses that are implanted in the eye as part of a treatment for a variety of ailments, such as cataracts." Alcon employees in Vietnam fraudulently funded bribes through a reimbursement scheme with distributors for up to 50 percent of the cost of the corrupt payments. In turn, these reimbursements were "falsely recorded as, among other things, consulting expenses, marketing expenses and human resource expenses."

The SEC said, "Novartis lacked sufficient internal accounting controls within its former Alcon business in China from 2013 to 2015, which used forged contracts as part of local financing arrangements that generated large losses and resulted in Novartis and Alcon writing off more than $50 million in bad debt."

Interestingly, the nefarious acts came to light through internal whistleblowers in Greece. Stephen M. Kohn, a founding partner in the *qui tam* whistleblower law firm of Kohn, Kohn & Colapinto LLC and the U.S. attorney for the whistleblowers, said in a blog post, "the confidential and anonymous Greek whistleblowers who documented these crimes are heroes. They put their reputations and careers at risk to inform law enforcement about widespread bribery schemes in Greek health care programs. Even today, their safety is under threat from corrupt officials who stole from the health care system and took bribes."

Doubly interesting is the now infamous hiring by Novartis of former Trump lawyer Michael Cohen back in 2017. According to MarketWatch, Cohen's hiring was "an important way for the company to understand the players of the Trump administration." One now must wonder if it had anything to do with the then-ongoing DOJ and SEC investigations. At the very least, it demonstrates the tone of Novartis' senior management at the time.

The Schemes: Into the Weeds

Novartis

The schemes used by Novartis in Greece had several important aspects that every compliance professional should study so they can assess their own compliance regime for similar weaknesses. Moreover, while the schemes themselves were almost basic, they once again demonstrate the capacity for companies to completely lose their ethical way – and also the lengths to which a business unit can go to attempt to hide its illegal actions. One scheme shows how a legitimate program that might have passed compliance muster morphed into something very different. Finally, the Novartis bribery schemes show the almost unbelievable capacity for business folks to put completely inane communications into emails detailing the bribery schemes.

The Investment Scheme

The investment scheme was the company's moniker to pay employees of government-owned health care providers (HCPs) to attend international medical congresses. These congresses were organized by various medical associations in the U.S. and Europe and typically took place over several days in a U.S. or European destination city. The cost for persons to attend these congresses was listed at between $6,000 and $8,700 per attendee.

According to the Novartis Hellas Information, the company kept "internal documentation noting that HCPs with the highest potential and highest propensity to prescribe Lucentis would receive 'investments,' such as sponsorships to attend international congresses, while HCPs with lower potential and less propensity to prescribe Lucentis would receive no such 'investments.'" Indeed, in written minutes ("Minutes") from the Novartis Hellas brand team that led this effort, the Information that noted a section entitled "Increase Pressure in [sic] HCPs" reflected Novartis Hellas' intent to use specific international congress sponsorships to corruptly influence Greek State HCPs. In particular, the Minutes stated that Greek State HCPs 'must understand that their participation in [specific congresses in the United States and Europe] will be cancelled if sales performance is not improved significantly.'" That is about as clear a *quid pro quo* as you can ever see in the world of FCPA enforcement.

Key Opinion Leaders

Clearly presaging the Fyre Festival, Novartis Hellas targeted influencers in the Greek HCP world by courting what the company called "key opinion leaders" or KOLs. No doubt channeling their inner Donald Trump, they sought to obtain "loyalty" (i.e., more HCPs writing more prescriptions of their product Lucentis by paying bribes directly to these KOLs). Once again, there was a clear *quid pro quo*, as Novartis Hellas would lower their investments in KOLs if their loyalty dipped as a result of not making more and additional prescriptions of Lucentis.

Novartis Hellas compounded this illegal action, hiding the loyalty payments by falsely recording them in the company's books and records as "'legitimate advertising and promotion expenses'… These false records were consolidated into Novartis AG's financial records and used to support Novartis AG's financial reporting to the SEC. As such, Novartis Hellas, through its employees and agents, knowingly and willfully conspired and agreed with others to cause the corrupt payments to be falsely recorded as legitimate expenses in Novartis AG's books, records and accounts."

Clinical Trial Study – The EXACTLY Scheme

This bribery scheme appears to have begun as a legitimate clinical study. It involved "phase four studies and epidemiological studies, both of which were research studies intended to answer scientific questions related to medical conditions treated by Novartis-branded prescription drugs. In this role, and depending on the study, NOVARTIS HELLAS selected Greek public and private HCPs to gather patient data for the studies." Moreover, "the phase four studies and epidemiological studies were designed to inform medical and clinical decisions, not to increase sales." However, Novartis Hellas morphed the program into a straight bribe-paying exercise.

The basis of the study had to be changed to meet certain Greek data-privacy issues. In doing so, Novartis Hellas simply went through a pro-forma exercise to have paperwork filed for the study, but the data was either cut and pasted between forms or simply filled in incorrectly so as to render it useless as the basis of a clinical study. No doubt recognizing the irony in this name, Novartis Hellas called it the "EXACTLY Program."

To heighten the situation further, a document entitled "The EXACTLY Debrief" contained the following statements: "The doctor believes that he/she participates in a study [EXACTLY] and gets paid for what he prescribes in reality and not for what he/she writes in the study"; "the doctors believe that the study was conducted in order to get paid for what they write, right?"; "this is a type of benefit provided to the doctors. They know that they will get paid, this is what happens in reality;" and, finally, "to be honest, the studies were conducted in a similar way in the past as well; they were conducted as marketing projects. That's within quotation marks. Between us."

EXACTLY Indeed.

Alcon

The Consultancy Program

The Alcon scheme was more straightforward and was called the "consultancy scheme." Here, a distributor was engaged to make bribery payments to HCPs in Vietnam. The Alcon Information stated, "under the guise of the consultancy program, the Distributor Company made corrupt payments to HCPs, including Vietnam State HCPs, in connection with sales of Alcon Division IOLs by the Distributor Company. The Distributor Company made the payments directly to HCPs, including to Vietnam State HCPs."

It began with Alcon "providing money to the Distributor Company, disguised as consultancy payments and in the form of credit notes, that the Distributor Company used to make corrupt payments to HCPs." At its peak, there were 200 Vietnam HCPs being paid bribes by the Distributor designated by Alcon. The scheme was facilitated internally through the following steps:

> "(a) Distributor Company employees would regularly send emails to an Alcon Vietnam Representative Offices employee requesting a credit note for a certain amount related to the consultancy program; (b) the Alcon Vietnam Representative Offices employee reviewed and forwarded the requests to regional management, including Alcon Pte, Ltd. Executive 2; and

(c) once approved by regional management, credit notes were issued to the Distributor Company with the stated reason for the credit note as 'consultancy fees.'"

Internal Controls

Novartis

The bribery schemes used by Novartis in Greece were of three types:

1. The investment scheme paid HCPs travel and associated fees to attend international medical congresses.

2. The key opinion leaders scheme paid influencers in the health care profession bribes so they would write more prescriptions of the Novartis product Lucentis.

3. The EXACTLY scheme paid HCPs to falsely, wrongly and uselessly fill out data about a clinical study in exchange for bribe payments for Novartis products prescribed.

In Korea, a scheme was used that was similar to the investment scheme: "Novartis Korea sales managers and employees organized the sponsorship of HCPs to international medical conferences as an inducement for HCPs to increase their prescriptions of Novartis products." In yet another scheme in Korea, similar to the EXACTLY scheme, the company's neuroscience business unit devised a local non-interventional clinical study with 17 pre-selected HCPs to improve relationships with those HCPs.

Alcon

The bribery schemes by Alcon in Asia included the consultancy scheme, where a distributor was engaged to make bribery payments to HCPs in Vietnam. In Korea, a variety of bribery schemes were used. One of the schemes to make improper payments to HCPs was disguised as payments made for ostensible medical journal activities organized by a third-party vendor. The payments were made to the medical journals, who forwarded the payments to the HCPs.

In a scheme in China, the company placed surgical equipment in hospitals with little or no money down. There was no proper evaluation of the equipment cost, accounting for revenue paid or write-offs for the equipment. The Order noted, "nearly half of the 844 pieces of equipment in question had been placed pursuant to contracts that lacked a formal hospital 'chop' but had been validated by the hospital; the remaining pieces of equipment either could not be located, had been moved to other hospitals or were obtained pursuant to forged or unverified contracts."

The question under the FCPA and for the SEC was the failure, circumvention, override and disregard of internal controls. While payment for travel to and attendance at medical conferences may well be high risk, it can be managed with robust internal controls and compliance oversight. Yet both failed at Novartis. According to the Information, Novartis Hellas employees "falsely recorded the corrupt payments associated with congress sponsorships as legitimate advertising and promotion expenses in Novartis Hellas' internal accounting records" for both the investment scheme and the KOL scheme.

The internal controls worked somewhat better for the EXACTLY scheme, at least initially. A Novartis internal audit initially flagged the study as lacking in "transparency outside of the medical affairs function in the planning, design and execution of clinical studies in Greece." Moreover, there were "weaknesses in process, and control design in execution did not ensure that the studies were of a non-promotional nature." Finally, there were "numerous control deficiencies surrounding phase four studies conducted in Greece, including (1) unsupported medical or scientific rationale to perform the studies and (2) indications the studies were promotional and designed to achieve commercial advantage. Internal audit also found controls weaknesses in the collection of data and publication of study results." Novartis Hellas agreed to a remediation plan and to improve the finance department's oversight of clinical studies, but apparently there was no follow up.

Additionally, when it came to payment under the original EXACTLY scheme, there were control weaknesses that made it difficult to ensure that HCPs were paid the correct amounts for their participation in the clinical studies. For example, in the EXACTLY study, approximately four times as many HCP names were submitted to the local health authority than actually received payments. Additionally, some payments were made to HCPs using a vendor named "dummy vendor." The bottom line was that the EXACTLY scheme was a "black box" into which it lacked visibility.

Lastly, Novartis Hellas also lacked sufficient controls around grants provided to HCPs. One example is that grants were provided without complete due diligence of the recipient, without clear details regarding the use of the funds and in circumstances where there was an improper connection to sales strategies. In response to the internal audit review, Novartis Greece agreed to improve internal controls over the grant approval and governance processes. Yet once again, there appears to have been no follow-up to ensure compliance.

For Alcon in Vietnam, there was clear circumvention of internal controls by mislabeling payments made to the corrupt distributor for payment to the HCPs as credit notes. Additionally, there were "payments through other, inflated reimbursable costs, such as marketing, human resources or margin reconciliation costs." There were also payments made to the distributor, mischaracterized as "consultancy fees," which were used to pay bribes to HCPs.

In China, the bribery scheme was provisioning of equipment to HCPs. To facilitate these long-term business relationships, the company created "equipment financing arrangements" (EFAs) in which HCPs would allegedly make payments for the proffered equipment. However, as the SEC Order noted, the company "lacked adequate internal accounting controls to ensure the appropriate accounting treatment for the arrangements and to appropriately record the transactions in its books and records." Eventually, the company had to write off the equipment provided under the EFAs to the tune of $50 million.

Fines, Penalties and the Cost of Recidivism

Novartis Hellas

With Novartis, you must begin with the 2016 FCPA settlement with the SEC (resolved with a cease-and-desist order (the 016 Order)) for its bribery and corruption in China. A portion of that SEC settlement dealt with conduct that was also reported in this 2020 settlement. The illegal acts reported the 2016 Order include the investment scheme, the EXACTLY scheme and the key opinion leaders scheme. The bribery schemes all began in 2009, around the same time as the conduct began in Greece by Novartis. One must reasonably ask why the same conduct in China made the subject of the 2016 Order was not uncovered in the internal investigation performed by Novartis after it was put on notice by the SEC staff's investigation in 2013. This failure or oversight cost Novartis significantly in the 2020 DOJ resolution.

The 2020 Novartis DPA specifically noted that the company did not self-disclose the violations of the FCPA in Greece or in China. However, the company did make a comeback in its subsequent cooperation and remediation. Regarding cooperation, the company received full credit for conducting a thorough investigation, production of "extensive documentation" and translations of these documents. Regarding remediation, the company enhanced its compliance regime specifically including sponsorships to international medical congresses and phase four studies. The company also continued to enhance its compliance program to the extent that no ongoing monitorship was required under the DPA.

The DOJ summarized all of these factors in its analysis under the FCPA Corporate Enforcement Policy, which reads as follows:

> "If a company did not voluntarily disclose its misconduct to the Department of Justice (the Department) in accordance with the standards set forth above, but later fully cooperated and timely and appropriately remediated in accordance with the standards set forth above, the company will receive, or the Department will recommend to a sentencing court, *up to a 25 percent reduction off of the low end of the U.S.S.G. fine range.*"

Novartis was a recidivist. The company did not self-report, but did receive a full cooperation and remediation credit of a 25 percent reduction from "a point above the midpoint of the applicable Sentencing Guidelines fine range."

That brings us to the calculation under the Sentencing Guidelines. After going through the initial set of base numbers and enhancements, a company can obtain a reduction if the "organization fully cooperated in the investigation and clearly demonstrated recognition and affirmative acceptance of responsibility of its criminal conduct." Here, a company can receive a reduction of up to five points, but Novartis Hellas only received a reduction of two points. Unfortunately, there is no description in the DPA as to why only two points' reduction was given. As the DPA is replete with language of the full and extensive cooperation, that only leaves "clearly demonstrated recognition and affirmative acceptance of responsibility of its criminal conduct" as reason for lack of any additional point reduction. Such lack of recognition and lack of affirmative acceptance could relate to the recidivism, but based upon the language found in the Alcon DPA, discussed below, I do not believe so.

The range of fines under the final calculation under the Sentencing Guidelines was between a low of $180 million to a high of $360 million. This would make the midpoint at $270 million. As the final penalty was $225 million, this means the "point above the midpoint" was somewhere between $340 million and $350 million. All of this means that Novartis' recidivist conduct cost the company somewhere in the range of $90 million.

Alcon

Alcon found itself in a situation similar to Novartis Hellas in that it did not self-disclose and thus received no credit under the FCPA Corporate Enforcement Policy. It did, however, extensively cooperate and remediate. The cooperation included a thorough investigation, sharing of documents and other work. On the remediation front, in addition to upgrading the entire compliance regime, similar to Novartis Hellas, the company terminated high-level executives and disciplined others and terminated its relationship with the distributor used to pay bribes in Vietnam.

In a key distinction with Novartis Hellas, Alcon received credit for having "no prior criminal history" and agreed to cooperate with the DOJ. In contrast to Novartis Hellas, Alcon "received an aggregate **discount of 25 percent of the bottom** of the otherwise-applicable Sentencing Guideline range." When you look at the language around the Sentencing Guidelines calculation, you see the same language found in the Novartis Hellas DPA – particularly the two points' reduction given – so once again, it is not clear what conduct the DOJ found lacking. However, it is clear that the fine range under the Sentencing Guidelines set a low of $11.9 million, and Alcon received a 25 percent discount, for a total penalty of $8.925 million.

Novartis AG

Finally, there is the penalty assessed by the SEC against Novartis AG. Here, it is much clearer and more straightforward. After noting the total penalty assessed by the DOJ at $233.925 million, the Order required disgorgement of $92.3 million and prejudgment interest of $20.5 million, for a total amount of $112.8 million.

Data Analytics and Lessons Learned

Data Analytics

Matt Kelly (the Coolest Guy in Compliance) not only was the first to post on the Novartis matter, but also presciently raised the issue of how data analytics could be used to help detect the illegal conduct at issue. Regarding the key opinion leader bribery scheme, Kelly said in Radical Compliance,

> "If the marketing team can rank the company's most promising customers (and rest assured, it can), and accounting can track the company's spend per customer (which it should) — then clever data analytics can cross-reference those lists to see which high-value targets are getting showered with 'investments.'"

As usual, Kelly is spot on.

The most basic form of data analytics would have been able to determine where each of the KOLs were in the sales (or writing prescriptions) leaderboard. When you tie this to the "investment" made in each KOL in the form of international medical conferences attended at the expense of Novartis, it would be easy to flag for further investigation. Always remember: The purpose of data analytics is not to tell you the answer, it is to provide insights that can be flagged for further investigation. Also, simply because the information might well come from disparate data sets is no excuse.

The DOJ spoke directly to these issues in the 2020 Update to the Evaluation of Corporate Compliance Programs when it noted that a compliance function must have sufficient resources to effectively undertake the requisite monitoring, documentation and analysis; there must be sufficient subject matter expertise to "understand and identify the transactions and activities that pose a potential risk;" and, finally, the DOJ posed the following questions:

- *Do compliance and control personnel have sufficient direct or indirect access to relevant sources of data to allow for timely and effective monitoring and/or testing of policies, controls and transactions?*

- *Do any impediments exist that limit access to relevant sources of data and, if so, what is the company doing to address the impediments?*

Novartis' EXACTLY bribery scheme could also have been detected through the use of data analytics. The phase four was perhaps the most direct when a simple review of the forms coming back from the Greek HCPs would have shown the uselessness of the information, the significant number of "cut and paste" jobs, where the same information was put into multiple patient reports, and the inordinate number of incomplete forms returned. Finally, the compliance function could monitor if there was even ever going to be a phase four report, which apparently there was no intention of completing.

In China, where the bribery was giving equipment and supplies to HCPs while trying to disguise them as long-term rentals, an analysis of the different financing terms for hospitals throughout the country or even in the same geographic region would have been a good starting place for data analytics. Such reviews could have been expanded to include credit assessments of HCPs, the amount of allowances for bad debt established at inception for each HCP, compliance billing, equipment repossession, proof of delivery or installation and completion of required training associated with equipment and products delivered. This would seem to be exactly what the DOJ wants in connection with ongoing monitoring built into each compliance program.

For Alcon in Vietnam, a review of the information from the corrupt distributor would have been an excellent starting point. The distributor's P&L analysis "included a number of line items that concealed improper payments to HCPs, including to Vietnam State HCPs, in fiscal year ('FY') 2013 and FY 2014, including: purported 'consultant cost' of approximately $111,157 for FY 2013, purported "'consultant cost' of approximately $97,000 for FY 2014, purported 'HR' cost of approximately $800,000 for FY 2013, purported 'HR' cost of approximately $740,000 for FY 2014, purported 'administration cost' of approximately $514,000 for FY 2013 and purported 'administration cost' of approximately $572,000 for FY 2014." Each one of these line items could have been tested against similarly situated distributors in Vietnam and across the Asia-Pacific region.

Lessons Learned

The Novartis FCPA enforcement action presents several important lessons, both new and old, for the compliance professional. Going far beyond "crime doesn't pay" is the wisdom of not engaging in illegal bribery and corruption when you are under a cease-and-desist order for another set of FCPA violations (see the 2016 Novartis FCPA settlement with the SEC). For reasons not clear, Novartis either did not uncover all the illegal conduct resolved in the 2020 settlement when it investigated the conduct that led to the 2016 resolution or knew about the conduct and made the decision not to self-disclose. This lack of self-disclosure (for whatever reason) reduced the credit given to Novartis and Alcon by 25 percent each. It was clear the company finally got the message, because apparently its remediation was outstanding, as it was not required to have a monitor. However, the recidivist conduct appears to have cost the company approximately $90 million in additional fines and penalties.

Going far beyond "crime doesn't pay" is the wisdom of not engaging in illegal bribery and corruption when you are under a cease-and-desist order for another set of FCPA violations.

The second major lesson I believe this enforcement action conveys is that a compliance function must use data analytics going forward. The straightforward analysis I have laid out here can be used with internal company resources. While many will exclaim "what an order, we cannot go through with it," that dysfunctional denial will no longer wash. If you cannot get access to your own corporate data, you had better be prepared to explain why and what you did to get access. ◆

Novartis Domestic US Corruption Settlement

As bad as Novartis' conduct was abroad, I can only say it was much worse inside the U.S. In addition to long-running corruption schemes, the company either corrupted or worked with corrupt 503(c) companies to manipulate charitable co-payments for patients using certain Novartis drugs. The total fine and penalty paid for illegal conduct inside the U.S. was over double that paid by Novartis for its conduct outside the U.S. Novartis settled domestic False Claims Act and Anti-Kickback violations for $729 million and settled FCPA violations for foreign bribery for $337 million. These cases had much for every compliance practitioner to consider, including the specific illegal conduct of Novartis, the deficiencies in their compliance program, compliance function and Chief Compliance Officer (CCO); the role of the whistleblower; corrupt culture; and lessons learned.

In later sections, I will consider the Novartis US settlements, as outlined in the stipulation and order of settlement and dismissal (the Stipulation), settlement agreement (the Agreement) and corporate integrity agreement (the CIA).

The Novartis US conduct consisted of two different corrupt schemes. The first, detailed in the Stipulation, involved illegal conduct under the Anti-Kickback Statute (AKS). The AKS prohibits anyone from offering or paying, directly or indirectly, money or any other thing of value to induce referrals of items or services covered by Medicare, Medicaid and other federally funded programs. It extends not only to improper payments to providers, but also to the improper payment of patients' copay obligations. According to the press release:

> "Novartis hosted tens of thousands of speaker programs and related events under the guise of providing educational content, when in fact the events served as nothing more than a means to provide bribes to doctors. Novartis paid physicians honoraria, purportedly as compensation for delivering a lecture regarding a Novartis medication, but, as Novartis knew, many of these programs were nothing more than social events held at expensive restaurants, with little or no discussion about the Novartis drugs. Indeed, some of the so-called speaker events never even took place; the speaker was simply paid a fee in order to induce the speaker to prescribe Novartis drugs."

According to Andrew E. Lelling, the U.S. Attorney for the District of Massachusetts:

> "Novartis coordinated with three co-pay foundations to funnel money through the foundations to patients taking Novartis' own drugs. As a result, the Novartis conduct was not 'charitable,' but rather functioned as a kickback scheme that undermined the structure of the Medicare program and illegally subsidized the high costs of Novartis' drugs at the

> expense of American taxpayers. At the same time, we recognize that Novartis' current management has taken constructive steps to address the government's concerns with the company's prior relationships with copay foundations."

For the second corruption scheme, as detailed in the Agreement,

> "Novartis has agreed to pay $51.25 million to resolve allegations that it illegally paid the copay obligations for patients taking its drugs. When a Medicare beneficiary obtains a prescription drug covered by Medicare, the beneficiary may be required to make a partial payment, which may take the form of a copayment, coinsurance or a deductible (collectively "copays"). Congress included copay requirements in the Medicare program, in part, to serve as a check on health care costs, including the prices that pharmaceutical manufacturers can demand for their drugs."

According to Audrey Strauss, the Acting U.S. Attorney for the Southern District of New York:

> "For more than a decade, Novartis spent hundreds of millions of dollars on so-called speaker programs, including speaking fees, exorbitant meals and top-shelf alcohol that were nothing more than bribes to get doctors across the country to prescribe Novartis' drugs. Giving these cash payments and other lavish goodies interferes with the duty of doctors to choose the best treatment for their patients and increase drug costs for everyone. This office will continue to be vigilant in cracking down on kickbacks, however they may be dressed up, throughout the pharmaceutical industry."

Mike Volkov has said of Novartis, “we have a new poster child for a defective corporate culture of wrongdoing. Novartis has joined the exclusive club, along with Siemens, General Motors, Wells Fargo and others in the misconduct Hall of Fame.” He went on to say the company now faces a significant challenge:

> “Is it really prepared to address its culture problems, its record of misconduct and make the changes and commitment to right the ship, meaning to bring about a culture of compliance? In the absence of real changes from the head of the organization on down, the likely answer will be a resounding ‘no.’”

Just how corrupt was Novartis? Novartis is the entity that hired former Trump lawyer Michael Cohen back in 2017 amid ongoing DOJ and SEC investigations. Novartis is now a recidivist under the FCPA and a violator of a prior CIA. One can only hope that Novartis would have a serious wake-up call about their culture. But hope is not a strategy, and as Volkov said, “so far, we have seen little accountability – no major changes in senior management, the board or senior legal or compliance teams. Until that happens, Novartis is likely to limp along – as we always say, time will tell.”

The Corruption Schemes

Speaker Programs and Roundtables

According to the Stipulation, under Novartis compliance policies, speaker programs were supposed to be promotional programs led by a speaker who was approved and trained by the company and who received an honorarium for presenting an on-label and medically relevant slide presentation and Q&A session related to a Novartis product. Novartis paid for the attendees’ meals and alcohol for programs held in restaurants.

However, in practice, they were far different, beginning with the budgets for speaker programs and roundtables. Novartis sales representatives were directed to "spend all of their budgets." Moreover, these sales representatives were incentivized to do so "as part of an evaluation of their overall sales efforts. If a sales representative failed to spend all of their budget, that could be a negative factor in their annual review" as a part of their bonus compensation.

The sales representatives selected the HCPs who were "high-volume prescribers" to become speakers and paid honoraria to induce these HCPs to continue to write or to write more Novartis products. Indeed,

> "Novartis paid many high-prescribing doctors tens or hundreds of thousands of dollars in honoraria. For instance, over the course of the relevant period, Novartis paid over $320,000 in honorarium to a doctor who wrote more than 8,000 prescriptions for the covered drugs; over $220,000 in honorarium for a doctor who wrote more than 9,000 prescriptions for the covered drugs; and over $200,000 to a doctor who wrote more than 3,600 prescriptions for the covered drugs."

For dinners, there was a limited budget of $125 per person. However, this limit was routinely exceeded without pre- or post-approval. Usually, the sales representatives falsified their expense reports for these expenditures, but even when they did not, there were a large number of reports that noted the expenditure amount was exceeded. For instance, "in 2006, an internal Novartis presentation noted that between August 2005 and April 2006 "[o]ver 24 percent of the [speaker] events appear to have exceeded the guideline for average [food and beverage] cost per attendee in major cities." It noted that one of the "reasons for excessive costs per person" was that 'events are planned with high costs (e.g., very exclusive places, expensive menu choices, no control over alcohol spending).'"

Although the company's compliance policies required that speaker programs and roundtables provide medical information regarding the company's products to HCPs, at many events, there was little to no medical discussion. It was reported that at many, the sales representative hosting the events did not require the speaker, who was being paid an honorarium, to even bother to deliver a presentation at all. Finally, the company "in a number of instances paid doctors honoraria for purportedly speaking at events that never took place."

Co-Pay Corruption

The second corruption scheme was detailed in the Settlement Agreement and involved fraudulent copays. When a Medicare beneficiary obtains a prescription drug covered by Medicare, the beneficiary may be required to make a partial payment, which may take the form of a copayment, coinsurance or a deductible (copays). Congress included copay requirements in the Medicare program to serve as a check on health care costs, including the prices pharmaceutical manufacturers can demand for their drugs.

The copay scheme was carried out with or through three charitable entities, including The Assistance Fund (TAF), National Organization for Rare Disorders (NORD), and Chronic Disease Fund (CDF). Each of these entities claim 501(c)(3) status as funds that paid the copays of certain patients, including Medicare patients. The Settlement Agreement stated, "Novartis used TAF as a conduit to pay kickbacks to Medicare patients taking Gilenya and used NORD and CDF as conduits to pay kickbacks to Medicare patients taking Afinitor."

With TAF, Novartis was providing free Gilenya to 364 patients who would become eligible for Medicare the following year. When these patients filed their Medicare Part D, Novartis would obtain revenue from Medicare when the patients filled their prescriptions for Gilenya. The corruption involved a plan for Novartis to cover their copays through

TAF, which operated a fund that offered copay assistance to any MS patient who met TAF's financial eligibility criteria, allegedly regardless of which MS drug the patient was taking. Novartis arranged for TAF to open its MS fund at 6:00 p.m. on Friday, December 14, 2012, to have personnel working overtime that night and the following morning submitting applications to TAF on behalf of patients who previously had been receiving free Gilenya from Novartis. Novartis knew that the timing of the opening of the fund and the submission of applications on behalf of Gilenya patients at that time would result in Gilenya patients receiving a disproportionate share of the grants from the fund while it was open. Indeed, after this special application period closed the next day, Novartis confirmed TAF used Novartis funds to provide 374 Gilenya patients with grants for Medicare copay assistance in 2013. Novartis subsequently made further payments to TAF, and TAF provided many of these same Gilenya patients with grants for Medicare copay assistance in 2014.

With respect to NORD, the corruption scheme was equally insidious. Here, the Novartis drug Afinitor was approved for use as a second-line renal cell carcinoma (RCC) treatment only, and only when certain first-line products had failed. Novartis also knew, therefore, that any copay assistance given to patients for initial RCC treatments would not be used to provide copay assistance to patients on Afinitor. Novartis informed NORD that it would be willing to donate to its RCC fund if NORD narrowed the fund's eligibility definition so as not to cover first-line treatments. Novartis wanted the definition narrowed to ensure that a greater amount of its donations would subsidize its product as opposed to others. NORD then created a new fund entitled "Advanced Renal Cell Carcinoma Second Line Co-Payment Assistance Program." This fund excluded any patients seeking assistance with first-line RCC treatments and disproportionally funded patients taking Afinitor compared to its overall usage rate among all RCC drugs. Novartis financed this NORD fund through 2014.

Finally, with respect to CDF, after Afinitor was approved to treat a pancreatic neuroendocrine tumor (PNET),

> "Novartis asked CDF to open a copay assistance fund to pay Afinitor copays for PNET patients. At that time, Novartis knew that the FDA had approved a competing drug to treat PNET. Nonetheless, with Novartis's knowledge, CDF launched a fund labeled 'PNET' that paid the copays of Afinitor patients only and not those of patients seeking assistance for the other PNET drug. Novartis continued with this understanding as the sole donor to this supposed 'PNET' fund through 2014."

Compliance Failures

Rarely in a major multinational does one see such an under-staffed, continually overwhelmed and seemingly impotent compliance function. It appeared Novartis US had no intention of having anything close to an effective compliance program. Their approach is a sobering reminder of the cost of a company wholly disregarding its obligations to have a compliance program. Indeed, the lack of a functioning compliance discipline at Novartis US might even seem to rise to a rare *Caremark* violation by the board. According to the Stipulation, Novartis only created a compliance department in 1999, and for its initial two years, the company's compliance program "consisted of one employee."

Thereafter – although Novartis hired additional compliance personnel in later years – it did not employ sufficient staff to investigate potential Anti-Kickback (AKS) violations. As a result, there was a large backlog of potential AKS violations that needed to be investigated. Because of this backlog and the resulting passage of time, in many cases, Novartis did not investigate potential misconduct at all. The compliance department did not have "the personnel and resources to adequately monitor that the tens of thousands of speaker and roundtable events that Novartis organized throughout the country each year complied with the AKS."

This was as basic as it gets. The compliance function was under-resourced to do the most basic job that could have been assigned to it. There was nothing in the Stipulation or Settlement reflecting on the quality of the compliance department, but it was clear that the compliance department was provided nowhere near enough resources to process the requests which came into it. Even when it came to testing the corporate compliance policy requirements around its physician speaker program, the company "did not conduct a comprehensive field audit of speaker events until 2008, after approximately 90 percent of the events at issue in this case had already occurred. Novartis supervisors and compliance staff attended only a small number of the hundreds of thousands of speaker and roundtable events that Novartis arranged during the relevant period." Moreover, the audits were likely no more than perfunctory examinations, as "sales representatives would typically receive advance notice if their programs were going to be audited."

Yet just how invested was the Novartis US compliance function in actually doing compliance? Or was it more focused on simply looking the other way? Consider the following from the Stipulation: "Novartis' compliance training materials suggested that emails advocating illegal kickbacks were improper in part because they 'reflect[] ignorance of the import of written communications, and put[] the company at risk.' Novartis's Chief Compliance Officer also stated in training presentations, 'if you don't have to write it, don't. Consider using the phone.'"

Let us unpack this quote for a few moments. Here, the CCO was admitting there were emails advocating illegal kickbacks. In legal parlance, that is called *actual knowledge*. So, the CCO had actual knowledge of illegal conduct, and their only advice was to not put it in writing. This was in *compliance* training; not in training on how to engage in illegal kickbacks to help drive our corrupt business model.

Just as in the FCPA world, Novartis US is a recidivist for corruption in the U.S. In 2010, it was put under a corporate integrity agreement (the 2010 CIA), which required the expert to conduct a "year one compliance program effectiveness review" a year after the 2010 CIA went into effect. The Stipulation stated,

> "As part of the review, the expert concluded that Novartis had only 'partially' met its compliance goals in certain areas. For example, the expert concluded that compliance monitoring had still largely remained 'the responsibility of the business [team],' rather than those working in the compliance department, and that Novartis had not 'defined' how that monitoring was to occur or how the business team's findings would be reported to compliance officials. The expert found that there were no written policies or procedures addressing how to conduct investigations of allegations of speaker program abuses and that the reporting of investigative results had not been standardized. The expert also found that Novartis did not consistently undertake 'appropriate disciplinary action' for compliance violations in nontermination cases."

The Novartis US approach to compliance: Incentivize the business folks to engage in violations of the AKS.

If you ask the people who have money to spend (to make sales) to monitor themselves for their own spending where they are evaluated and even compensated on the amount they spend, the results will always be the same. That group will NEVER find that they did anything wrong. That encapsulates the entire Novartis US approach to compliance: Incentivize the business folks to engage in violations of the AKS; then have those same business folks monitor themselves; and, finally, have your compliance function, who knows illegal conduct is going on, tell employees "don't put any evidence of your illegal conduct in emails."

It would seem that Novartis US had their own motto: "What? Me, worry?"

CIA Structural Requirements

Novartis US settled via a CIA for its U.S. illegal actions. A CIA sets out the requirements of an entity settling with the Office of Inspector General (OIG) of the United States Department of Health and Human Services (HHS) to promote compliance with the statutes, regulations and written directives of Medicare, Medicaid and all other federal health care programs and with the statutes, regulations and written directives of the Food and Drug Administration. They are long and detailed documents outlining specific goals and requirements. However, for the non-HCP corporate compliance professional, they provide a wealth of information about some of the most current thinking on a best-practices compliance program and the compliance failures that led to the enforcement action.

Structural Requirements

CCO

The first thing to note is that the CIA runs for a period of five years and requires Novartis US to *hire and retain* a CCO for the pendency of the CIA. Can you imagine ever having to tell an ethical company anything close to "you must hire and keep a CCO for the next five years?" That probably communicates all you need to know about the culture of Novartis US. The CIA also mandates that the CCO shall be a "member of senior management of Novartis; shall report directly to the President of Novartis; and shall not be, or be subordinate to, the General Counsel or Chief Financial Officer of Novartis or any Novartis Affiliate or have any responsibilities that involve acting in any capacity as legal counsel or supervising legal counsel functions for Novartis or any Novartis Affiliate." Finally, Novartis is required to report to OIG any changes in the identity of the CCO or any changes that would affect the CCO's ability to perform the duties or obligations set out in the CIA, within five business days after such a change. Once again, you can see the problem the OIG is trying to remedy.

Compliance Committee

The company is required to create a compliance committee that sits between the CCO and the board of directors. In addition to the CCO, the compliance committee must include other members of senior management from Novartis and its affiliates necessary to meet the requirements of this CIA. This includes senior executives of relevant departments, such as sales, marketing, legal, medical affairs, regulatory affairs, human resources, finance and operations. In addition to supporting the CCO, the compliance committee is required to assist in analyzing risk areas and overseeing the monitoring of internal and external audits and investigations.

Board of Directors

The board of directors has specific responsibilities under the CIA. First and foremost, it is required to hire an independent board director who is a true compliance professional to sit on the board. (Hint: call Keith Darcy now). The board is also mandated to meet at least quarterly to review and oversee the compliance program. It must submit to the "OIG a description of the documents and other materials it reviewed, as well as any additional steps taken, such as the engagement of an independent advisor or other third-party resources, in its oversight of the compliance program and in support of making the resolution below during each reporting period." Significantly, each year the board must adopt a signed resolution, "summarizing its review and oversight of Novartis' compliance with federal health care program Novartis corporate integrity agreement requirements, FDA requirements and the obligations of this CIA."

Compliance Expert and Certifications

The company is required to hire a compliance expert for reporting years two and four. The person must be truly a compliance expert and independent of Novartis US and is subject to approval by the OIG. Equally interestingly, a wide range of Novartis executives must personally certify that their business unit is in "compliance with applicable federal health care program and FDA requirements and with the obligations of [the] CIA." Those required to do so include the Head of Novartis Pharma USA, the Executive Vice President of US Novartis Oncology, the Executive Director of Patient Assistance Programs, the Head of US Business Planning & Analysis, the US Country Lead, the Chief Business Officer, the Chief Medical Officer, the Chief Regulatory Officer, the Chief Financial Officer and the USA General Manager.

The Whistleblower

The following is the tale of the whistleblower who caused all this to happen, Ozzie Bilotta. Bilotta was awarded $109 million for his work in bringing a successful False Claims Act case against Novartis US. According to Gretchen Morgenson on NBC.com, Bilotta felt as if he had gotten his dream job when he got the job at Novartis. He said, "the positions are very competitive — they have thousands of applicants per job. You felt almost honored to have gotten the position." However, he quickly found out that the company was engaged in shady conduct to get doctors to prescribe Novartis drugs.

Bilotta said to Morgenson that almost right away "some things seemed off." Even though Novartis employees knew this type of corruption was illegal, as "Novartis' ethics policy stated that it was a criminal offense to offer payments or inducements to prescribe its drugs," Bilotta said that "keeping high-prescribing doctors happy was an intense focus at Novartis. At meetings with higher-ups, sales representatives would get hundreds of dollars in American Express gift checks to present to doctors."

Moreover, the corrupt culture at Novartis US only got worse during the time Bilotta was with the company. Morgenson noted, "as the years progressed, talk grew among pharmaceutical sales representatives about other drug companies' buying big-ticket items for doctors — covering the cost of a swimming pool was one rumor Bilotta recalled. Some physicians started asking for more — a television for the waiting room, a donation to a child's graduation. A top prescriber demanded that Novartis hire his son, which it did. The son didn't last long on the job, Bilotta said."

All of this will sound very familiar to any compliance professional who deals with the FCPA. Indeed, one needs only to look at the Novartis FCPA enforcement action to see that employees outside the U.S. were told that corruption was illegal, yet the company turned a very blind eye to it, or worse, actively led it, both inside and outside the U.S.

As the decade proceeded, Novartis US grew more brazen about corruption. It became more than routine; it became mundane. Bilotta said, "I saw things evolve. We went from a strictly product focus to one that is more about incentivizing." This is the functional definition of paying money to get a result. It was so brazen (and mundane at the same time) that "every quarter, Novartis would require its sales representatives to spend a budgeted amount, say, $5,000 apiece, on doctor speaker programs, Bilotta said. The funds were allocated immediately." If a sales representative did not pay out all the allocated funds, "there'd be hell to pay. 'I had situations where my sales were good and for some reason, I didn't spend all my money, and they would threaten my job…' They had a specific return on investment they attached to the money they spent." Nothing like incentives to pay bribes.

Then the company began its doctor speaker programs, through which "the company paid physicians to educate other practitioners about a drug's merits. But some of the drugs Bilotta sold had been around for years and were well-known, making it clear to him that the events were simply a payment system, he said. At the vast majority of the programs, small talk dominated and the drugs weren't mentioned… 'They wanted to have the veneer of conveying medical knowledge,' he said. 'But how much education on these old drugs do you need? I'd be stunned if 10 percent of the programs were legitimate.'"

The end came for Bilotta in 2010 when he went to a supervisor about the corrupt conduct. Nothing happened, so Bilotta "decided to contact whistleblower lawyers. By early 2011, he'd been debriefed by law enforcement, and before he filed suit, he began wearing a wire to record conversations with six doctors in his territory. Two took $500 each in cash, and the others confirmed receiving prior inducements or being willing to do so in the future." It was at this point that it all became very real for Bilotta. He eventually had to move from his home in New York after his name was revealed and he and his family were targeted with death threats.

Now that he has gone through the process, Bilotta says "he wants to work to change health care practices and laws that harm patients and taxpayers. Allowing the reimportation of drugs and letting the government negotiate drug prices would save taxpayers tens of billions of dollars, he said, and he plans to work on promoting those changes. 'My intention is to keep this good momentum up and benefit the taxpayers,' he said."

About the ordeal he and his family went through, "he said the process isn't for everyone. 'It is not an easy road — it's very psychologically taxing,' Bilotta said. 'You have to be very sincere in what you're doing and be prepared to be opened up to a tremendous amount of scrutiny. Go with your convictions, but if you're doing it for financial gain, it's a mistake.'"

The U.S. government and all its citizens owe a heartfelt *thank you* to Ozzie Bilotta.

Final Thoughts

The FCPA enforcement action was made worse because Novartis AG is a recidivist, having entered into a resolution in 2016 with the SEC for bribery and corruption in the company's Chinese business unit. In addition to joining the ignoble class of FCPA recidivists, Novartis AG somehow missed identifying years of bribery and corruption in Greece, Vietnam and Korea while allegedly investigating the corruption conduct in China. It would certainly appear that not only did Novartis AG put sales, sales, sales above any semblance of compliance, but it also had a culture of corruption baked into the organization so that it would seek out to make corrupt payments to HCPs for starting to and continuing to prescribe Novartis AG drugs.

Indeed, the prescriptions written were the "return on investment" of illegal payments to HCPs. According to the SEC Order, the corrupt payment schemes were in violation of the company's compliance policies. But more than simply violating the company's internal compliance policy of the prohibition of paying bribes, the business units routinely side-stepped the company's compliance oversight process by engaging in the bribery schemes without required authorization. It was a complete, total and utter evisceration of the corporate compliance function by the business unit.

As many compliance lessons as there are to be garnered from the FCPA and False Claims Act actions, I find there to be one overriding lesson: It really does all start with tone at the top. Clearly, Novartis top management in both Switzerland and the U.S. had no intention of letting a little compliance get in the way of making money. With this clear message from top management, the company's compliance function had zero chance of success of preventing, detecting or remediating illegal conduct. It was simply baked into the DNA of the company.

And never forget the cherry on top: Novartis was the company that had chief executive and general counsel approval to hire convicted felon Michael Cohen to lobby the Trump Administration. ◆

Goldman Sachs: The Largest FCPA Enforcement Action Ever

A resolution in the largest FCPA corruption scandal ever was announced in October involving The Goldman Sachs Group, Inc. (Goldman Sachs) and its subsidiary Goldman Sachs (Malaysia) Sdn. Bhd. (GS Malaysia). According to the DOJ press release,

> "[The company and its subsidiaries] admitted to conspiring to violate the Foreign Corrupt Practices Act (FCPA) in connection with a scheme to pay over $1 billion in bribes to Malaysian and Abu Dhabi officials to obtain lucrative business for Goldman Sachs, including its role in underwriting approximately $6.5 billion in three bond deals for 1Malaysia Development Bhd. (1MDB), for which the bank earned hundreds of millions in fees. Goldman Sachs will pay more than $2.9 billion as part of a coordinated resolution with criminal and civil authorities

in the United States, the United Kingdom, Singapore, and elsewhere."

Introduction

According to the New York Times DealBook, the resolution was a part of a series of global settlements, with "detailed accounts compiled by regulators around the world — the U.S. Justice Department, New York's financial regulator, the Federal Reserve (the Fed), the SEC, British watchdogs and securities regulators in Hong Kong and Singapore." Acting Assistant Attorney General Brian Rabbit noted the monetary fines broke down as follows:

Country	Regulatory Authority	Amount	Settlement Agreement
U.S.	DOJ	$1,263B in criminal penalty	DPA
U.S.	SEC	$400M (credit for $606M in disgorgement)	Cease-and-desist order
U.S.	The Fed	$154M	Cease-and-desist order
U.K.	Financial Conduct Authority (FCA)	$63M	Final notice
U.K.	Bank of England Prudential Regulation Authority (PRA)	$63M	Final notice
Hong Kong	Securities and Futures Commission (SFC)	$350M	Statement of disciplinary action
Singapore	Monetary Authority of Singapore	$122M	Direction under Section 101 of the Securities and Futures Act
Singapore	Commercial Affairs Department	$61M in disgorgement	Conditional order
State of NY	Department of Financial Services (DFS)	$150M	Consent order

Goldman Sachs entered into a DPA with the DOJ in connection with a criminal information filed in the Eastern District of New York charging them with conspiracy to violate the anti-bribery provisions of the FCPA. GS Malaysia pleaded guilty in the U.S. District Court for the Eastern District of New York to a one-count criminal information charging it with conspiracy to violate the anti-bribery provisions of the FCPA.

According to Acting U.S. Attorney Seth D. DuCharme of the Eastern District of New York, the conduct involved three bond offerings made by 1MDB.

> "Over a period of five years, Goldman Sachs participated in a sweeping international corruption scheme, conspiring to avail itself of more than $1.6 billion in bribes to multiple high-level government officials across several countries so that the company could reap hundreds of millions of dollars in fees, all to the detriment of the people of Malaysia and the reputation of American financial institutions operating abroad."

The first was Project Magnolia where, in early 2012, Jho Low, Timothy Leissner and Roger Ng with the assistance of Goldman Sachs, assisted 1MDB in issuing $1.75 billion in bonds guaranteed by an entity wholly owned and controlled by the government of Abu Dhabi. After Project Magnolia closed in May 2012, more than $500 million of the bond proceeds were allegedly misappropriated and diverted from 1MDB through numerous wire transfers to bank accounts in the name of shell companies beneficially owned and controlled by Low, Leissner, Ng and others.

The second and third were Projects Maximus and Catalyst, which were bond offerings in which Goldman handled the bond offering. These transactions generated substantial fees and revenues for Goldman Sachs. As alleged – although both transactions were designed to raise more than $4 billion for 1MDB's investment and development projects – Low, Ng, Leissner and others used the transactions to further the criminal scheme, ultimately laundering hundreds of millions of dollars of diverted funds into bank accounts beneficially owned and controlled by them. This included laundering money in the U.S. by buying luxury residential real estate in

New York City and elsewhere, by purchasing artwork from a New York-based auction house and by funding major Hollywood films, including "The Wolf of Wall Street."

While Goldman Sachs originally claimed Leissner and Ng were the ubiquitous "rogue employees," under the DPA and Information,

> "Goldman also admitted that, although employees serving as part of Goldman's control functions knew that any transaction involving Low posed a significant risk, and although they were on notice that Low was involved in the transactions, they did not take reasonable steps to ensure that Low was not involved. Goldman further admitted that there were significant red flags raised during the due diligence process and afterward — including but not limited to Low's involvement — that either were ignored or only nominally addressed so that the transactions would be approved and Goldman could continue to do business with 1MDB. As a result of the scheme, Goldman received approximately $606 million in fees and revenue, and increased its stature and presence in Southeast Asia."

Control Failures

What were the failures of internal controls that lay at the basis of the SEC Order? Before we get to those failures, I want to detail some of the things the Goldman Sachs compliance function got right. It was around the myriad attempts by self-admitted FCPA felon and former Goldman Sachs partner Timothy Leissner to have Jho Low approved into the Personal Wealth Management (PWM) program. According to the DPA, "Leissner and [Goldman Sachs Managing Director Roger] Ng also attempted to onboard Low as a Goldman client, or otherwise work with Low, on numerous occasions in or about and between 2009 and 2013."

Each of these attempts was rejected by the Goldman Sachs compliance function. In the first instance, a member of the firm's Business Intelligence Group (BIG) wrote, "I do not believe we will ever be able to get comfortable with this matter. I'd like to shut this down once and for all ... It is seldom that one sees a vendor report, which has been backed up verbally by them, that so clearly states that we should exercise extreme caution." Later attempts brought the same result. "In early 2011, Leissner tried to onboard two of Low's companies as clients of Goldman but was unable to do so due to compliance's continued objections to Low."

Not being deterred one iota, Leissner made an additional attempt to bring Low on as a PWM client through Goldman's Singapore office without referencing the prior attempt. Low was again denied due to (among other things) his questionable source of wealth. In a March 11, 2011 email chain discussing the attempt, a high-ranking employee in compliance and MD noted, "To be clear, we have pretty much zero appetite for a relationship with this individual," and a high-ranking employee in BIG and MD expressed, "this is a name to be avoided."

However, when it came to the three bond transactions at issue – Project Magnolia, Project Maximus and Project Catalyze – the Goldman Sachs due diligence fell apart. For deals of this nature, Goldman Sachs had three committees review each deal: (1) The Goldman Sachs Capital Committee (GSGC), (2) Firmwide Capital Committee (FWCC) and (3) BIG. Both the company's compliance function and FWCC had representatives on the FWCC.

In the due diligence done on Project Magnolia, employees within Goldman's control functions suspected that Low was involved in the deal, yet "the only step taken by the control functions to investigate that suspicion was to ask members of the deal team whether Low was involved and to accept their denials without reasonable confirmation." There was no independent verification of the information provided by the deal team. Leissner repeatedly lied to anyone internally who asked if Low was involved in Project Magnolia. Yet apparently Goldman Sachs control personnel knew that Leissner was not telling them the truth, with one unnamed employee stating, "Important we have no role on our side for Low and we should ask that any payments from any of [the] participants to any intermediaries are declared and transparent." The deal was approved internally by Goldman Sachs.

In Project Maximus, both "Leissner and Ng understood and intended that Low and others would pay bribes and kickbacks to influence Malaysian and Abu Dhabi officials to obtain the necessary approvals to execute the Project Maximus bond offering." Moreover,

> "Once again, Goldman's control functions simply accepted at face value the representations of the deal team members and failed to further investigate Low's suspected involvement in this bond deal. For example, on or about June 20, 2012, a member of Goldman's control functions asked members of the deal team, 'Is Jho Low involve[d] in this transaction? Please also keep us posted if there are any other politically exposed person involve[d] in this transaction in a non-official capacity.' A deal team member responded 'no.'"

Finally, "Despite their continued concern, as evidenced by their repeated questions, Goldman's control functions did not engage in electronic surveillance of Leissner's correspondence or activities to determine whether Low was involved in the deal."

The same pattern presented itself with Project Catalyze. The SEC Order stated, "Goldman's control functions had continued suspicions that Low was working on the third bond deal. Once again, however, the control functions relied solely on the deal team members' denials of Low's involvement without any further scrutiny." This was the third bond deal in less than 20 months, all in 2012. This obvious red flag was never investigated, let alone cleared.

What makes these control failures in the three bonds deals stand out so much is that Goldman Sachs not only knew who and what Low was, but the company itself had investigated him. Further, according to the state of New York's DFS consent order, Goldman Sachs had a single, enterprise-wide compliance function. Yet it appears that the information that was developed by the compliance function when Leissner sponsored Low to become a PWM client seemingly did not make its way to the GSCC, FWCC or BIG.

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Fines and Penalty

One of the conundrums from this enforcement action is the total amount of the fines and penalties. In his press conference, Acting Assistant Attorney General Brian C. Rabbitt announced the following fines:

- Total: $2.921 billion
- DOJ: $1.263 million
- SEC: $400 million, with $606 million in disgorgement credited to monies previously paid to the country of Malaysia
- The Fed: $154 million

Neither of these amounts were spelled out in the DOJ press release or the release of Rabbitt's written remarks.

Rabbitt went on to say that these amounts added up to $2.2 billion and the difference between the total amount of $2.921 billion and this $2.2 billion was made up of other fines and penalties which Goldman Sachs paid and received a credit for. However, as Harry Cassin noted, "the FCPA Blog found no apparent basis for that value."

All this means it is not entirely clear what the total amount paid to the U.S. or credited by the U.S. is for Goldman Sachs. We can all agree that it was a very large amount.

The penalty was based on the following under the FCPA Corporate Enforcement Policy. Goldman Sachs did not self-disclose the conduct at issue, hence it did not receive any credit for self-disclosure. The DPA revealed the following. Goldman Sachs received partial credit for its cooperation with the DOJ investigation of the underlying conduct, including: collecting and producing voluminous evidence located in other countries; making regular factual presentations and investigative updates to the Offices; and voluntarily making foreign-based employees available for interviews in the U.S.

Yet even with this partial cooperation credit, the DPA noted,

> "The Company did not receive full credit for its cooperation because the Company was significantly delayed in producing relevant evidence, including recorded phone calls in which the Company's bankers, executives, and control functions personnel discussed allegations of bribery and misconduct relating to the conduct set forth in the Statement of Facts."

Eventually, Goldman Sachs got the message to quit fighting the government (probably impressed on them by their outside counsel), as "the Company ultimately provided to the Offices all relevant facts known to it, including information about the individuals involved in the misconduct."

Goldman Sachs also eventually got the message that it had to move past its paper compliance program, which had allowed the illegal conduct. The DPA noted,

> "Ultimately Goldman Sachs engaged in remedial measures, including (i) implementing heightened controls and additional procedures and policies relating to electronic surveillance and investigation, due diligence on proposed transactions or clients and the use of third-party intermediaries across business units; and (ii) enhancing anti-corruption training for all management and relevant employees."

Moreover, Goldman Sachs' commitment to the DOJ was recorded as follows:

> "The Company has committed to continuing to enhance its compliance program and internal controls, including ensuring that its compliance program satisfies the minimum elements set forth in Attachment C to this Agreement (Corporate Compliance Program)."

Goldman Sachs did receive a huge benefit from finally getting that message, as "based on the Company's remediation and the state of its compliance program, and the Company's agreement to report to the Offices as set forth in Attachment D, the Offices determined that an independent compliance monitor is unnecessary."

All of this led the DOJ to conclude,

> "The appropriate resolution in this case is a deferred prosecution agreement with the Company; a criminal monetary penalty of $2,315,088,000, which reflects an aggregate discount of ten (10) percent off of

the bottom of the otherwise-applicable Sentencing Guidelines fine range for the FCPA conduct; disgorgement of $606 million; and a guilty plea by Goldman Malaysia."

So, where does the DOJ penalty of $1.263 billion come from? According to the DPA,

> "The Offices agree to credit the remaining amount of the Total Criminal Penalty against the amount the Company pays to the SEC, Fed, DFS, UK FCA and PRA, Singapore AGC, Singapore CAD and Hong Kong SFC. The Offices will credit the entire penalty amount that the Company pays to the SEC, Fed, DFS, UK FCA and PRA, Singapore AGC and Singapore CAD, as well as $100 million of the penalty the Company pays to Hong Kong SFC, in connection with parallel resolutions entered into between the Company and those authorities."

These amounts were:

Country	Agency	Amount
U.S.	SEC	$400M (credit for $606M in disgorgement)
U.S.	The Fed	$154M
U.K.	Financial Conduct Authority (FCA)	$63M
U.K.	Bank of England Prudential Regulation Authority (PRA)	$63M
Hong Kong	Securities and Futures Commission (SFC)	$350M
Singapore	Monetary Authority of Singapore	$122M
Singapore	Commercial Affairs Department	$61M in disgorgement
State of NY	Department of Financial Services (DFS)	$150M
		Total: **$1.363B**

Since I still cannot make all the DOJ numbers work, I will simply have to leave it at that.

Avoiding a Monitor

In the DPA, Goldman Sachs stressed its commitment to the DOJ (and probably the other government regulators) to enhance its compliance program and internal controls. And Goldman Sachs received a huge benefit as a result when the DOJ determined that an independent compliance monitor was unnecessary.

One might think – after not self-disclosing, denying the firm had done anything wrong and claiming high-level rogue employees – that Timothy Leissner and Roger Ng had deceived the firm (see Goldman Sachs November 2018 10-Q statement) or that low-level compliance functionaries had failed to do their jobs and uncovered the massive fraud and that a corporate monitor was appropriate. However, mounting a vigorous defense (even if both wrong and wrong-headed) is no longer the criteria for a monitor.

The test is now found in the Benczkowski Memo. The Memo notes that factors to consider from the compliance program remediation perspective include "whether the corporation has made significant investments in, and improvements to, its corporate compliance program and internal controls system and … whether remedial improvements to the compliance program and internal controls have been tested to demonstrate that they would prevent or detect similar misconduct in the future."

But the Memo does not stop there in prescribing the inquiry a DOJ prosecutor should make. Other factors include whether remedial actions were taken against those involved and those who may have looked the other way or through inaction, effectively overriding internal controls. Further, the DOJ prosecutors have to drill down and look at the risk each company is facing, including assessments of the industry the company operates in, the geographic regions it does business in, how the company does business and the "nature of the company's clientele."

This section of the Memo ends with "where a corporation's compliance program and controls are demonstrated to be effective and appropriately resourced at the *time of resolution*, a monitor will not be necessary."

The first part requires a look at remedial actions taken by Goldman Sachs. Prior to his indictment, the Goldman Sachs mastermind, Leissner, had resigned from the firm. Ng was fired when he was indicted. Finally, although not indicted (as of yet) former Goldman Sachs banker Andrea Vella was put on leave in November 2018 and left the firm after being banned by the Federal Reserve System in February 2020 over his alleged involvement in the 1MDB scandal. It is not clear if the departure of the former head of Goldman Sachs, Lloyd Blankfein, was in any way related to the 1MDB scandal. So at least some persons were sanctioned or left Goldman Sachs.

But more than simply termination, the board of directors announced it was seeking clawbacks and engaging in holdbacks of compensation in not only those involved, but also a group in senior management as well. In a press release, the board noted the firm has undertaken clawbacks as to Leissner, Ng and Vella. The amounts the firm is seeking to forfeit from these individuals total approximately $76 million, of which the firm is currently holding approximately $24 million.

Separately,

> "Five of the Firm's former senior executive officers, the former Chief Executive Officer, the former Chief Operating Officer, a former Chief Financial Officer, the former Vice Chairman who was a CEO of Goldman Sachs International and the former Vice Chairman who was the Global Head of Growth Markets, will, to the extent not already paid, forfeit all or the majority of their outstanding Long-Term Performance Incentive Plan Awards that were granted in 2011 and which have a performance period that includes 2012

> and 2013 when the 1MDB bond underwritings took place, and forfeit a portion of other previously awarded compensation, if applicable."

Finally, the board found it "*appropriate* that the current executive leadership team, the Chief Executive Officer, the Chief Operating Officer and the Chief Financial Officer, as well as the current CEO of Goldman Sachs International, have their overall compensation reduced by $31 million for 2020."

What has Goldman Sachs done to demonstrate that, at the time of resolution, its compliance program and internal controls were effective and appropriate resourced?

These clawbacks, holdbacks and compensation reductions will total approximately $174 million in the aggregate.

What has Goldman Sachs done to demonstrate that, at the time of resolution, its compliance program and internal controls were effective and appropriate resourced? In the same press release, David Solomon, current Goldman Sachs Chief Executive Officer (CEO), said about the improvements to the compliance function:

> "These improvements include re-designing our framework for addressing reputational risk, including the creation of a Firmwide Reputational Risk Committee that is made up of predominantly control-side members who are empowered to stop any transaction. More broadly, since the 1MDB transactions eight years ago, our Global Compliance Division has nearly doubled in size.

> More recently, we imposed additional conditions for sovereign-related financings, including requiring certifications from certain government bodies on the use of proceeds within six months of a transaction closing and subjecting these transactions to review by an independent team of bankers. In addition, we have created a Compliance Forensics Program that ensures forensic reviews focusing on people, places, events and processes that could present risk. Related to this effort, we established an Insider Threat Program that leverages enhanced surveillance analytics to prevent and detect potentially harmful action by employees."

The Remediation

Released as a part of the press release, Goldman Sachs laid out with some detail the "completed and ongoing enhancements since the 1MDB transactions." After the company finally awoke and realized they were in serious FCPA hot water, they began designing a best practices compliance program. Initially, Goldman Sachs focused on the processes surrounding review and approval of complex transactions, including the heightened risk of reputational consequences that such transactions bring. Specifically, Goldman Sachs focused on:

- "Ensuring that we have sufficient controls to prevent business considerations from overriding control-side concerns
- Increasing the understanding of employee responsibility to escalate signs of inappropriate behavior or control transgressions
- Requiring additional focus on the review of transactions that might cause reputational risk

- Improving documentation and evidence of the committee discussions regarding transactions that might cause reputational risk

- Addressing transactions that might have reputational risks early enough to reduce the possibility of momentum 'carrying them over the line'

- Ensuring additional focus on transactions with large, 'day-one' P&Ls, and/or those deemed 'significant and complex'"

From this base starting point, Goldman Sachs made additional enhancements, which included:

- "Exercising heightened scrutiny of senior level people engaged in high-risk areas, business or products

- Reviewing the firm's committee structure to ensure it is fit for purpose

- Ensuring greater focus and additional actions when 'red flags' are identified

- Further developing targeted e-communication surveillance based on new emerging technology

- Improving training on compliance responsibilities firmwide

- Enhancing the firm's systems and controls to prevent and detect money laundering and bribery-related behavior by the firm and its clients"

Goldman Sachs also put in some specific controls in both the anti-corruption and anti-money laundering (AML) arenas. In the area of anti-bribery and anti-corruption controls, Goldman Sachs worked to enhance the firm's systems and controls to prevent and detect bribery- and corruption-related behavior. Regarding insider threats, the firm developed a program to monitor employee behavior that could cause reputational or financial harm to the firm, its employees or its clients. The firm also required additional focus on transactions that might cause reputational risk and significant and complex transactions.

The firm put in place a heightened scrutiny of senior-level people engaged in high-risk areas, businesses or products to provide another set of eyes on high-risk transactions. The firm will increase its reliance on data analytics to uncover anomalies by improving and increasing the use of data and metrics within the corporate compliance function. Goldman Sachs has put in additional backstops to prevent business unit control override by ensuring sufficient controls to prevent business considerations from overriding control-side concerns.

The authority of the compliance function within Goldman Sachs was enhanced by ensuring the corporate compliance function has the proper stature and empowerment to properly challenge the operations folks. For the additional oversight on high-risk transactions, Goldman Sachs has worked to improve the documentation and evidence of committee discussions regarding transactions that might cause reputational risk.

The firm will move to a more proactive stance with early intervention on high-risk transactions to address transactions that might have reputational risks early enough to reduce the possibility of momentum "carrying them over the line." Red flags will be given a higher priority for clearance by ensuring greater focus and additional actions when "red flags" are identified. Finally, there is a renewed escalation process to increase the understanding of employee responsibility to escalate signs of inappropriate behavior or control transgressions.

In the area of AML, Goldman Sachs will enhance the firm's systems and controls to prevent and detect money laundering by the firm and its clients. This will include refining the firmwide suitability committee charter to require all large "day-one" P&Ls to be specifically reviewed, encouraging a more "speak up" culture.

All of these are certainly good starting points, but they will only work if Goldman Sachs makes a commitment to a cultural change of doing business ethically and in compliance. Obviously, this starts at the very top of the organization and, at least now, the Chief Executive Officer (CEO), David Solomon, and the firm's board of directors are *saying* the right things. But the proof will be in the pudding the next time a deal similar to 1MDB pops up on the firm's radar and whether senior management overrides the existing internal controls and/or the corporate compliance function.

One might think that a $5 billion fine and penalty would be enough to get the firm's attention. We can only hope so at this point.

Timothy Leissner

Now let us consider he most prominent Goldman Sachs person involved in the 1MDB fraud and corruption, firm partner Timothy Leissner. According to the SEC cease-and-desist order (Order),

> "Leissner knowingly circumvented those internal accounting controls that Goldman Sachs had in place and caused the company's books, records and accounts to be falsified through the misrepresentations that he made to Goldman Sachs's executives and committees. Leissner's conduct caused Goldman Sachs to improperly record in the 1MDB bond documents payments that it made in connection with the bond deals."

Jho Low

The financier and architect of the massive 1MDB scandal was Jho Low. Early on in the formation of 1MDB, Low began working with Leissner, Roger Ng and others at Goldman Sachs. Leissner put Low forward to be a Goldman Sachs client, but the three attempts to do so were all rebuffed by the Goldman Sachs compliance group and legal function.

> "Their refusal was based, in part, on concerns that these groups had concerning the source of Low's wealth. Personnel within the Compliance Group and the Intelligence Group communicated the rejection of Low's application to Leissner and others within Goldman Sachs."

Thereafter, during the times when Leissner was working on behalf of Low to have Goldman Sachs make bond offerings to raise funds for 1MDB, "Low also specifically requested that Leissner, Ng and others conceal his involvement in Goldman Sachs's business."

The Bond Deals

According to the Order,

> "Goldman Sachs's written policies required bankers who submitted transactions to [Goldman Sachs] Committees for approval, such as Leissner, to broadly disclose information relevant to the matters at issue, including 'a full assessment of the transaction risks.' Nevertheless … Leissner selectively concealed from other employees of Goldman Sachs, including the [Goldman Sachs] Committees and their members, that he was working with Low as an intermediary to secure the deals. Leissner did this in an effort to avoid potential heightened scrutiny of the bond deals

> by the GS Committees, the Compliance Group or the Intelligence Group."

Leissner facilitated three bonds deals through Goldman Sachs, each time circumventing the firm's internal controls through both the withholding of and supply of false and misleading information to the appropriate approval groups within Goldman Sachs.

Project Magnolia

The bond offering was allegedly to facilitate the purchase of a Malaysian energy company. To secure the bond offering, Goldman Sachs required it be guaranteed by a third party. Low proposed an Abu Dhabi sovereign wealth fund but explained,

> "… in order to secure the guarantee from the Middle Eastern Sovereign Wealth Fund discussed at the prior meeting with Leissner and others, they would have to pay bribes and kickbacks to government officials, including to certain officials in Malaysia and Abu Dhabi. After the February 2012 meeting, Leissner discussed this information with other senior executives of Goldman Sachs."

The bond deal went ahead and was funded to the tune of $1.75 billion. Interestingly, when it came time for actual funding,

> "Goldman Sachs's documentation of the wire transfer – including a signed payment authorization and instruction, an executed agreement between Goldman Sachs and its client and the Project Magnolia offering circular (collectively, the 'Magnolia Bond Documents') – falsely stated that the proceeds would be used only to pay for the acquisition of Malaysian En-

> ergy Company A or for 'general corporate purposes.' Leissner knowingly caused these records to be false."

Part of the proceeds were funneled to shell companies, which paid bribes to corruption Malaysian and Abu Dhabi officials.

Project Maximus

This bond offering was designed to raise funds to purchase a Malaysian power generation company. This bond deal was structured similarly to Project Magnolia, only with an indirect guarantee from the Middle Eastern Sovereign Wealth Fund. Although the Middle Eastern Sovereign Wealth Fund did not provide a direct financial guarantee of the Project Maximus bonds, as it had with Project Magnolia, it nevertheless agreed to privately secure the bonds on a bilateral basis with Goldman Sachs.

Of course, as with Project Magnolia, Leissner and others continued to work with Low to acquire this business for Goldman Sachs, but Leissner took his internal misrepresentation to a new level. As part of the internal approval process, in a meeting specifically convened to consider Project Maximus,

> "Leissner was directly asked whether Low was involved in Project Maximus. Leissner told the [Goldman Sachs] Committee affirmatively that Low was not involved in Project Maximus, though Leissner and other senior executives of Goldman Sachs knew at the time that this statement was false."

Once again, when it came time to transfer the proceeds from the bond sale, which totaled nearly $1.75 billion, the sign-off documents "falsely stated that the bond proceeds would be used solely to pay for the acquisition of Malaysian Energy Company B or for 'general corporate purposes.' Leissner knowingly caused these records to be false."

Project Catalyze

This was a bond offering designed to fund 1MDB's portion of a joint venture with a Middle Eastern Investment Firm. Leissner was now directly in on the bribery schemes from the prior projects as the Order noted, "although required by internal compliance policies of Goldman Sachs, Leissner failed to disclose that (a) he had received a portion of the funds diverted from the prior bond transactions via Low and (b) that Leissner, Low and others paid bribes and kickbacks to 1MDB officials and others who were involved in the transactions."

Once again, when it came to funding the bond offering,

> "Goldman Sachs's documentation of the transaction – including a signed payment authorization and instruction, an executed agreement between Goldman Sachs and its client, and the Project Catalyze offering circular (collectively, the 'Catalyze Bond Documents') – falsely stated that the bond proceeds would be used solely to fund Malaysia's contribution to a joint venture investment vehicle with Abu Dhabi or for 'general corporate purposes.' Leissner knowingly caused these records to be false."

What were Leissner's specific legal violations, and what lessons may be garnered for the compliance professional? They were laid out in the Information filed against Leissner. Leissner was a partner at Goldman Sachs, a U.S. company. He was pretty high up in the organization. What his actions mean for Goldman Sachs is, at this point, still an open question.

Leissner himself "made use of interstate commerce by, among other things, sending wire transfers from a foreign bank account to a U.S. bank account in furtherance of his corrupt offers and promises to bribe foreign officials, through which Leissner intended that the officials would use their official positions to assist Goldman Sachs in obtaining the bond deals and other business."

He also worked to actively conceal "information from financial, legal and compliance executives, including by making misstatements to these executives regarding Low's role as an intermediary in the bond deals." This knowing circumvention of the company's internal controls caused Goldman Sachs books and records to be falsely recorded.

It is certainly one issue to have employees bending rules to get around them, but it is an entirely different one to have partners who will lie, cheat and steal.

These actions break down into violation of the FCPA by paying or facilitating the payment of bribes, circumvention of internal controls and falsification of books and records. Based on these actions and Leissner's conduct, what can the compliance professional glean that can be used to improve a corporate compliance program going forward? It is certainly one issue to have employees bending rules to get around them, but it is an entirely different one to have partners who will lie, cheat and steal.

It all starts with the folks you hire and promote to senior leadership positions or, in the case of Goldman Sachs, to the partnership.

This is why character really does matter in such things. If someone cuts corners early in their career, they are far more likely to do so as they rise up the corporate ladder. It also demonstrates that there must be a compliance evaluation when an employee is promoted to senior management or, in a company like Goldman Sachs, to partner. Even if they have great metrics around revenue, if they do not have the ethical grounding, it does not matter what type of producer they are; they will eventually cost the company.

Goldman Sachs made nearly $600 million in profits from its three bond sales involving 1MDB. The Malaysian government wants that money returned, claiming it is ill-gotten gain (profit disgorgement), and Goldman Sachs has been charged criminally in that country. The company is also facing an FCPA enforcement action here in the U.S. The costs for Goldman Sachs promoting Leissner into its partnership ranks will be far higher than any amount of revenue he generated for the firm.

The next lesson is around Leissner's specific conduct of misrepresentations to both the company's compliance and legal functions. When it came to considering the Project Maximus bond offering, according to the Order, Leissner was asked directly whether Low was involved in Project Maximus, and he responded in the negative, knowing all the while that the statement was false." What is a compliance professional to do in this situation?

The first answer is to be found in the part of the language, which reads "and other senior executives of Goldman Sachs knew at the time that this statement was false."

Your first line of defense is other senior executives who know information is false and misleading and then say so. If not immediately, then privately, later. This means not only effective training, but also real leadership from the top of the organization, stressing that it will not tolerate inappropriate and illegal behavior and that it is incumbent on everyone to speak up and stop it. Unfortunately, under CEO Blankfein, such leadership was apparently lacking.

Another lesson calls to mind "the eyes of Doctor. T. J. Eckleburg" (how's that for cross-cultural metaphor?), the optometrist whose billboard advertising was a prominent feature of "The Great Gatsby," where the "eyes" watched Tom drive into New York City for his trysts with his mistress. Every process must have a second set of eyes.

You might call it *"trust, but verify."* There must be a mechanism to verify that the information provided is accurate. Goldman Sachs was already on notice about Jho Low and his involvement with 1MDB. Leissner had three times pushed for him to become a client of the firm, but he could not pass due diligence, as he could not demonstrate the source of his wealth. Leissner's tale is a sordid one.

Jho Low Forfeiture Agreement

As reported by Byron Tau and Aruna Viswanatha in the Wall Street Journal,

> "Jho Low, the businessman-turned-fugitive accused of masterminding a multibillion-dollar fraud involving Malaysia's sovereign-wealth fund, agreed to forfeit more than $700 million in assets U.S. authorities sought to seize, according to a settlement filed Wednesday. Mr. Low will give up assets that include real estate, a luxury yacht and a private jet, according to the settlement, which doesn't resolve the criminal cases against the Malaysian businessman or include any admission of wrongdoing by him."

Khadim Shudder, reporting in the Financial Times (FT) noted,

> "The settlement, the largest civil forfeiture ever agreed by the justice department, fully resolves 10 lawsuits brought by the DOJ as it sought to recover cash allegedly stolen from 1MDB, Malaysia's government investment fund. It marks the latest step toward a resolution of a multibillion-dollar corruption scandal that rocked Malaysia and implicated Goldman Sachs." It included assets located in the U.S., U.K. and Switzerland.

The DOJ press release announcing the settlement stated,

> "With the conclusion of this settlement, together with the prior disposition of other related forfeiture cases, the United States will have recovered or assisted in the recovery of more than $1 billion in assets associated with the 1MDB international money-laundering and bribery scheme. This represents the largest recovery to date under the Department's Kleptocracy Asset Recovery Initiative and the largest civil forfeiture ever concluded by the Justice Department."

Assistant Attorney General Brian A. Benczkowski of the Justice Department's Criminal Division noted,

> "As alleged in the complaints, Jho Low and others, including officials in Malaysia and the United Arab Emirates, engaged in a brazen multi-year conspiracy to launder money embezzled or otherwise misappropriated from 1MDB, and he used those funds, among other things, to engage in extravagant spending sprees, acquiring one-of-[a-]kind artwork and luxury real estate, gambling freely at casinos and propping up his lavish lifestyle. This settlement agreement forces Low and his family to relinquish hundreds of millions of dollars in ill-gotten gains that were intended to be used for the benefit of the Malaysian people, and it sends a signal that the United States will not be a safe haven for the proceeds of corruption."

Interestingly, even Jho Low himself was enthusiastic about the settlement, releasing his own statement about the settlement. In a letter sent to MalaysianInsight.com he stated,

> "I am very pleased to confirm that a landmark comprehensive, global settlement has been reached with the United States government, which fully and for-

> ever resolves in their entirety each of the U.S. government's civil, criminal and administrative actions or proceedings relating to the defendant assets at issue in the Central District of California. The historic agreement builds on a series of successful prior agreements negotiated with the U.S. Department of Justice and is the result of good faith discussions between the parties. Importantly, the agreement does not constitute an admission of guilt, liability or any form of wrongdoing by me or the asset owners. We believe all parties consider this resolution, which is subject to final court approval, to be a successful and satisfactory result."

Regarding that final point, the DOJ had a very different interpretation on the settlement. Their press release said,

> "Low separately faces charges in the Eastern District of New York for conspiring to launder billions of dollars embezzled from 1MDB and for conspiring to violate the Foreign Corrupt Practices Act (FCPA) by paying bribes to various Malaysian and Emirati officials, and in the District of Columbia for conspiring to make and conceal foreign and conduit campaign contributions during the United States presidential election in 2012 … This agreement does not release any entity or individual from filed or potential criminal charges."

In addition to the scope of the resolution brought by the DOJ's Kleptocracy Asset Recovery Initiative in the Criminal Division's Money Laundering and Asset Recovery Section, there is one other keynote for the compliance practitioner or white-collar defense lawyer. As noted in the DOJ press release by Don Fort, Chief of IRS Criminal Investigations, "This case is a model for international cooperation in significant cross-border money laundering investigations."

A review of the investigative and prosecutorial services involved in this forfeiture effort reveals the following agencies: from Malaysia, the Attorney General's Chambers, the Royal Malaysian Police, and the Malaysian Anti-Corruption Commission; from Singapore the Attorney General's Chambers, the Singapore Police Force-Commercial Affairs Division and the Office of the Attorney General; from Switzerland, the Federal Office of Justice; from the Grand Duchy of Luxembourg, the judicial investigating authority of and the Criminal Investigation Department.

To say this forfeiture settlement is stunning understates just how massive and significant it is. It also demonstrates the effective power of dedicated law enforcement professionals to routing out the proceeds of corruption. This settlement will stand as a testament to the international fight against the scourge of bribery and corruption, literally across the globe.

Final Thoughts

As many commentators have noted, it is the largest FCPA settlement of all time, coming in at somewhere between $2.91 billion (according to the DOJ) and $3.3 billion (according to the FCPA Blog). One thing they both agree on is the criminal penalty assessed against Goldman Sachs by the DOJ, coming in at $1.263 million. Yet, as is the case with any massive anti-corruption enforcement action, many compliance professionals have difficulty relating to the resolution or finding anything in the resolution for their compliance program.

One of the best phrases I have seen written about lessons learned came from Asher Miller, writing in the FCPA Blog: "Like in poker, if you can't spot the fool around the table, it's probably you." While I tend to use "the fool" as a Shakespearian-based noun, Miller using it as a verb may be on to something, certainly about Goldman Sachs.

It was clear that at Goldman Sachs, compliance was the ultimate fool. It seemed to think it was there to perform a real corporate function, which amazingly it did by refusing to approve Jho Low as a Private Wealth Client; however, when it came to substantive due diligence on multibillion-dollar transactions (generating millions in fees for Goldman Sachs), it was completely marginalized.

"Like in poker, if you can't spot the fool around the table, it's probably you."

Did the Goldman Sachs compliance function know it was the fool at poker table? We may never know, but if you are thus marginalized in your organization, you have some hard decisions to make: You can stay and try to change things; you can move on, either "to pursue other opportunities or spend more time with your family" or to another job; you can report internally so that your backside is protected or to set up an SEC, Sarbanes-Oxley (SOX) or state law whistleblower claim if you are discriminated against; or you can put your head down and hope the nuclear fallout does not dust you too badly.

The problem at Goldman Sachs was Timothy Leissner and Low were clearly favored, as they were bringing big bucks into the firm. According to the Financial Times, Low even met with the prior Chief Executive Officer (CEO) Lloyd Blankfein. I doubt they colluded to talk about the weather or even the sorry state of the New York Mets. If you are a third-party and meet with the CEO of Goldman Sachs, it is most probably to thank him for bringing all the money into the firm's coffers. This simple fact of the meeting should tell you all you need to know about how Low and 1MDB were viewed by Goldman Sachs' top management.

Compliance must figure out a way to continue to ask questions and perform due diligence to get to the bottom of the matter. I recognize that you should be able to take the word of a firm partner. However, if you are on notice that the information given to you is an outright lie, you should take steps to test the veracity of the information. There are no "alternative facts," only the truth. So, if you as a compliance professional have any inkling of illegal or unethical conduct, you should channel Ronald Reagan and "trust, but verify."

For a final lesson, I would ask you to consider *what is risk*? In the case of Goldman Sachs, it meant several things. The first was that Goldman Sachs was using its own capital to purchase the bonds from Projects Magnolia, Maximus and Catalyze. This meant a heightened risk for the firm, which led to the requirement there be iron-clad guarantees for Goldman Sachs that another entity would guarantee the risk (i.e., risk-shifting). This is where the Abu Dhabi sovereign wealth fund came into the picture and bribes were authorized and paid by Goldman Sachs to garner those guarantees.

If your company is wiring out funds to shell accounts, it may well be engaging in money laundering.

What about timing as a risk factor? These three bond deals where from 2012 to 2013. In basically a 12-month period, 1MDB raised over $6 billion in bond deals (and Goldman Sachs received $600 million in fees). Did anyone think that raising so much money in such a short period of time seems suspicious? Did anyone even ask that question? If anyone did so internally at Goldman Sachs, they did not do so very loudly, or they were shouted down quite quickly.

Payment as a risk factor? Every compliance practitioner should take away from the Goldman Sachs enforcement action that they must understand the payment process at their company. In the Leissner Order, the SEC detailed how, after each of the bond deals was pushed through, the proceeds were laundered directly from Goldman Sachs to shell companies owned or controlled by Low. Regarding Project Magnolia, the Leissner Order stated,

> "Goldman Sachs transferred the proceeds of the Magnolia bond offering via wire to the 1MDB entity designated to receive the payment. At the time, Leissner, Low and others knew that a large portion of the proceeds of the bond offering would be diverted to themselves and others, including government officials, through shell companies beneficially owned and controlled by Low, Leissner and others."

If your company is wiring out funds to shell accounts, it may well be engaging in money laundering.

Roger Ng is set for trial in April 2021, so it will be interesting to see how that turns out. This entire saga involving Goldman Sachs has laid low one of the world's top consultancy firms, literally with the best and the brightest. One can only hope they have learned their lesson. ◆

Cardinal Health

Cardinal Health Inc. (Cardinal) settled its FCPA matter with the SEC in April. According to the SEC press release, Anita B. Bandy, Associate Director in the SEC's Division of Enforcement, said

> "Cardinal's foreign subsidiary hired thousands of employees and maintained financial accounts on behalf of a supplier without implementing anti-bribery controls surrounding these high-risk business practices. The FCPA is designed to prohibit such conduct, which undermined the integrity of Cardinal's books and records and heightened the risk that improper payments would go undetected."

Per the SEC cease-and-desist order (the Order) Cardinal agreed to pay $5.4 million in disgorgement, $916,887 in prejudgment interest, and a civil penalty of $2.5 million.

Background Facts

Cardinal entered the Chinese market through an acquisition. The acquired entity had "longstanding distribution agreements with a number of global manufacturers of prescription medications, medical devices and consumer health products."

After the acquisition,

> "Cardinal China terminated most of the marketing accounts due in part to known FCPA-related compliance risks associated with channeling the marketing expenses of third parties through its own books and records. But despite these risks, until 2016, Cardinal China maintained and operated marketing accounts for a European supplier [European company] of non-prescription, over-the-counter dermocosmetic products for which Cardinal China served as the exclusive product distributor in China."

It was through this European relationship that Cardinal came to FCPA grief.

This business relationship was extremely unusual, to say the least. For reasons not made clear in the Order, Cardinal "formally employed approximately 2,400 employees for the dermocosmetic company pursuant to an administrative and HR services agreement."

While the largest numbers of these employees were beauty assistants and their supervisors, Cardinal also employed approximately 100 sales, marketing, management and back-office employees. According to the Order,

> "The sales and marketing employees were responsible for marketing and selling the dermocosmetic company's products in China and regularly drew down funds from the marketing accounts to pay third parties for marketing-related expenses."

It was this final action which caused problems and raised red flags for Cardinal. The company did not put the same rigor around the European company that it did around its Chinese operation. It is not clear from the Order whether Cardinal either did not correctly assess the FCPA risk at the European company or thought because it was headquartered in a lower-risk area than China that such a rigorous approach was not warranted. Regardless, Cardinal did put sufficient internal controls at this business operation, after which, red flags were raised; however, they did not take sufficient steps to stop the actions of this business operation.

The marketing, sales and management employees contracted to Cardinal not only made unauthorized payments out of the marketing funds, but also failed to accurately record payments on the company's books and records. These actions included failing to obtain verification of a legitimate business purpose for payments and making payments that were "redirected to government-employed health care providers and employees of Chinese state-owned retailers to promote the sale of the dermocosmetic company's products."

Lessons Learned

Clearly, there were internal controls violations, as laid out in the Order. I was equally interested in the business relationship that Cardinal had with the European company and how it did not fall neatly into any established nomenclature of business affiliation.

Most compliance professionals are familiar with a standard third-party relationship, such as with a commissioned sales agent, distributor, joint venture partner and the like. Yet the relationship between Cardinal and the European company was something very different. Cardinal "administered the marketing accounts" of the European company. Further, it "retained approximately 2,400 employees" on behalf of the European company. Finally, even the marketing employees were managed day to day by and reported to the European company, "Cardinal China entered into employment contracts with the marketing employees, administered their payroll and assumed other human resource and administrative functions for them." What do you call that type of business relationship?

Equally important, how would you even think about assessing them from a compliance perspective? You should start with the life cycle of a third-party relationship and the five basic steps:

1. Business Justification;

2. Questionnaire;

3. Due Diligence and its evaluation;

4. Contract; and

5. Managing the Relationship thereafter.

Did Cardinal engage in any of these five steps in its relationship with the European company? There is no evidence from the Order that it did so.

In addition to the "follow the money" issues present in every business relationship, the European company obviously had its own interactions with foreign government representatives and representatives of state-owned enterprises in the Chinese health care market. This would have mandated the need to train the European company on Cardinal's compliance programs and make sure that the European company had its own compliance program in place – or place them under the Cardinal compliance program. Both compliance structure and oversight are required. In a business relationship such as the one between Cardinal and the European company, a company must use its full compliance tool kit in managing the relationship. There must be active management of the compliance risk going forward on an ongoing basis.

The bottom line is that many compliance practitioners have not thought through the specific risks of business ventures such the one between Cardinal and the European company. I hope the Cardinal FCPA enforcement action will help facilitate discussions around recognition of the different types of business relationships, lead to greater consideration of the risk parameters and, perhaps, put a better risk management strategy in place. ◆

Recidivist Eni

Eni S.p.A (Eni) joined the two-time FCPA loser ranks in April 2020 when it agreed to a cease-and-desist order (Order) with the SEC for violations of the Accounting Provisions of the FCPA, both in books and records and internal controls. The allegations centered around one of their subsidiaries, Saipem S.p.A. (Saipem) (in which Eni held a 43% interest at the time), which entered into four sham contracts with an intermediary to assist in obtaining contracts awarded by Algeria's state-owned oil company, Sonatrach.

Recidivist Conduct

Eni joins a select group of recidivist companies who have violated the FCPA multiple times. It was one of the four companies involved in the joint venture TSJK, which paid bribes in Nigeria for the now infamous Boney Island project. The Order noted,

> "In July 2010, in settlement of an action brought by the SEC, Eni and its then wholly owned subsidiary, Snamprogetti Netherlands, B.V. ('Snamprogetti'), consented to a judgment entered by the U.S. District Court for the Southern District of Texas that permanently enjoined Eni from violating the books and records and internal accounting controls provisions of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and permanently enjoined Snamprogetti from violating the anti-bribery, books and records and internal accounting control provisions of the FCPA."

Eni obviously did not fulfill its obligations under the Boney Island FCPA enforcement action.

Background Facts

The allegations centered on Saipem's Chief Financial Officer (CFO), identified in the Order as "Executive A," known to be Alessandro Bernini. Talk about having a friend at the top: Bernini was CFO when he instigated the plan in 2006 and kept running the bribery scheme when he moved up to become CFO of the parent Eni in 2008. Bernini was convicted by an Italian court of his participation in this multi-year, multi-company bribery scheme and was sentenced to 49 months in prison. His conviction was overturned by an Italian court of appeals.

In 2006, Bernini and Saipem management were told by the Algerian Energy Minister that not only would they need a local agent, but they were to hire a specific intermediary. Not only was this person the personal secretary to the Energy Minister, but someone he considered as a "son." The intermediary company had no experience in such matters, had no offices or employees in Algeria and only had a virtual office in Switzerland. This intermediary was contracted to "help Saipem identify and evaluate business opportunities, assist with bidding processes, develop strategies for procuring contracts and provide advice and assistance in connection with the performance of such contracts." Of course, it goes without saying that this "intermediary never rendered any legitimate services to Saipem." Yet, the intermediary was paid some €198 million over three years by Saipem.

Books and Records Violations

Bernini led a team dedicated to hiding these corrupt payments for multiple years, at both Saipem and while he was the Eni CFO. The payments were fraudulently recorded as brokerage fees. "By virtue of its consolidation of Saipem's financial statements, Eni included the false line item for 'brokerage fees' in its financial statements that it filed with the Commission in its annual reports on Form 20-F for the years 2007 through 2010."

Moreover, and certainly more brazenly, Saipem claimed a tax deduction of approximately $57 million for its fraudulent payments. Finally, "approximately $19,750,000 of the unwarranted tax benefit obtained by Saipem also flowed to Eni as a result of its 43 percent interest in Saipem during the time when Executive A was Eni's CFO."

Here, Bernini and his team were equally creative. Initially, there was no substantive due diligence performed on the intermediary. But the Order went further, noting that Saipem's internal controls were neither adequately implemented nor effective. This included no substantive reviews of the intermediary's contracts. Indeed, the legal department approved the contracts with no knowledge of the counter-party or -parties. After the contract was signed, there was no audit or even substantive review other than simply matching the amount of the intermediary invoice with the amount paid to the intermediary. Standard procurement controls were also bypassed through both falsifying of information given to the supply chain function and back-dating of contracts. Finally, the payment amounts were at such a high level that senior management approval was required to be obtained prior to funding of payment. Yet no such approval was obtained.

When Bernini moved up the ladder to Eni, he continued to approve and even order the illegal payments to continue to be made to the intermediary. He even went so far as to approve underreported and underlisted payment amounts for the intermediary. Bernini ordered prepayment of invoices not yet received from the intermediary. Finally, he "also circumvented Saipem's anti-bribery internal controls by emailing the intermediary's 'strawman' owner and also meeting with the intermediary's true owner."

Lessons Learned

As Sam Spade knew in long-ago San Francisco, it is good to have a friend on the force. When engaging in bribery and corruption, it is good to have the CFO involved. While Eni demonstrated itself to be a corrupt organization through its actions on the Boney Island project as well as Sonatrach, even Eni eventually became wise to Bernini in 2012 and "separated" him from Eni.

Of course, all these actions happened while Eni was either under investigation for its actions around Boney Island or after it had signed the DPA in December 2008. So much for living up to your agreements.

What can the compliance professional do when faced with systemic corruption at the CFO level? Again, the answer is a second set of eyes. This means real review and audit of the life cycle in a third-party relationship. If Eni had cared enough to look at any point, it would have seen that the intermediary for this Sonatrach contract was not fit as a business partner for the company. Also clear red flags: the payment of some €198 million for non-existent services and payments made to an Algerian agent in Switzerland. Even if, as CFO, Bernini did substantively, routinely and many times override internal controls, a paper trail is created for a board of directors or regulators when the company is so corrupt that it either does not care or actively facilitates the corruption at the C-suite level. ◆

Chapter 2

The Guidance

2020 Update to the Evaluation of Corporate Compliance Programs

> *"It's taking business intelligence and putting it into compliance."*
>
> \- Jonathan Marks

In June, the DOJ, without fanfare, released an update to its 2019 Evaluation of Corporate Compliance Programs, the 2019 Guidance. For simplicity, this new document will be called the 2020 Update. The 2020 Update is most welcome news for every Chief Compliance Officer (CCO), compliance professional and corporate compliance program in the U.S. and beyond. The reason is simple: It ends, once and for all, the clarion call for paper compliance programs written by lawyers for lawyers.

The DOJ has now articulated what both the business and compliance communities have been learning: Compliance is a business process, and as a process, it can be measured, managed and, most importantly, improved. Here, I explore the 2020 Update and see where it takes corporate compliance programs in this year and beyond.

Key Themes

In the introduction (with all changes noted in italics), the DOJ now states:

> "Because a corporate compliance program must be evaluated in the specific context of a criminal investigation, the Criminal Division does not use any rigid formula to assess the effectiveness of corporate compliance programs. We recognize that each company's risk profile and solutions to reduce its risks warrant particularized evaluation. Accordingly, we make *a reasonable*, individualized determination in each case *that considers various factors including, but not limited to, the company's size, industry, geographic footprint, regulatory landscape and other factors, both internal and external to the company's operations, that might impact its compliance program*."

This change makes clear that every policy will be evaluated on its own merits. The DOJ lays out some of the factors it will consider, but such consideration will be tempered by a reasonableness standard. Borrowing language from the Antitrust Division, the 2020 Update adds that any compliance program under evaluation by the DOJ will be considered *both at the time of the offense and at the time of the charging decision and resolution*.

The significance of this cannot be overstated, as now you cannot simply remediate your compliance program and basically ask for forgiveness after the FCPA violation has occurred. This statement clarifies any confusion generated by the Benczkowski Memo that all you have to do is aggressively remediate and such post-event cleanup will lead to a declination.

Moreover, this point is further driven home by the addition to fundamental question #2 that prosecutors are required to ask: "Is the program being applied earnestly and in good faith?" In other words, is the program *adequately resourced and empowered to function effectively*? By tying this new language to question #2, companies that want to cut back to a paper program and take away the ability of a CCO to effectively do their job will lose the credit going forward, as this language clearly references both monetary resources and headcount.

The final addition in the introduction adds the following language: "In any particular case, the topics and questions set forth below may not all be relevant, and others may be more salient given the particular facts at issue and the *circumstances of the company*."

Here is an important part near and dear to my heart, as it clearly equates to "document, document and document:" If you make changes to your program, if you lose headcount, if you are not allowed to have the most current tech solution, then be prepared to explain why your company cannot do so. The only way to do so is through a clearly articulated business justification, aka a document. You should plan to take this a step further to document how your solution then fully follows compliance guidance as robust as the 2012 FCPA Guidance, issued by the DOJ and SEC. This section also allows room for creativity and imagination in your compliance program, if you can justify it and there is documentation for it.

From the changes in the tactical information presented in the 2020 Update, it is clear that the DOJ expects a continually evolving compliance program. It once again demonstrates that the days of a paper program are over. (Note: It also separates the DOJ analysis from the approach in ISO 37001, which is also a paper program approach to compliance.) There are multiple references throughout the 2020 Update to using a variety of compliance tools to garner information and then incorporating that information back into your best-practices compliance program on an ongoing basis so that your compliance program is a living, breathing program, not a static program dependent on policies and procedures.

Just as a compliance program begins with a risk assessment, your continual improvement continues with your risk assessment, which now needs to move from once every three years to a much more robust time frame. But your risk assessment is much more than simply the starting point of your compliance program. It is the basis of how you design, create, implement and then update your compliance program, and it also serves as the basis to document the decisions you made and why you made them. The 2020 Update specified, *"in short, prosecutors should endeavor to understand why the company has chosen to set up the compliance program the way that it has, and why and how the company's compliance program has evolved over time."*

But information to update your compliance program comes from more than the risk assessment. You now need to use other information sources to engage in continuous improvement. Your policies should also be a guide to inform your compliance program. Not only should your policies and procedures now be in searchable formats, but you must consider which policies are viewed with the most frequency and the attendant questions raised by employees as a part of your efforts to evolve your compliance regime. The 2020 Update stated, *"does the company track access to various policies and procedures to understand what policies are attracting more attention from relevant employees?"*

I began with a quote from Jonathan Marks about the wedding of business intelligence to a best-practices compliance program. After going through these key themes found in the 2020 Update, I am even more convinced Marks was correct. As compliance moves into the second half of 2020 and into the third decade of this century, the 2020 Update may well be seen as a key demarcation where the government demonstrated that properly viewed, compliance is more than a business process; it is a business program.

Data, Continuous Monitoring and Continuous Updating

I want to focus now specifically on the tactical steps of moving toward both continuous monitoring and continuous improvement of your compliance program. These twin concepts are perhaps the biggest modifications in the 2020 Update. The changes began in Section 1 – Risk Assessments, which stated:

> "**Updates and Revisions** – Is the risk assessment current and subject to periodic review? *Is the periodic review limited to a "snapshot" in time, or based upon continuous access to operational data and information across functions? Has the periodic review led to updates in policies, procedures and controls?* Do these updates account for risks discovered through misconduct or other problems with the compliance program?
>
> *Lessons Learned – Does the company have a process for tracking and incorporating into its periodic risk assessment lessons learned either from the company's own prior issues or from those of other companies operating in the same industry and/or geographical region?"*

The question-by-question analysis begins with the question, *"is the periodic review limited to a 'snapshot' in time, or based upon continuous access to operational data and information across functions?"* Do you have access to continuous and real-time transactional data at your organization? How about across silos within your organization? Most likely the answer to both is "no." This means you no longer have a best-practices compliance program at this point in time. How can you garner such information?

If you find yourself in this situation, how you begin to address it? My suggestion is to begin with your highest-risk activity – most likely sales. Go to each point in the sales cycle:

1. Prospecting,
2. Contacting,
3. Qualifying for tender process,
4. RFQ and RFP,
5. Contract negotiation and
6. Contract execution.

Pull compliance-related data from each one of these data points and begin your updated risk assessment there. The next question found in the Updates and Revisions subsection ties into the sole question found in the Lessons Learned subsection. They both relate to the single inquiry of how you used the data. Did you incorporate your findings into updating your compliance program?

While there is only one question in the Lessons Learned section, it is a compound question, inquiring about data you may have obtained not only through your own work, but also from other companies in your industry operating in the same geographic region. Without commenting on the potential anti-trust aspects of this issue, if there is public information available to you (and there always is), how are you using this information in your compliance regime? This can mean simply having your fully operationalized employee base keeping their eyes and ears open at trade shows or any other gatherings of industry employees.

Also embedded in these two questions is another old theme in compliance: Is there sufficient documentation in your compliance program? But here, the question is about the documentation of the data garnered and how you utilized that data. I have long preached the mantra "document, document and document," and this mantra is as important now as it has ever been. It is not simply that, in the government's eyes, if it not documented, it never happened; it is that if you documented the basis for your decision, then you can explain your decision-making calculus. Remember, no compliance professional, compliance program or even company under FCPA investigation or scrutiny has ever been punished for making an incorrect decision where a sufficient and documented business justification was in place. Such entities and persons have been sanctioned when there was no documentation in place.

The next area for continuous monitoring and continuous improvement was in an area of compliance that is not normally associated with those concepts: policies and procedures. Here the 2020 Update stated:

> "**Design** – What is the company's process for designing and implementing new policies and procedures *and updating existing policies and procedures*, and has that process changed over time? Who has been involved in the design of policies and procedures? Have business units been consulted prior to rolling them out?
>
> **Accessibility** – How has the company communicated its policies and procedures to all employees and relevant third parties? If the company has foreign subsidiaries, are there linguistic or other barriers to foreign employees' access? *Have the policies and procedures been published in a searchable format for easy reference? Does the company track access to various policies and procedures to understand what policies are attracting more attention from relevant employees?*"

When was the last time your policies and procedures were updated? Perhaps more importantly, what was your process for doing so? Was there any rigor around your process? Did that rigor include incorporating information and data collected through continuous monitoring, real-time monitoring or continuous access to operational data and information across functions? Novelly, the 2020 Update asks if you have tracked who is looking at your policies and procedures and where they are located as data points for you to consider in updating your compliance program.

The final area in the 2020 Update for consideration is appropriately called Continuous Improvement, Periodic Testing and Review, found in the subsection monikered Evolving Updates. It reads:

> "How often has the company updated its risk assessments and reviewed its compliance policies, procedures and practices? Has the company undertaken a gap analysis to determine if particular areas of risk are not sufficiently addressed in its policies, controls or training? What steps has the company taken to determine whether policies/procedures/practices make sense for particular business segments/subsidiaries? *Does the company review and adapt its compliance program based upon lessons learned from its own misconduct and/or that of other companies facing similar risks?*"

Similar to the language in the Risk Assessment section, this compound question considers the adaptation of a compliance program from your own lessons learned, but also from other companies. The distinction now is that phrase is "other companies facing similar risks." Think about how this language would apply to any company operating in China, West Africa or any other high-risk region in the globe. I would interpret this to mean that every CCO and compliance practitioner needs to stay abreast of international anti-corruption enforcement actions where your company may be doing business.

M&A and Third Parties

Next, I want to consider the changes in the areas of mergers and acquisitions (M&A) and your third-party risk management protocols.

Mergers and Acquisitions

Under M&A, the 2020 Update stated (all changes in italics):

> "**Mergers and Acquisitions (M&A)** A well-designed compliance program should include comprehensive due diligence of any acquisition targets, *as well as a process for timely and orderly integration of the acquired entity into existing compliance program structures and internal controls. Pre-M&A due diligence, where possible,* enables the acquiring company to evaluate more accurately each target's value and negotiate for the costs of any corruption or misconduct to be borne by the target. Flawed or incomplete *pre- or post-acquisition* due diligence *and integration* can allow misconduct to continue at the target company, causing resulting harm to a business's profitability and reputation and risking civil and criminal liability."

The specific questions posed by the 2020 Update are:

> "**Due Diligence Process** – *Was the company able to complete pre-acquisition due diligence and, if not, why not?* Was the misconduct or the risk of misconduct identified during due diligence? Who conducted the risk review for the acquired/merged entities and how was it done? What is the M&A due diligence process generally?

> **Integration in the M&A Process** – How has the compliance function been integrated into the merger, acquisition and integration process?
>
> **Process Connecting Due Diligence to Implementation** – What has been the company's process for tracking and remediating misconduct or misconduct risks identified during the due diligence process? What has been the company's process for implementing compliance policies and procedures *and conducting post-acquisition audits*, at newly acquired entities?"

The clear emphasis of the DOJ is around the pre-acquisition phase in M&A work. Were you prevented from engaging in pre-acquisition due diligence because of some rule or regulation? If so, what did you do about it? Did you take the approach of Halliburton, as it did in the resulting Opinion Release 08-02, and seek DOJ input? Was your post-acquisition integration protocol more robust? If so, how? Also, after closure, did you perform a full audit of the acquired entity? For the sake of your compliance program, I hope you did. Yet the clear emphasis here was on the pre-acquisition phase.

Pre-acquisition due diligence provides an early assessment that will inform the transaction research and evaluation phases. This could include an objective view of the risks faced and the level of risk exposure, such as best/worst case scenarios. A pre-acquisition risk assessment could also be used as a lens through which to view the feasibility of the business strategy and to help value the potential target.

The next step is to develop the risk assessment as a base document. From this document, you should be able to prepare a focused series of queries and requests to be obtained from the target company. Thereafter, company management can use this pre-acquisition risk assessment to attain what might be required in the way of post-acquisition integration. It would also help to inform how the corporate and business functions may be affected. It should also assist in planning for timing and anticipation of the overall expenses involved in post-acquisition integration. These costs are not insignificant, and they should be thoroughly evaluated in the decision-making calculus.

Third Parties

Even in 2020, third parties still represent the highest risk under the FCPA. Here, the DOJ noted:

> "Prosecutors should also assess whether the company knows *the business rationale for needing the third party in the transaction and the risks posed by third-party partners, including* the third-party partners' reputations and relationships, if any, with foreign officials… In sum, a company's third-party management practices are a factor that prosecutors should assess to determine whether a compliance program is in fact able to 'detect the particular types of misconduct most likely to occur in a particular corporation's line of business.'"

The DOJ then posed the following questions:

> "**Management of Relationships** – How has the company considered and analyzed the compensation and incentive structures for third parties against compliance risks? How does the company monitor its third parties? Does the company have audit rights to analyze the books and accounts of third parties, and has the company exercised those rights in the past? How does the company train its third-party relationship managers about compliance risks and how to manage them? How does the company incentivize compliance and ethical behavior by third parties? *Does the company engage in risk management of third parties throughout the lifespan of the relationship, or primarily during the onboarding process?*"

It is this (new) final question, coupled with the new language in the preamble to the section on third parties that is so significant. It makes clear that management of third parties is a process, and one that must continue on an ongoing basis throughout the lifetime of the relationship with your organization. This also re-emphasizes the importance of managing the relationship after the contract is executed from the compliance perspective. Your role in the compliance function is not simply to review due diligence and add compliance terms and conditions to the contact. Your role is to oversee the relationship the business sponsor manages on the ground. This is fully operationalizing your compliance regime.

CCO & Compliance

Next, I want to consider the emphasis on the CCO and the compliance function, the two clear winners in this 2020 Update.

Quality of CCO and Compliance

Under Part II, the changes started with the title of the section, which was amended to read, ***"Is the Corporation's Compliance Program Adequately Resourced and Empowered to Function Effectively?"*** This change was then driven home immediately in the introductory paragraph (all changes noted in *italics*): "even a well-designed compliance program may be unsuccessful in practice if implementation is lax, *under-resourced or otherwise ineffective*."

The introduction also added language from the U.S. Sentencing Guidelines, which reads, "those with 'day-to-day operational *responsibility' shall have 'adequate resources, appropriate authority and direct access to the governing authority or an appropriate subgroup of the governing authority*.'"

This builds upon the changes started in the DOJ's 2016 FCPA Pilot Program and the 2017 FCPA Corporate Enforcement Policy around the quality of your CCO and compliance function. It begins with questions such as, what is the overall corporate investment in compliance? Is your spend in line with similarly situated organizations? What about the salaries of your CCO and compliance personnel? Does your organization skimp on them to save money? One major company in Houston has laid off their entire compliance staff; how will that be received by the government two, three or five years down the road?

The new queries posed by the 2020 Update in this area are:

> "**Experience and Qualifications** – Do compliance and control personnel have the appropriate experience and qualifications for their roles and responsibilities? Has the level of experience and qualifications in these roles changed over time? *How does the company invest in further training and development of the compliance and other control personnel?* Who reviews the performance of the compliance function and what is the review process?"

In experience and qualification, clearly there must be ongoing professional development for the CCO, the compliance team members and also the other control personnel in the company. This means that as a leader, every CCO should work with their compliance team to set up a clear path for career development and, more importantly, specific compliance subject matter expertise (SME). This includes the latest developments in compliance and evolving best practices. It also means as a CCO, you have to do the same.

What about the phrase "other control personnel?" Who is this group? I have long advocated use of noncompliance-function gatekeepers in any best-practices compliance program. Personnel should include the legal department, compliance function, supply chain, human resources, payroll and/or internal audit – basically any person in your company who makes decisions regarding compliance issues.

Look beyond paper line reporting and assess lines of communications and information reporting structures to ascertain how decisions and actions are taken regarding compliance issues. When it comes to budget and spend, for example, it is important to understand who authorizes compliance expenditures – the CCO, the board, audit committee, CEO or perhaps other(s)?

Here, you need to tread carefully, because if gatekeepers believe they understand compliance, yet have very little appreciation of best practices, doing compliance or the operationalization of compliance and are entrenched in their uninformed views, it may be a difficult process to move the company to a point that meets DOJ requirements. You will need to determine if these gatekeepers will defer to the CCO and compliance SME or outside consultants as SMEs. The optimal situation is where the gatekeepers are highly knowledgeable, but willing to defer to the CCO as the compliance SME.

Data, Data, Data

The second area of inquiry is the access to and use of data, data analytics and transaction monitoring by the compliance function.

> *"**Data Resources and Access** – Do compliance and control personnel have sufficient direct or indirect access to relevant sources of data to allow for timely and effective monitoring and/or testing of policies, controls and transactions? Do any impediments exist that limit access to relevant sources of data and, if so, what is the company doing to address the impediments?"*

This set of queries is not simply phrased in the negative, but they require a company to work to make such data available to the CCO and compliance function. This is a much more stringent requirement than the CCO calling up IT to find out what data might be available to monitor on an ongoing basis. These questions require every company to take affirmative steps to make the data available and get to it the compliance in some type of usable format.

Finally, this inquiry ties back to the part of Data, Continuous Monitoring and Continuous Updating referenced above, requiring that a CCO and compliance function "be empowered to function effectively." The requirement for accessibility to siloed data and its use by compliance will be critical in the business world moving forward. Compliance is truly at an inflection point, and the forces of the coronavirus health crisis, the economic disruption and, now, the 2020 Update will drive compliance functions toward more and greater use of data in compliance going forward.

Renewed Importance on Compliance

Coincidence or not, the release of the 2020 Update amid the worst economic downturn since the Great Depression and efforts to reopen the American economy in the wake of the worst pandemic in over 100 years makes clear the importance of compliance as a regulatory scheme to comply with laws such as the FCPA.

There have been misplaced calls by some for a hiatus on compliance so that business can get back on its feet. Those commentators advocate that it is somehow acceptable to override compliance and financial controls because of the unprecedented times that currently exist. Such thinking was wrong then, and its wrong now. Bribery and corruption under the FCPA have been illegal since 1977, and they remain so today. Compliance programs are the way to operate within the boundaries of the law; this is true even now.

The push around data, ongoing monitoring and continuous improvement of compliance programs also re-emphasizes that compliance is now properly seen as a business process, no longer the purview of lawyers and the legal department. Compliance is there to *prevent, detect and remediate* issues before they become full-blown legal violations. This call for increased improvement of your compliance program on an ongoing basis will eventually lead to more thorough and robust transaction monitoring by organizations. By improving their compliance programs, companies will have the opportunity to make their business processes and operations more efficient and, at the end of the day, more profitable.

While many commentators have focused on the section of the 2020 Update mandating that the compliance function have access to data throughout the organization, I think the more important point is that there is a plethora of data available to CCOs and companies that they are not using.

Obviously, hotline complaints are a rich source of data and can be used in a variety of ways, but the 2020 Update also spoke to questions raised about policies and procedures. Where did those questions come from? Who in the company raised them? Who in the company is accessing your policies and procedures, and in what geographic region are they located? What does that tell you about your compliance program? If you cannot travel for some period of time due to COVID-19, you should identify ways to assess and address the questions the customers of your compliance program (i.e., your employees) are raising.

The same types of analysis can be true for other information. Where are your corporate social responsibility (CSR) initiatives located? Are they in high-risk jurisdictions? What visibility do you have into them before the money is spent? What about marketing budget spend? Any large expenditures in high-risk jurisdictions? What about hiring? When was the last time you looked at your organization's hiring in high-risk jurisdictions? All of these could provide information that can be incorporated back into your compliance program.

The final aspect from the 2020 Update was first raised by Dick Cassin. The question Cassin cited was "does the compliance function monitor its investigations and resulting discipline to ensure consistency?" Cassin went on to add, "why is the added emphasis on monitoring to 'ensure consistency' so important? Because inconsistency — showing favoritism to those who violate the compliance program, or don't implement it — undermines the entire idea of compliance, and those responsible for making it happen."

This speaks to institutional justice and institutional fairness. These are not simply two cornerstones of a compliance program; they are the cornerstones of any company. If there is no fairness and justice, what is the point of working for a company? I recognize this is an evolutionary step, but the CCO and compliance function must lead this dialogue in an organization. If the ubiquitous control-overrider and compliance corner-cutter becomes the highest-grossing salesperson, receives the biggest bonus and most promotions, this all speaks to a lack of fairness and justice in the organization. If such situations exist, employees will correctly conclude that there are no consequences for wrongdoing or, more insidiously, the only way to get ahead in an organization is to lie, cheat and steal. Even worse if top management actively or tacitly encourages such behavior.

The cost of such a culture is far higher than the fines, penalties and attendant legal fees incurred; there is also the reputational impact to consider. The loss of business is of first and foremost importance, but employees today want to work at ethical companies. The compliance program cannot be seen as simply window-dressing. Wells Fargo has never recovered from its fraudulent accounts scandal but, equally importantly, who would ever want to work for a company where raising your hand to report unethical – even illegal – conduct means termination?

The DOJ should be applauded by every compliance practitioner for the 2020 Update. They have reinforced the importance and value of CCOs and corporate compliance programs. As we move back to reopening our economy and a renewed sense of the need for racial justice, the 2020 Update lays out some of the key tools for every compliance professional to utilize. ◆

The FCPA Resources Guide, Second Edition

In yet another very soft release, the DOJ and SEC released the updated "A Resource Guide to the U.S. FCPA Second Edition" (2020 Resource Guide). The reason for this update was stated in the forward, which read in full:

> "We are pleased to announce the publication of the Second Edition of A Resource Guide to the U.S. Foreign Corrupt Practices Act. The Guide was originally published by the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) in November 2012 to provide companies, practitioners, and the public with detailed information about the statutory requirements of the Foreign Corrupt Practices Act (FCPA) while also providing insight into DOJ and SEC enforcement practices through hypotheticals, examples of enforcement actions and anonymized declinations, and summaries of applicable case law and DOJ opinion releases. Then and now,

the Guide represents one of the most thorough compilations of information about any criminal statute, and remains relevant to this day.

Although many aspects of the Guide continue to hold true today, the last eight years have also brought new cases, new law, and new policies. The Second Edition of the Guide reflects these updates, including new case law on the definition of the term 'foreign official' under the FCPA, the jurisdictional reach of the FCPA, and the FCPA's foreign written laws affirmative defense. It addresses certain legal standards, including the mens rea requirement and statute of limitations for criminal violations of the accounting provisions. It reflects updated data, statistics, and case examples. And it summarizes new policies applicable to the FCPA that have been announced in the DOJ's and SEC's continuing efforts to provide increased transparency, including the DOJ's FCPA Corporate Enforcement Policy, Selection of Monitors in Criminal Division Matters, Coordination of Corporate Resolution Penalties (or Anti-Piling On Policy), and the Criminal Division's Evaluation of Corporate Compliance Programs.

Foreign bribery is a scourge that must be eradicated. It undermines the rule of law, empowers authoritarian rulers, distorts free and fair markets, disadvantages honest and ethical companies, and threatens national security and sustainable development. This updated Guide is meant not only to summarize the product of the dedicated and hardworking individuals who combat foreign bribery as part of their work for the U.S. government, but also to help companies, practitioners, and the public — many of whom find themselves on the front lines of this fight — prevent corruption in the first instance. We hope that the

> Guide will continue to be an invaluable resource in those efforts."

The New Hallmark

Obviously, this 2020 Resource Guide has been some time in coming, and it represents the work of many dedicated professionals in the DOJ and SEC. It is a welcome resource for every compliance practitioner. I want to focus on the primary changes and additions to the Hallmarks of an Effective Compliance Program. The first change to note is the expanded definition to the question, "is [the corporate compliance program] being applied in good faith" with the addition of the query, "in other words, is the program adequately resourced and empowered to function effectively?" This language comes from the 2020 Update to the Evaluation of Corporate Compliance Programs (2020 Update). This change clearly reflects the need for a company to do far more than have a paper compliance program in place, which presaged many of the changes brought forward in the 2020 Update.

However, the biggest change is the addition of a new Hallmark, entitled "Investigation, Analysis, and Remediation of Misconduct," which reads in full:

> "The truest measure of an effective compliance program is how it responds to misconduct. Accordingly, for a compliance program to be truly effective, it should have a well-functioning and appropriately funded mechanism for the timely and thorough investigations of any allegations or suspicions of misconduct by the company, its employees, or agents. An effective investigations structure will also have an established means of documenting the company's response, including any disciplinary or remediation measures taken.

> In addition to having a mechanism for responding to the specific incident of misconduct, the company's program should also integrate lessons learned from any misconduct into the company's policies, training, and controls. To do so, a company will need to analyze the root causes of the misconduct to timely and appropriately remediate those causes to prevent future compliance breaches."

There are many interesting aspects to this new Hallmark, not the least is that it begins with "the truest measure of an effective compliance program is how it responds to misconduct." This builds upon the language found in the "Confidential Reporting and Internal Investigation" Hallmark, which stated, "…once an allegation is made, companies should have in place an efficient, reliable, and properly funded process for investigating the allegation and documenting the company's response." Now, beyond being properly funded, you must have a "well-functioning mechanism" for the "timely and thorough investigations of any allegations or suspicions of misconduct by the company, its employees, or agents."

This clearly mandates that once an allegation or even suspicion comes to the attention of compliance, it must be properly triaged and your investigation protocol should kick in with a detailed and effective investigation that is completed in a reasonable time and that provides a response to the investigative findings. Moreover, an investigation is not the ending point and should be followed with a robust root cause analysis. This builds upon several sources.

Initially, the FCPA Corporate Enforcement Policy brought forward this requirement for a root cause analysis with the following language: "Demonstration of thorough analysis of causes of underlying conduct (i.e., a root cause analysis) and, where appropriate, remediation to address the root causes."

The 2020 Evaluation also raised the following questions under "Root Cause Analysis – What is the company's root cause analysis of the misconduct at issue? Were any systemic issues identified? Who in the company was involved in making the analysis?"

Well-known fraud investigator Jonathan Marks defined root cause analysis as "a research-based approach to identifying the bottom-line reason of a problem or an issue; with the root cause, not the proximate cause, representing the source of the problem." He contrasted this definition with that of a risk assessment, which he said "is something performed on a proactive basis based on various facts. A root cause analysis analyzes a problem that (hopefully) was previously identified through a risk assessment." He went on to note, "root cause analysis is a tool to help identify not only what and how an event occurred, but also why it happened. When we are able to determine why an event or failure occurred, we can then recommend workable corrective measures that deter future events of the type observed."

The 2020 Resource Guide is a most welcomed document from the DOJ and SEC. It brings forward the top FCPA and compliance resource from the past decade into this decade.

FCPA Corporate Enforcement Policy

Obviously, there have been multiple developments by the DOJ and SEC since the 2012 release of the First Edition of the FCPA Resources Guide (2012 Resources Guide). The evolution in the DOJ's thinking has clearly been at the forefront of many of these developments. While the seeds were clearly sown in the 2012 Resources Guide, there have been multiple FCPA enforcement actions in which the DOJ demonstrated a clear commitment to rewarding companies. Two FCPA settlements that clearly articulated this view were Parker Drilling, in 2013, and Hewlett-Packard (HP), in 2014.

In 2015, then-Assistant Attorney General Leslie Caldwell further clarified this development in her remarks at New York University Law School's Program on Corporate Compliance and Enforcement. In this talk, Caldwell laid out for the first time the key metrics the DOJ would consider in determining if a company was operationalizing compliance rather than simply having a paper program. If a company met these metrics, it could receive additional credit from the DOJ in an enforcement action.

In April 2016, the DOJ rolled out the FCPA Pilot Program, which modified enforcement and provided more information on the specifics of a best-practices compliance program. It fashioned two new categories of credit companies could receive:

1. Up to a 25 percent reduction off the bottom guideline of the US Sentencing Guidelines fine range if the firm cooperated and engaged in appropriate remediation and

2. Up to a 50 percent reduction off the bottom end through self-disclosure, cooperation and full remediation.

In 2017, there were two significant additions to both FCPA enforcement and compliance programs. February saw the release of the first version of the Evaluation of Corporate Compliance Programs, which was most recently updated in June 2020. In November 2017 came the new FCPA Corporate Enforcement Policy, which formalized parts of and also extended the Pilot Program by providing a presumption of a declination for FCPA enforcement actions when four criteria were met:

1. self-disclosure,

2. extensive remediation,

3. thorough investigation and

4. profit disgorgement.

From the compliance program perspective, the FCPA Corporate Enforcement Policy formalized the mandate for professionalism in corporate compliance personnel and adequate resources to be made available in the compliance function. This FCPA Corporate Enforcement Policy was discussed in detail in the 2020 FCPA Resources Guide.

The FCPA Corporate Enforcement Policy was expanded in 2019 to give greater benefits during the mergers and acquisition (M&A) process, recognizing

> "the potential benefits of corporate mergers and acquisitions, particularly when the acquiring entity has a robust compliance program in place and implements that program as quickly as practicable at the merged or acquired entity. Accordingly, where a company undertakes a merger or acquisition, uncovers misconduct by the merged or acquired entity through thorough and timely due diligence or, in appropriate instances, through post-acquisition audits or compliance integration efforts, and voluntarily self-discloses the misconduct and otherwise takes action consistent with the CEP, there will be a presumption of a declination in accordance with and subject to the other requirements of the CEP. In appropriate cases, an acquiring company that discloses misconduct may be eligible for a declination, even if aggravating circumstances existed as to the acquired entity."

In the 2020 Resources Guide there was a discussion of three cases where companies received full declinations as they were able to meet the four prongs on the FCPA Corporate Enforcement Policy. As with the 2012 Resources Guide, the inclusion of any information on declinations is a boon for the compliance professional. The 2020 Resources Guide continued this most welcome source of information.

Declination 1

In 2018, the DOJ declined to prosecute a U.K. company that manufactured and sold equipment used to detect earthquakes and other seismic events. The company had voluntarily self-disclosed to the DOJ that it had made numerous payments amounting to nearly $1 million to the director of a Korean government-funded research center. Following the disclosure of these payments, the DOJ indicted the director, trying and convicting him of one count of money laundering in violation of 18 U.S.C. § 1957. The director was subsequently sentenced to 14 months in prison in October 2017. The company achieved a declination because it voluntarily self-disclosed, fully cooperated and promptly and appropriately remediated. In addition, the company was the subject of a parallel investigation by the U.K.'s Serious Fraud Office (SFO) for legal

Declination 2

In the second declination, the DOJ declined to prosecute an insurance company incorporated and headquartered in Barbados. The investigation found that the company, through its employees and agents, paid bribes to a government official in exchange for insurance contracts. High-level employees of the company took part in a scheme to pay bribes to the Minister of Industry in Barbados and to help launder the payments in the U.S. The 2020 Resources Guide stated, "despite the high-level involvement of corporate officers in the misconduct, [the] DOJ declined prosecution based on a number of factors."

The factors that led to this result included:

1. the company's prompt, voluntary self-disclosure of the illegal conduct;

2. the company's thorough and comprehensive investigation;

3. the company's cooperation and its agreement to continue to cooperate in the DOJ's ongoing investigations and/or prosecutions;

4. the company's agreement to disgorge to the DOJ all profits it made from the illegal conduct;

5. the steps the company had taken to enhance its compliance program and its internal accounting controls;

6. the company's remediation, including terminating all of the executives and employees who were involved in the misconduct; and

7. the fact that the DOJ had been able to identify and charge the culpable individuals.

Declination 3

The third and final example listed in the 2020 Resources Guide involved a declination to prosecute a publicly traded technology services company. The company authorized its agents to pay approximately a $2 million bribe to one or more government officials in India for securing and obtaining a statutorily required planning permit in connection with the development of an office park, as well as other improper payments in connection with other projects in India. Despite the fact that certain members of senior management participated in and directed the bribery scheme, the DOJ declined prosecution of the company based on an assessment of the factors set out in the FCPA Corporate Enforcement Policy.

As listed in the 2020 Resource Guide, they included:

1. the company's voluntary self-disclosure within two weeks of the board learning of the criminal conduct;

2. the company's thorough and comprehensive investigation;

3. the company's full and proactive cooperation in the matter and its agreement to continue to cooperate in the DOJ's ongoing investigations and any prosecutions that might result;

4. the nature and seriousness of the offense;

5. the company's lack of prior criminal history;

6. the existence and effectiveness of the company's pre-existing compliance program, as well as steps it had taken to enhance its compliance program;

7. the company's full remediation, including disciplining and/or terminating the employment of employees and contractors involved in the illegal activity;

8. the adequacy of remedies as demonstrated by the company's resolution with SEC to pay a civil penalty of $6 million;

9. the company's agreement to disgorge the full amount of its cost savings from the bribery; and

10. the fact that, as a result of the company's prompt and voluntary disclosure, the DOJ was able to conduct an independent investigation and identify individuals with culpability for the corporation's malfeasance.

The Accounting Provisions

The next area I want to explore in the 2020 Resource Guide is the information found in the chapter on Accounting Provisions, including both books and records and internal controls. Here, the DOJ and SEC put forward the following statement:

> "Bribes, both foreign and domestic, are often mischaracterized in companies' books and records. Section 13(b)(2)(A) of the Exchange Act (15 U.S.C. § 78m(b)(2)(A)), commonly called the 'books and records' provision, requires issuers to 'make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.' This language comes directly from the Foreign Corrupt Practices Act (FCPA)."

For most companies, the most serious test has been around the "in reasonable detail" qualification, which was adopted by Congress "in light of the concern that such a standard, if unqualified, might connote a degree of exactitude and precision which is unrealistic." The addition of this phrase was intended to make clear "that the issuer's records should reflect transactions in conformity with accepted methods of recording economic events and effectively prevent off-the-books slush funds and payments of bribes."

The Resource Guide goes on to state, "the term 'reasonable detail' is defined in the statute as the level of detail that would 'satisfy prudent officials in the conduct of their own affairs.' Thus, as Congress noted when it adopted this definition, 'the concept of reasonableness of necessity contemplates the weighing of a number of relevant factors, including the costs of compliance.'"

Yet here is the kicker: There can be no *reasonable* recording of ill-gotten gains or mischaracterized payments. Put another way, a company can never negligently record a bribery payment as something as mundane (and legal) as "Commissions or Royalties, Consulting Fees, Sales and Marketing Expenses, Scientific Incentives or Studies, Travel and Entertainment Expenses, Rebates or Discounts, After-Sales Service

Fees, Miscellaneous Expenses, Petty Cash Withdrawals, Free Goods, Intercompany Accounts, Supplier/Vendor Payments, Write-offs or 'Customs Intervention' Payments." Simply put, any recording of a bribe payment as anything other than a bribe payment is a FCPA violation. Every practitioner should always remember there is not materiality level to the books and records provisions.

This leads to the internal controls provisions requirement, in combination with the books and records provision, that issuers maintain books and records that accurately and fairly reflect the corporation's transactions to assure, "among other things, that the assets of the issuer are used for proper corporate purpose[s]." The Resource Guide went on to state,

> "Although a company's internal accounting controls are not synonymous with a company's compliance program, an effective compliance program contains a number of components that may overlap with a critical component of an issuer's internal accounting controls. Fundamentally, the design of a company's internal controls must take into account the operational realities and risks attendant to the company's business, such as: the nature of its products or services; how the products or services get to market; the nature of its work force; the degree of regulation; the extent of its government interaction; and the degree to which it has operations in countries with a high risk of corruption."

This language strengthens the relationship between compliance controls and financial controls; indeed, demonstrating them to be interrelated. This is a key insight for many compliance professionals – particularly those with a legal background or those who only focus on the text of the FCPA. Moreover, just as financial controls make a company run more efficiently and more profitably, compliance controls fulfill the same function.

The Resource Guide goes on to state,

> "Just as a company's internal accounting controls are tailored to its operations, its compliance program needs to be tailored to the risks specific to its operations. Businesses whose operations expose them to a high risk of corruption will necessarily devise and employ different compliance programs than businesses that have a lesser exposure to corruption, just as a financial services company would be expected to devise and employ different internal accounting controls than a manufacturer."

All of this means that a compliance professional needs to tailor compliance controls based on a risk assessment to identify key risks and a gap assessment to determine what controls are lacking or insufficient.

Gibson, Dunn & Crutcher LLP noted in a client alert,

> "The Second Edition includes two key clarifications regarding the application of the books-and-records and internal controls provisions of the FCPA, which have grown in prominence in recent years, particularly in SEC matters, as a powerful tool to bring enforcement actions absent direct allegations of bribery. First, the Second Edition states the government's view that in the absence of a statute of limitations in the FCPA itself, substantive violations of the anti-bribery provisions are subject to a five-year statute of limitations under 18 U.S.C. § 3282, whereas criminal violations of the FCPA accounting provisions are considered "securities fraud offenses" subject to the six-year statute of limitations provided for in 18 U.S.C. § 3301. Second, the Second Edition clarifies that criminal penalties for violations of the FCPA accounting provisions are imposed only where the defendant knowingly and willfully failed to maintain

accurate books and records or implement an adequate system of internal accounting controls."

DOJ Policy and Case Law Updates

The next area I want to explore in the 2020 Resource Guide are developments in DOJ policy, case law updates and revisions to the FCPA Corporate Enforcement Policy.

Developments in DOJ Policy - One Pie to Anti-Piling On to Coordinated Resolutions

Originally, there was the "one pie concept," which intoned that enforcement authorities were moving toward one total cost to anti-corruption violators, intended to be equitably split up by authorities where the corruption occurred or by the countries that had jurisdiction. Companies who self-disclosed to multiple regulators and extensively remediated along the lines originally laid out in the FCPA Pilot Program were more likely to garner credit with U.S. regulators for fines paid to overseas authorities. The "one pie" concept was later memorialized by the DOJ in its Anti-Piling On Policy. It has now become the "Coordinated Resolutions" initiative.

According to the 2020 Resource Guide, in resolving cases against companies, the DOJ and SEC will attempt to avoid imposing duplicative penalties, forfeiture and disgorgement for the same conduct. The DOJ and SEC will do so through crediting fines, penalties, forfeiture and disgorgement of foreign authorities resolving with the same company for the same conduct. The DOJ has memorialized this practice of coordinating resolutions to avoid "piling on" in the Justice Manual, which instructs prosecutors to "endeavor, as appropriate, to coordinate with and consider the amount of fines, penalties and/or forfeiture paid to other federal, state, local or foreign enforcement authorities that are seeking to resolve a case with a company for the same misconduct."

This focus has taken hold internationally as well. The 2020 Resource Guide discussed the case involving a publicly traded Brazilian petrochemical company, Petróleo Brasileiro S.A. (Petrobras), where the DOJ, SEC, Brazilian and Swiss authorities credited one another in imposing fines and disgorgement. The 2020 Resource Guide reports that the DOJ has coordinated resolutions with foreign authorities in more than 10 cases, and the SEC has coordinated resolutions with foreign authorities in at least five.

Successor Liability

Another DOJ initiative updated into the 2020 Resource Guide is around successor liability. It states,

> "Companies acquire a host of liabilities when they merge with or acquire another company, including those arising out of contracts, torts, regulations and statutes. As a general legal matter, when a company merges with or acquires another company, the successor company assumes the predecessor company's liabilities. Successor liability is an integral component of corporate law and, among other things, prevents companies from avoiding liability by reorganizing. At the same time, the DOJ and SEC recognize the potential benefits of corporate mergers and acquisitions, particularly when the acquiring entity has a robust compliance program in place and implements that program as quickly as practicable at the merged or acquired entity."

The key for compliance practitioners is recognizing that once a target is acquired and the merger is complete, if bribery and corruption continues in the acquired entity, it is no longer "them" but now "you" who are engaging in FCPA violations.

The 2020 Resource Guide provides heightened lucidity into such liability under the FCPA. If your organization cannot (as opposed to *does not*) engage in thorough pre-acquisition due diligence prior to a merger or acquisition, there are steps that can be taken post-closure. These steps include prompt and thorough integration efforts, deep-dive forensic auditing and voluntary disclosure of uncovered wrongdoing post-acquisition.

Moreover, under the FCPA Corporate Enforcement Policy, the acquiring company can still move toward a presumption of a declination if it voluntarily discloses post-acquisition conduct by the acquired company and takes appropriate remediation steps. Also, as noted in the Gibson, Dunn & Crutcher LLP client alert, the 2020 Resource Guide details "additional interpretive guidance regarding the authorities' approach to successor liability in M&A transactions" while retaining the 2012 "*Resource Guide's* direction regarding sound practices in this context in relation to pre-acquisition due diligence, the prompt application of anti-corruption policies and procedures to new acquisitions, the training of relevant stakeholders regarding the parent's anti-corruption obligations and applicable policies, prompt anti-corruption audits of newly acquired businesses or entities and the prompt and thorough disclosure of any corrupt payments identified through these due diligence and audit processes."

Case Law Update – Hoskins

The case law updates may well be the most controversial part of the 2020 Resource Guide. The most controversial case discussed in the 2020 Resource Guide is the *Hoskins* case. In *Hoskins*, the Second Circuit interpreted the FCPA to hold that foreign nationals are subject to the FCPA anti-bribery provisions only if they are agents, employees, officers, directors or shareholders of a U.S. issuer or domestic concern or if they act in furtherance of a bribery scheme while in the territory of the United States.

The client alert stated,

> "Though the Second Edition acknowledges Hoskins, it takes the position that this decision has not been applied outside the Second Circuit, characterizes

> this legal question as 'unsettled,' and cites to a contradictory district court opinion which held, relying on a Seventh Circuit precedent, that defendants can be liable for conspiracy to violate, or for aiding and abetting in violations of, the FCPA even where they do not 'belong to the class of individuals capable of committing a substantive FCPA violation.'"

The client alert goes on to opine,

> "Such a reluctance to accept the limits of Hoskins speaks volumes regarding the DOJ's desire to expand the FCPA further than permitted by the Second Circuit… and this suggests that the government will continue to construe Hoskins narrowly, in terms of both the breadth of its holding and its precedential effect outside of the Second Circuit."

What this would seem to mean for compliance practitioners and white-collar defense counsel is that on FCPA criminal actions filed outside the Second Circuit, the DOJ will continue to argue for a more expansive reading of such liability. In other words, the answer is not fully settled.

The original FCPA Resource Guide was without a doubt the single best one-volume reference book for all things FCPA. The 2020 Resource Guide is a most welcome update to the original documents released by the DOJ and SEC. The 2020 Resource Guide brings the top FCPA and compliance resource from the past eight years to lead us all into this decade. Every compliance practitioner should give a round of hearty applause to the DOJ and SEC for their great work. We are all better off for this volume. ◆

Opinion Release 20-01

For the first time in six years, the DOJ released an opinion release, denominated Opinion Release 20-01. At first blush, it appears to be a straightforward recitation of the equivalent of black-letter law in the world of the FCPA enforcement. However, a more expansive reading provides some very interesting insights into where both international anti-corruption and FCPA enforcement actions may well be headed.

The Facts

The Requestor desired to purchase some assets of a foreign investment bank (Country Office A), which was "indirectly owned by a foreign government." To facilitate this transaction, it enlisted the assistance of a different foreign subsidiary of the same foreign investment bank, Country Office B. After the transaction was completed, Country Office B sought compensation for their work in facilitating the transaction.

Country Office B "provided various legitimate and commercially valuable services" and the fee sought was commercially reasonable. The payment would be made directly to Country Office B.

Analysis

A quick review of the analysis demonstrated why this transaction was straightforward under the FCPA. First, the payment would be made to Country Office B and not any individual. Second, the payment was for legitimate services rendered and was commercially reasonable. At this point, most compliance practitioners would say the transaction is permissible under the FCPA.

Yet, there was another set of analysis that bore closer scrutiny. It read:

> "Second, based on the representations of Requestor, there is no indication that Requestor intends or believes the money will be diverted to any individual, and there is no indication that the money will, in fact, be diverted to any individual. The payment is transparent to the Country B Office and its management. Indeed, the Chief Compliance Officer of the Country B Office has certified to Requestor that the payment into the Country B Office's corporate bank account will only be used for the benefit of the Country B Office, for general corporate purposes of the Country B Office, and will not be forwarded to any other entity. Even though the Country B Office is a wholly owned subsidiary of the foreign investment bank that, in turn, is indirectly majority owned by a foreign government, there are no indicia that Requestor's payment to the Country B Office is intended to corruptly influence a foreign official. Moreover, the Requestor represents that there have been no corrupt offers, promises or payments of anything of value, direct-

> ly or indirectly, to any individual in connection with this transaction."

Why would these extra steps be taken when the transaction appeared to pass FCPA muster? It comes down to two things: **ENI/Shell** and **OPL 245** in offshore Nigeria. What was this transaction involving these two international energy concerns? As laid out in the TRACE Compendium, the concession for offshore oil block OPL 245, awarded to Eni and Shell by the Nigerian government in 2011 for a payment of $1.3 billion.

> "Emails published by Global Witness indicate that executives at Shell were informed and had reason to believe or know that part of the payment would go to then-President Goodluck Jonathan, as well as others in Nigeria, as bribes. President Goodluck Jonathan allegedly received between $200 million and $500 million. Emails also indicate that Shell was aware that the payment would go to Dan Etete. In a phone call recorded in 2016, Shell's CEO Ben van Beurden and then-CFO Simon Henry expressed concern that the deal violated the FCPA."

Although denying any wrongdoing, both companies self-disclosed their actions to the DOJ. Both received declinations.

However, prosecutors in Italy had a different interpretation under Italian law. They brought criminal prosecutions against both companies and, according to a report by Reuters.com, "another 13 people are involved in the case, including current Eni Chief Executive Claudio Descalzi and former Shell head of upstream Malcolm Brinded."

The prosecutors' basic claim is that "Eni and Royal Dutch Shell were aware that most of the money they spent to buy a Nigerian oilfield in 2011 would go in corrupt payments to politicians and officials… They were kickbacks. And Eni and Shell knew it." The Prosecutor "read out a series of emails between former Shell managers, including one saying it had been taken for granted Etete would have only kept a part of the price for himself, using the rest to pay off Nigerian politicians."

Discussion

So why make all the additional representations when they are not required under the FCPA? Put simply, the fact pattern in ENI/Shell and OPL 245 was that the purchasers wanted to buy government assets and pay the Nigerian government directly for those assets. That is exactly what the Relator in 20-01 wanted to do and did in the transaction at issue, which clearly was within the parameters of a legal transaction under the FCPA.

Does this mean the DOJ (and SEC) will now look at the *knowledge* of how a payment made directly to a foreign government or state-owned enterprise will be used by that foreign government or state-owned enterprise? Is a purchaser of assets from a foreign government or state-owned enterprise now required to obtain some type of certification, similar to the Requestor received from the Chief Compliance Officer (CCO) of Country Office B, that the payment made "into the Country B Office's corporate bank account will only be used for the benefit of the Country B Office, for general corporate purposes of the Country B Office, and will not be forwarded to any other entity"? Does there need to be a certification that the payment will not be used to pay any *individuals*?

What about in jurisdictions outside the U.S.? Could all the additional representations here have been made to protect the Requestor from an anti-corruption enforcement action from a country other than the U.S.? After all, the Requestor is a "multinational firm," so could it be the Requestor had (or even has) other jurisdictions to worry about.

Many commentators have downplayed 20-01. However, I find it to be very instructive of where international anti-corruption enforcement may be headed. As Mike Volkov is wont to say, the DOJ always communicates its position well in advance of taking actions. Opinion Release 20-01 could well be tea leaves worth reading. It could also portend where a more robust international anti-corruption enforcement is heading. ◆

Chapter 3

Compliance Lessons from Two Failures

There were two matters from 2020 that bear noting for the compliance professional. The first was the Delaware Supreme Court decision in *Marchand v. Barnhill*. In this case, the most important state jurisdiction for corporate governance laid down a strong mandate that boards of directors must be involved in a corporate compliance program. It is the strongest statement about board involvement. It laid out the bare minimum a board must do to avoid shareholder liability for failing to oversee a compliance program.

As with most years, Wells Fargo continues lead the way for corporate culture failures. This summer, Wells Fargo CEO Charles Scharf blamed the bank's lack of diversity on "very limited pool of Black talent." I am sure that was news to minorities working at the bank. But beyond the continued tone-deaf statements of Well Fargo CEOs (maybe it's a job requirement), the bank was hit with a $3 billion settlement by the DOJ, SEC and Office of Comptroller of the Currency (OCC) for its fraudulent accounting scandal.

Blue Bell

Once, Blue Bell Ice Cream was the pride of Texas. The company universally known as "the little creamery in Brenham" represented the great state of Texas at home and abroad with some of the best commercial ice cream ever produced. Indeed, it was the #3 best-selling ice cream in America when the scandal broke in 2015. Unfortunately, that little creamery seriously lost its way and, in doing so, negligently caused the deaths of at least three people.

The Criminal Charges

In May, the DOJ announced via a press release that the company had "agreed to plead guilty to charges it shipped contaminated products linked to a 2015 listeriosis outbreak." The press release relates a sordid tale of a company and former president that seriously lost their collective way and then lied about it, with people losing their lives because of the conduct. That conduct is related in a plea agreement that led to a fine against the company of $17.4 million.

Texas state health officials first notified Blue Bell in February 2015 that two ice cream products from the company's Brenham factory tested positive for *listeria monocytogenes*. Blue Bell directed its delivery route drivers to remove remaining stock of the two products from store shelves, but the company did not recall the products or issue any formal communication to inform customers about the potential listeria contamination.

According to the Texas Tribune, in March 2015, Kansas Department of Health officials determined that

> "Listeria-tainted portions of the company's ice cream made it into products served to five hospital patients between January 2014 and January 2015. Of the five who became ill, three died. By March 24, Kansas officials traced the source of the listeria to Blue Bell's plant in Broken Arrow, Oklahoma, built by the Texas company in 1992. On April 3, the Centers for Disease Control had traced Blue Bell's listeria strain to six other patients going back to 2010. Four had been hospitalized in Texas for unrelated problems when they became sick from listeria. Five days later, on April 8, the CDC had identified two clusters of Blue Bell listeria victims. The strains were traced to the plants in Oklahoma and Texas."

Once again, Blue Bell chose not to issue any formal notification to customers regarding the positive tests.

According to the plea agreement, FDA inspections in March and April 2015 revealed sanitation issues at the Brenham and Broken Arrow facilities, including problems with the hot water supply needed to properly clean equipment and deteriorating factory conditions that could lead to insanitary conditions. Blue Bell temporarily closed all of its plants in late April 2015 to clean and update the facilities. The press release noted that "since re-opening its facilities in late 2015, Blue Bell has taken significant steps to enhance sanitation processes and enact a program to test products for listeria prior to shipment."

There was also a civil False Claims Act settlement for $2.1 million, which resolved allegations the company "shipped ice cream products manufactured in insanitary conditions to U.S. facilities, and later failed to abide by contractually required recall procedures when its employees removed products from federal purchasers' freezers without properly disclosing details about the potentially contaminated ice cream to the appropriate federal officials."

The fallout for the company has been nothing short of catastrophic. Immediately after the scandal broke, the company had to shut down its full production line and clean up all of its facilitates. The Fort Worth Star-Telegram reported that it led to the layoff of 1,450 workers and furlough of 1,400 others (from a total workforce of 3,900). In the summer of 2015, then-President Kruse (more on him later) basically sold a controlling interest in the company through a loan convertible into ownership for $125 million. At the time the company was allegedly worth $900 million, so the purchaser was able to obtain a severely distressed asset.

Now we have the company pleading guilty to two misdemeanor counts of distributing adulterated ice cream products. The criminal penalty and settlement of the False Claims Act totaled $19.5 million. Blue Bell is also the poster child for incredibly poor corporate governance practices, as determined by the Delaware Supreme Court in the *Marchand v. Barnhill* case.

The Board and Failures of Corporate Governance

As sickening as it was to read about the company's failures and the deliberate actions alleged to have been taken by former CEO and President Paul Kruse, the board's failures are even worse. For a major U.S. company, indeed according to the Delaware Supreme Court, as the board of directors for the top ice cream manufacturer in the U.S., it is alleged that the board completely abrogated its duty around the single largest safety issue it faced: food safety.

That abrogation allowed a listeria outbreak,

> "causing the company to recall all of its products, shut down production at all of its plants, and lay off over a third of its workforce. Blue Bell's failure to contain listeria's spread in its manufacturing plants caused listeria to be present in its products and had sad consequences. Three people died as a result of the listeria outbreak. Less consequentially, but nonetheless important for this litigation, stockholders also suffered losses because, after the operational shutdown, Blue Bell suffered a liquidity crisis that forced it to accept a dilutive private equity investment."

The failures at the board level were around both governance and actual duties of a board as originally set out in the *Caremark* decision, as modified by *Stone v. Ritter*. Yet perhaps the key reason for the board's failure was its lack of impartiality; flipped around, over half of the board members had a massive conflict of interest in that they owed their entire livelihoods and – most particularly – their board seats to the CEO and Chairman of the Board, Kruse.

The failures of the board were so egregious and its conflicts so massive that my review of the board's role will be extensive. I'll first consider the lack of board independence, then its corporate governance failures under *Caremark* and *Stone v. Ritter*.

Since 1919, Blue Bell has been run by the same family in Brenham TX: the Kruse family. Paul Kruse became a Director of Blue Bell in 1983, took over as President/CEO in 2004 and assumed the Chairman of the Board title in 2014 after the retirement of his father, who held the Chair since the 1950s.

Over one-half of the board members had previously worked for one or both of the Kruses. It was alleged that the plaintiff maintains "a majority of the BB USA board members have such close ties to the officer defendants, particularly Paul Kruse, that they would be incapable of impartially considering a demand to bring a fiduciary duty claim against him on behalf of the company."

What did the trial court find? In the trial court's opinion, it noted that three of the directors – Bridges, Howard Kruse and Jim Kruse – were members of Paul Kruse's immediate or extended family. Even the defendants admitted that these directors "could not disinterestedly consider a suit against Paul Kruse due to their family ties."

Another board member, Dorothy MacInerney, wrote a book about the Kruse family and then another book about Blue Bell. The complaint alleged that Paul Kruse wrote the foreword for one of the books in which he expressed "a sincere word of appreciation" to MacInerney for writing the book. As the trial court noted, "one might have reason to doubt whether MacInerney's fascination with, and apparently close connection and access to, Paul Kruse and his family will not 'heavily influence [her] ability to exercise impartial judgment.' When the court has reason to doubt, the court is obliged to conclude that the complaint adequately pleads a lack of independence for purposes of demand futility."

Board member Richard Dickson had worked for Blue Bell since 1981. The trial court noted that "before being named President in 2017, he served as general sales manager, plant manager of the Broken Arrow, Oklahoma plant and then as VP of Sales and Marketing at the Company, a position he was appointed to in 2010." According to the complaint, Dickson is "indebted to the Kruse family for his career." Board member John "Barnhill has either worked for or been affiliated with Blue Bell for his entire work life (nearly 60 years). Here again, the complaint alleges that Barnhill "owes his career to the Kruse family and has close personal relationships with several members of the Kruse family," including with Jim Kruse, who currently serves as President of a bank founded by Barnhill." He also lacked impartiality.

Finally, as to board member W. J. Rankin, the trial court noted he had worked for Blue Bell for 28 years, serving as CEO from 1986 through 2014. It is alleged that, "[d]ue to donations [totaling approximately $450,000] from the Kruse family," the Agricultural Complex at Blinn College was dedicated in Rankin's name. The trial court found this was not a conflict and Rankin could remain impartial, but the Delaware Supreme Court reversed this finding, stating "Rankin's apparently deep business and personal ties to the Kruse family raise a reasonable doubt as to whether Rankin could 'impartially or objectively assess whether to bring a lawsuit against the sued party.'" The Supreme Court reinstated the plaintiffs' entire claim for lack of impartiality.

As the board was under the control of Kruse, not only did they abrogate their *Caremark* duties, they acted as sycophants. After there were public notifications of the listeria outbreak, "Blue Bell's board met and adopted a resolution 'express[ing] support for Blue Bell's CEO, management and employees and encourag[ing] them to ensure that everything Blue Bell manufacture[s] and distributes is a wholesome and good testing [sic] product that our consumers deserve and expect.'"

The Blue Bell board did not meet the most basic requirement of any board, which is not to be under the thumb of the CEO. The reason for this is simple: If you are under the CEO's thumb, you will not take any steps to govern the corporation to protect anyone but the CEO. That was certainly the role of the board at Blue Bell.

A final piece of evidence? In February 2016, the board voted to strip Kruse from his joint role as CEO and Chairman of the Board. However, when Kruse threw a fit and "threatened to resign as President and CEO if the split occurred, the board held another vote in which all members, except Reimann and Rankin, voted to restore the position of CEO and Chairman of the Board."

The Board and Failures of its Caremark Duties

In its opinion, the Delaware Supreme Court stated,

> "the plaintiff also challenges the Court of Chancery's dismissal of his *Caremark* claim. Although *Caremark* claims are difficult to plead and ultimately to prove out, we nonetheless disagree with the Court of Chancery's decision to dismiss the plaintiffs' claim against the Blue Bell board. Under *Caremark* and *Stone v. Ritter*, a director must make a good faith effort to oversee the company's operations. Failing to make that good faith effort breaches the duty of loyalty and can expose a director to liability."

But it is more than simply not doing your job as a board, it is doing so in bad faith. The court states,

> "In other words, for a plaintiff to prevail on a *Caremark* claim, the plaintiff must show that a fiduciary acted in bad faith — 'the state of mind traditionally used to define the mindset of a disloyal director.' Bad faith is established, under *Caremark*, when 'the directors [completely] fail[] to implement any reporting or information system or controls[,] or ... having implemented such a system or controls, consciously fail[ ] to monitor or oversee its operations, thus disabling themselves from being informed of risks or problems requiring their attention.' In short, to satisfy their duty of loyalty, directors must make a good faith effort to implement an oversight system and then monitor it."

As noted previously, a majority of board members were so beholden to the Kruse family in general and CEO and Board Chairman Paul Kruse particularly that they could not exercise independent judgment. It was so bad that the board actually passed a resolution in the middle of the crisis – after there were public notifications of the listeria outbreak – "express[ing] support for Blue Bell's CEO, management and employees and encourag[ing] them to ensure that everything Blue Bell manufacture[s] and distributes is a wholesome and good testing [sic] product that our consumers deserve and expect."

The job of every board member is to represent the shareholders, not the incumbent CEO and Chairman of the Board. To do so, the board must oversee the risk management function of the organization. Blue Bell was and to this day is a single-product food company, and that food is ice cream. This sole source of income would mandate that the highest risk the company might face is around food. But as the underlying compliant noted, "despite the critical nature of food safety for Blue Bell's continued success, the complaint alleges that management turned a blind eye to red and yellow flags that were waved in front of it by regulators and its own tests, and the board — by failing to implement any system to monitor the company's food safety compliance programs — was unaware of any problems until it was too late."

The plaintiffs reviewed the board records and made the following allegations:

- there was no board committee that addressed food safety;
- there was no existing regular process or protocols that required management to keep the board apprised of food safety compliance practices, risks or reports;
- there was no existing schedule for the board to consider on a regular basis, such as quarterly or biannually, any key food safety risks;

- during a key period leading up to the deaths of three customers, management received reports that contained what could be considered red, or at least yellow, flags, and the board minutes of the relevant period revealed no evidence that these were disclosed to the board;

- the board was given certain favorable information about food safety by management, but was not given important reports that presented a much different picture; and

- the board meetings are devoid of any suggestion that there was any regular discussion of food safety issues.

The board's several responses to the plaintiffs' allegations can only be characterized as pathetic. The opinion stated,

> "the directors largely point out that by law, Blue Bell had to meet FDA and state regulatory requirements for food safety and that the company had in place certain manuals for employees regarding safety practices and commissioned audits from time to time. In the same vein, the directors emphasize that the government regularly inspected Blue Bell's facilities, and Blue Bell management got the results."

The Delaware Supreme Court made short shrift of this argument, stating

> "fact that Blue Bell nominally complied with FDA regulations does not imply that the board implemented a system to monitor food safety at the board level. Indeed, these types of routine regulatory requirements, although important, are not typically directed at the board. At best, Blue Bell's compliance with these requirements shows only that management was follow-

> ing, in a nominal way, certain standard requirements of state and federal law. It does not rationally suggest that the board implemented a reporting system to monitor food safety or Blue Bell's operational performance."

The board's next defense was even more inane and was so preposterous that the Delaware Supreme Court labeled it as "telling." It was telling because the board had received information on the company's operational issues and, in performing oversight on operational issues, it had fulfilled its *Caremark* obligations. This is basically the same as every paper-pushing argument for a compliance program: the "we have something on paper, so we have complied" defense is the mantra of such practitioners.

The Delaware Supreme Court also saw through the flimsiness of this argument, stating, "if that were the case, then *Caremark* would be a chimera."

This is because operational issues are always discussed at the board level. Finally,

> "Although *Caremark* may not require as much as some commentators wish, it does require that a board make a good faith effort to put in place a reasonable system of monitoring and reporting about the corporation's central compliance risks. In Blue Bell's case, food safety was essential and mission critical."

The bottom line is that the Blue Bell board did nothing to fulfill its *Caremark* obligations. Every CCO needs to read and understand this case so they can present it to their board. I am not sure how much D&O coverage the Blue Bell board carries, but I hope it is quite a bit, as they are going to need it. ◆

Wells Fargo Settlement

While not an FCPA case, one for the record books in 2020 was the $3 billion settlement by Wells Fargo with the DOJ, SEC and OCC for its fraudulent accounting scandal. I did not think that the Wells Fargo fraudulent accounts scandal could get worse for the bank. Boy, was I wrong. A DOJ press release announced that Wells Fargo & Company and its subsidiary, Wells Fargo Bank, N.A., (collectively "Wells Fargo") agreed to pay $3 billion to resolve potential criminal and civil liability stemming from its fraudulent accounts scandal between 2002 and 2016 of "pressuring employees to meet unrealistic sales goals that led thousands of employees to provide millions of accounts or products to customers under false pretenses or without consent, often by creating false records or misusing customers' identities."

It's Even Worse Than Imagined

It was not simply the amount of the fine and penalty or even the scope of the fraudulent conduct that was so damning for Wells Fargo; it was that the entire cross-selling program was a fraud upon the customers of the company, the market, the regulators and the public.

Rarely do you see such a large and prominent organization engage in a nearly 18 years-long fraud, all the while not simply denying they are doing anything wrong but touting their fraudulent conduct as the reason for years and years of business success. This was a fraud perpetrated at the highest levels of the company by bank executives with actual knowledge of the fraud who continually lied to anyone either who asked about it or who reported to such as the regulators and even the Wells Fargo board of directors. It really does not get much worse than the facts laid out about Wells Fargo senior management in the statement of facts referenced in the DOJ press release.

In the DOJ press release, Deputy Assistant Attorney General Michael D. Granston of the DOJ Civil Division said,

> "When companies cheat to compete, they harm customers and other competitors. This settlement holds Wells Fargo accountable for tolerating fraudulent conduct that is remarkable both for its duration and scope and for its blatant disregard of customers' private information. The Civil Division will continue to use all available tools to protect the American public from fraud and abuse, including misconduct by or against their financial institutions."

U.S. Attorney Central District of California Nick Hanna said,

> "This case illustrates a complete failure of leadership at multiple levels within the Bank. Simply put, Wells Fargo traded its hard-earned reputation for short-term profits and harmed untold numbers of customers along the way… We are hopeful that this $3 billion penalty, along with the personnel and structural

> changes at the Bank, will ensure that such conduct will not reoccur."

In the SEC press release, Daniel Michael, Chief of the Enforcement Division's Complex Financial Instruments Unit, said,

> "It is important that brokers do their homework before they recommend that their retail customers buy or sell complex structured products. The products sold by Wells Fargo came with high fees and commissions, which Wells Fargo should have taken into account before advising retail customers to sell their investments and reinvest the proceeds in similar products."

It also noted that, according to the order,

> "The SEC found that Wells Fargo generated large fees by improperly encouraging retail customers to actively trade the products, which were intended to be held to maturity. As described in the SEC's order, the trading strategy – which involved selling the MLIs before maturity and investing the proceeds in new MLIs – generated substantial fees for Wells Fargo, which reduced the customers' investment returns.
>
> The order further found that the Wells Fargo representatives involved did not reasonably investigate or understand the significant costs of the recommendations. The SEC found that Wells Fargo supervisors routinely approved these transactions despite internal policies prohibiting short-term trading or 'flipping' of the products."

The DOJ led a criminal investigation into false bank records and identity theft that led to a three-year DPA under which the bank will not be prosecuted if it abides by certain conditions, including continuing to cooperate with further government investigations. Wells Fargo also entered a civil settlement agreement under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) based on Wells Fargo's creation of false bank records. The bank also agreed to the SEC instituting a cease-and-desist proceeding finding violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The $3 billion payment resolves all three matters, and this total fine and penalty includes a $500 million civil penalty to be distributed by the SEC to investors. Additionally, under the SEC Order, Wells Fargo agreed to disgorgement of $930,377 of ill-gotten gains plus $178,064 of interest and to pay a $4 million penalty.

The statement of facts laid out the violations engaged in by the bank, which I will detail with greater specificity below. The fraud began with the institution of the cross-selling program itself back in 1998, when the bank focused on sales volume and annual sales growth through the sales model of the "cross-sell strategy" to sell existing customers additional financial products. It was "the foundation of our business model," according to Wells Fargo. In its 2012 vision and values statement, Wells Fargo stated, "We start with what the customer needs – not with what we want to sell them." Yet the cross-selling strategy had nothing to do with customer needs; it was only designed to pump up the numbers.

To properly motivate bank employees to engage in this fraud, senior management set completely unrealistic sales goals. To meet these goals, illegal and unethical sales strategies were developed that were so pervasive at the bank they had a name: "gaming."

According to the DOJ press release,

> "Gaming practices included forging customer signatures to open accounts without authorization, creating PINs to activate unauthorized debit cards, moving money from millions of customer accounts to unauthorized accounts in a practice known in-

> ternally as 'simulated funding,' opening credit cards and bill pay products without authorization, altering customers' true contact information to prevent customers from learning of unauthorized accounts and prevent Wells Fargo employees from reaching customers to conduct customer satisfaction surveys and encouraging customers to open accounts they neither wanted or needed."

Not only were senior executives aware of this "gaming," they actively encouraged employees to use these strategies to meet their sales goals. When questioned about these tactics by regulators and even the board of directors, these same senior executives denied any illegal activities or unethical actions were ongoing.

Cross-Selling

Consider Wells Fargo's veritable miasma of fraud, deceit, toxic culture, unethical sales practices, illegal activity and the cross-selling model. As with any corporate business initiative, unless it has an illegal component built into it, it is usually benign. While sales initiatives can be stupid, inane, over-reaching or contentious, trying to sell more products is not usually viewed as illegal. Such was the Wells Fargo cross-selling model, the premise of which was "for Wells Fargo to meet all of its customers' financial needs by focusing on selling to its existing customers additional financial products that those customers wanted, needed and would use."

Moreover, as with any sales model, it was designed to make the company money. "Wells Fargo represented to investors that its ability to execute successfully on its cross-selling strategy provided the Company with a competitive advantage caused an increase in revenue and allowed it to better serve its customers."

Wells Fargo later expanded on the mandate that its cross-selling strategy was a key component to its business model, saying its "primary strategy" was to achieve its "vision ... to increase the number of our products our customers utilize and to offer them all of the financial products that fulfill their needs." The bank characterized cross-selling as "the cornerstone" the bank's business model and later saying it was even "the foundation of our business model."

To the outside world, (i.e., investors and regulators) the bank presented the cross-selling strategy as having a rational *business* basis, that it was "needs-based." This meant Wells Fargo would only sell to customers the services, products and financial tools that they actually needed.

Carrie Tolstedt, then head of Wells Fargo's Consumer Bank business unit, said at the 2010 Investor Day Conference, "Our cross-sell focus starts with customers' needs." Indeed, in its 2012 vision and values statement, Wells Fargo stated: "We do not view any product in isolation, but as part of a full and long-lasting relationship with a customer and with that customer's total financial needs. We start with what the customer needs — not with what we want to sell them."

Tolstedt repeated her words at the 2016 Investor Day conference saying, "[A]s we think about products per household or cross-sell, the first thing we anchor ourselves on is our vision of satisfying our customers' needs." This sentiment was carried forward right up until the time the bank entered into it original $185 million settlement with Consumer Finance Protection Board (CFPB), the Office of the Comptroller of the Currency and the City and County of Los Angeles (collectively "the 2016 Settlement").

Obviously, all of these statements, from Tolstedt's through to the bank's multiple vision and values, were total and utter fraudulent declarations to themselves, their customers, the greater banking public and investors. The reason they were fraudulent was that Wells Fargo employees were instructed to sell eight products, services and financial tools to every customer. Where did the number eight come from? It was from former bank CEO John Stumpf, who liked the rhyming phrase "8 is Great!" as a sales motivation tool.

One of the primary reasons Wells Fargo went down the rabbit hole of fraud in its sales practices is that it used reports of cross-selling success as a key metric to report to regulators and investors. Beginning as early as 2000 and right up until the time it entered into the 2016 Settlement, it reported what it called "the cross-sell metric" to investors and analysts "as proof of its success at executing on this core business strategy. Wells Fargo touted to investors the consistent growth of the cross-sell metric over time as demonstrative of its success at executing on its cross-selling strategy." This was done in the bank's annual reports, and 10K, 10Q and 8K filings with the SEC.

This is the insidiousness of the Wells Fargo fraud. The company reportedly made only about $400,000 in actual revenue in all the years of its cross-selling. However, that pales beside the growth in stock price the bank garnered for hitting or exceeding growth in literally every quarter from the implementation of the cross-sell strategy back in 1998 through 2014, when the metric (as reported by Wells Fargo) flattened out.

What may have started off as a legitimate, legal and beneficial business strategy became not only high-risk, but illegal because of the manner in which Wells Fargo administered its approach to cross-selling.

The sales incentives under which Wells Fargo came to such grief is a simple, and even benign, cross-selling of products. After all, large banks cross-sell their clients all the time, and nobody seems to blink an eye at the cross-selling McDonald's engages in every time you buy a Big Mac when the representative asks if you would like fries with it. But there are other reasons for engaging in this type of business practice. Each and every time a company has a touchpoint, particularly a commercial touchpoint, with a business, it strengthens the relationship.

Wells Fargo was using this cross-selling metric to defraud investors by opening up fraudulent accounts on unsuspecting bank customers. Further, what may have started off as a legitimate, legal and beneficial business strategy became not only high-risk, but illegal because of the manner in which Wells Fargo administered its approach to cross-selling. As with any sales initiative, if a company wants to push it, it will set up incentives for the sales team to engage in such behavior. This can be done by increasing commissions around the service or product being emphasized, such as the bank's products. Companies can also increase sales by making clear that you will be evaluated on how much you sell a product or service. In other words, whether you receive a bonus, pay raise or even keep your job will be evaluated, in some part, on how much you cross-sell.

Gaming

The fraudulent system was so widespread at the bank that it had its own name. While Wells Fargo management was telling its customers, the banking public, investors and regulators that its cross-selling program was a needs-based program, it was in reality something very different. It was a fraudulent scheme that Wells Fargo foisted on its employees to sell via direct pressure of continued employment that "caused to sell large volumes of products to existing customers, often with little regard to actual customer need or expected use."

Community Bank head Carrie Tolstedt was noted to have "directly" approved pressurized employees to engage in fraudulent and even illegal conduct to meet her sales goals. Cross-selling the bank's products was a "significant criterion by which the performance of employees, ranging from tellers and bankers to RBEs, was evaluated." The cross-selling program led Wells Fargo employees to engage in both illegal and fraudulent conduct to meet their sales goals.

To meet these employment objectives and criteria, Wells Fargo employees developed a wide variety of tactics under the "gaming" rubric, which was known within the bank as "employees' manipulation and/or misrepresentation of sales to meet sales goals, receive incentive compensation and/or avoid negative consequences, such as reprimands or termination."

Gaming was accomplished in two general manners: First, Wells Fargo employees would engage in illegal "conduct to attain sales through fraud, identity theft and the falsification of bank records;" the second type of conduct was both fraudulent and unethical, "[selling] products of no or low value to the customer while believing that the customer did not actually need the account and was not going to use the account."

What were the gaming schemes? One was to simply create false records by forging customers' signatures to open accounts that were never authorized or about which the customer was never even contacted. From there, Wells Fargo employees would use customers' personal information to create PIN numbers to activate the unauthorized debit cards. This scheme also involved employees creating fake applications for debit cards and other banking services from personal information.

Bank employees would take great pains to hide these fraudulent accounts from the customers in whose names they had been illegally created. They would alter customer information, such as phone numbers, email addresses and physical addresses to prevent customers from actually receiving the debit cards or activation of the fraudulent services.

Yet another gaming scheme was a practice known as "simulated funding." Under this fraud scheme, bank employees would fashion false records by opening unauthorized checking and savings accounts to meet the cross-selling goals. They would then fraudulently and without authority transfer funds to the unauthorized account to meet the funding criteria required to receive credit for "selling" the new account.

In this clearly illegal conduct, Wells Fargo employees would then transfer funds from existing accounts of the customers without their consent. It was found that literally millions of Wells Fargo customer accounts reflected transfers of funds between two accounts that were equal in amount to the product-specific minimum amount for opening a new account, which, thereafter, had no further activity. It was so pervasive that Wells Fargo employees would use personal funds or other methods to simulate actual funding of accounts that they had opened without customer consent.

Wells Fargo also approved, countenanced and otherwise allowed customers who by no means needed eight banking products or services to have them foisted upon such customers. The bank's employees "intentionally persuaded customers to open accounts and financial products that the customers authorized but which the employees knew the customers did not actually want, need or intend to use."

There were multiple fraud schemes used by Wells Fargo employees to convince customers to open these unnecessary accounts. Some of them included "opening accounts for friends and family members who did not want them and by encouraging customers to open unnecessary, duplicate checking or savings accounts or credit or debit cards. Millions of secondary accounts and products were opened from 2002 to 2016, and many of these were never used by customers."

All of these examples show just how insidious Wells Fargo management was to countenance and promote such tactics. Wells Fargo management, literally right up to the top of the organization, did so by making it clear to employees that their jobs were on the line if they did not meet their cross-selling sales quotas. The order of charges from the OCC states, "Community Bank [headed by Carrie Tolstedt] intimidated and badgered employees to meet unattainable sales goals year after year."

Further, Wells Fargo senior management, to whom Tolstedt and the Community Bank ELT reported, tolerated these illegal and fraudulent sales practices "as an acceptable side effect of the Community Bank's profitable sales model." Wells Fargo senior management declined to implement effective internal controls and actively overrode what few controls existed and "turned a blind eye to illegal and improper conduct" in the gaming program.

How did Wells Fargo become a business that tolerated as a side effect illegal, unethical conduct to hit a self-created metric? Was it perverse incentives? Did the Community Bank leadership in the form of Carrie Tolstedt and her ELT have a single focus on making the cross-selling metric to the exclusion of all else? Were they simply evil people who wanted to cheat everyone and everything, including customers, investors, regulators, the board of directors, employees, the banking public and everyone else?

Why Would You Ever Do Business with Wells Fargo Again?

Even if you believe the cross-selling program started for legitimate business reasons (i.e., to sell more products and services), it very quickly morphed into something illegal and fraudulent.

According to the SEC Order, "The cross-sell strategy called for Wells Fargo to meet all of its customers' financial needs by focusing on selling to its existing customers additional financial products that those customers wanted, needed, and would use."

The bank even created a metric around cross-selling, the *cross-selling metric*, to represent "to investors that its ability to execute successfully on its cross-selling strategy provided the Company with a competitive advantage, caused an increase in revenue and allowed it to better serve its customers." Note, this is a self-created non-GAAP metric.

In other words, a benign sales strategy was used to create a non-GAAP metric that Wells Fargo could tout to investors, shareholders and the market about the strength of its core business. The problem immediately became that to use the metric successfully, Wells Fargo had to make up numbers to support the made-up non-GAAP metric. The business unit involved, the Community Bank, almost immediately "directly and/or indirectly encouraged, caused and approved sales plans that called for aggressive annual growth in a number of basic banking products, such as checking and savings accounts, debit cards, credit cards and bill pay accounts."

The business unit response was that the employees created the Wells Fargo gaming program, which was almost immediately thereafter put into place. Community Bank was aware of the gaming program, which included illegal and fraudulent conduct because, as early as 2002, "Community Bank senior leadership became aware that employees were engaged in unlawful and unethical sales practices, that gaming conduct was increasing over time and that these practices were the result of onerous sales goals and management pressure to meet those sales goals."

The next series of problems involved the corporate headquarters that oversaw Community Bank. Community Bank made at least 50 percent and sometimes up to 75 percent of the bank's overall profits. It truly was the goose that laid Wells Fargo's golden egg(s). More than the fact that corporate headquarters did not want to lose this golden goose by instructing Community Bank to do business legally and ethically (or at the very least in compliance with the bank's code of conduct, policies and procedures), Wells Fargo touted far and wide that it was the only bank to come out of the 2008 financial crisis intact and in good financial shape. This was largely because of its non-reliance on toxic mortgages that befell so many other financial institutions.

I have more faith in American businesses than to believe that senior leadership at one of the top financial institutions in the country were simply evil fraudsters bent on engaging in illegal activity to make their numbers look better. I do not even think the cross-selling program was malevolent. After all, MacDonald's still asks if you want fries with that Big Mac.

But at some point, cross-selling was pushed into something fraudulent, then illegal. That push came from the leaders of Community Bank and was approved and applauded by the highest level at the corporate headquarters, right up to former CEO John Stumpf, even after the first fine of $185 million was paid to the CFPB. Addiction to fraudulent metrics – especially those fraudulently achieved – will get you every time.

Where does Wells Fargo go now? To date, the bank has spent billions in investigation and remediation costs and been fined billions as well. Some of the top leadership at Community Bank and the corporate headquarters have been fired, have retired or have resigned to pursue other opportunities. However, does anyone really think that a culture which for nearly 20 years "tolerated as a ***side effect*** illegal and unethical conduct" to meet some self-created (i.e., made up) number has really changed?

As of 2019, Wells Fargo had over 258,000 employees. Does anyone really think their attitudes about gaming and doing business fraudulently and illegally has changed significantly? What about the remaining senior management? Do they long for the days when shady business practices are tolerated so long as you met your numbers (8 is Great!)?

At this point, I am often reminded of the scene near the end of "On the Waterfront," where union boss Johnny Friendly (played by Lee J. Cobb) collects all the handguns used by his henchmen, throws them in a safe and announces, "from now on we're a clean union."

So, I end with the question I posed earlier, "why would you ever do business with Wells Fargo again?" Since I was not a Wells Fargo customer to begin with, I do not have to wonder if I would do business with them *again*. But after everything that has come out, I certainly will not start doing business with them now. ◆

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