Written Testimony

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"The Foreign Corrupt Practices Act"

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Good morning Chairman Sensenbrenner, Ranking Member Scott, and members of the Committee. I am Michael B. Mukasey, a partner at the law firm of Debevoise & Plimpton LLP in New York. I served as Attorney General of the United States from November 2007 to January 2009. I also served for more than eighteen years, from January 1988 to September 2006, as a United States District Judge for the Southern District of New York, including as Chief Judge from 2000 to 2006. I am testifying today on behalf of the U.S. Chamber Institute for Legal Reform, which seeks to make the nation's legal system simpler, fairer and more efficient for everyone. The Institute for Legal Reform was founded in 1998 by the U.S. Chamber of Commerce, which represents the interests of three million businesses and organizations of all sizes, sectors and regions.

The Foreign Corrupt Practices Act ("FCPA") is a valuable statute that helps reduce corruption and reinforce public and investor confidence in markets here and abroad. The primary aim of Congress in enacting the FCPA was to prohibit U.S. companies and companies listed on U.S. exchanges from paying or offering bribes to foreign government officials and political parties for the purpose of obtaining or retaining business opportunities. In addition to anti-bribery provisions, Congress included in the FCPA requirements that any corporation with securities listed on a U.S. exchange maintain financial books and records that accurately reflect transactions by the corporation and maintain adequate internal accounting controls. Collectively, these provisions properly target foreign bribery and the improper business practices that enable and facilitate such bribe schemes.

While I served as Attorney General, the Department of Justice ("DOJ" or "Department") took its responsibilities under the Act very seriously. Some of the largest FCPA penalties were imposed during my tenure. I think the Members will agree that I am not "soft" on crime of any kind – including overseas corruption.

However, for all the merits of the FCPA in curbing corrupt business practices, thirty-four years of experience have revealed ways in which the statute itself and its enforcement could be improved. In particular, while the past decade has seen an extraordinary increase in the level of FCPA enforcement and investigation by the Department and the Securities and Exchange Commission ("SEC"), judicial oversight of such enforcement remains minimal. Companies are rarely positioned to litigate an FCPA enforcement action to its conclusion or even risk indictment with consequent debarment in some industries, and the possibility of substantial prison time for individual defendants, has led most to negotiate pleas of guilty. The primary statutory interpretive function therefore is performed almost exclusively by the DOJ Fraud Section and the SEC, which are responsible for bringing FCPA charges. By negotiating resolutions in many cases before an indictment or enforcement action is filed, the agencies effectively control the disposition of the FCPA cases they initiate and impose their own extremely broad interpretation of the FCPA's key provisions. We are left with a circumstance in which, as Professor Mike Koehler, a specialist in the FCPA, has stated, "the FCPA means what the enforcement agencies say it means."[1]

Instead of serving the original intent of the statute, which was to punish companies that participate in foreign bribery, actions taken by the government under more expansive interpretations of the statute may ultimately punish corporations whose connection to improper acts is attenuated or, in some cases, nonexistent. The result is that the FCPA, as it is currently written and enforced, leaves corporations vulnerable to civil and criminal penalties for a wide variety of conduct that is in many cases beyond their control or even their knowledge.

The shortcomings in the FCPA and its enforcement may be remedied by several improvements and amendments that will enable businesses to have a clearer understanding of what is and is not a violation of the FCPA. Today I will outline six

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[1] Mike Koehler, *The Foreign Corrupt Practices Act in the Ultimate Year of Its Decade of Resurgence*, 43 Ind. L. Rev. 389, 410 (2010).

reforms that are intended to provide more certainty to businesses when trying to comply with the FCPA and to ensure that the statute and its enforcement are consistent with the fundamental principles of our criminal justice system. The six changes are:

(1) Adding a compliance defense;

(2) Clarifying the meaning of “foreign official”;

(3) Improving the procedures for guidance and advisory opinions from the DOJ;

(4) Limiting a company’s criminal liability for the prior actions of a company it has acquired;

(5) Adding a “willfulness” requirement for corporate criminal liability; and

(6) Limiting a company’s liability for acts of a subsidiary not known to the parent.

1. <u>Adding a Compliance Defense</u>

The FCPA does not currently provide a compliance defense -- that is, an affirmative defense that would permit companies to rebut the imposition of criminal liability for FCPA violations if the people responsible for the violations circumvented compliance measures that were otherwise reasonably designed to identify and prevent such violations. A company may therefore be held liable for FCPA violations committed by rogue employees, agents or subsidiaries even if the company has a state-of-the-art FCPA compliance program. It is true that the DOJ or SEC may look more favorably on a company with a strong FCPA compliance program when determining whether to charge the company or what settlement terms to offer,[2] and such compliance programs may be

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[2] *See* Principles of Federal Prosecution of Business Organizations, Title 9, Chapter 9-28.000, UNITED STATES ATTORNEY MANUAL, *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm (decision whether to charge). While evidence of a strong compliance program may help a corporation reach a resolution on less onerous terms than it otherwise would have received, the government has complete discretion as to how much credit to give for such a program.

taken into account by a court at the sentencing of a corporation convicted of an FCPA violation.[3] However, such benefits are subject to unlimited prosecutorial discretion, are available only after the liability phase of a prosecution, or both. There is also no guarantee that a strong compliance program will be given the weight it deserves.

By contrast, the comprehensive Bribery Act of 2010 passed by the British Parliament – Section 6 of which addresses bribes of foreign officials and closely tracks the FCPA – provides a specific defense to liability if a corporate entity can show that it has "adequate procedures" in place to detect and deter improper conduct.[4] The Ministry of Justice recently released detailed guidance on what may constitute "adequate procedures,"[5] and the Act is due to become effective on July 1, 2011. Similarly, in 2001, the Italian government passed a statute that proscribes foreign bribery but contains a compliance defense.[6] Articles 6 and 7 of the Italian statute permit a company to avoid liability if it can demonstrate that, before employees of the company engaged in a specific crime (such as bribery), it (1) adopted and implemented a model of organization, management and control designed to prevent that crime, (2) engaged an autonomous body to supervise and approve the model, and (3) the autonomous body adequately exercised its duties.[7]

The addition of a compliance defense would align the FCPA with the enforcement regimes of the U.K. and Italy, helping to ensure consistent application of anti-corruption law across jurisdictions. Furthermore, the principles embodied in the U.K. Bribery Act and the Italian statute closely track the factors currently taken into consideration by courts in the United States, albeit at a very different phase of the criminal process – namely, sentencing.[8] These principles – which Congress and the Sentencing Commission

[3] *See* U.S.S.G. § 8B2.1.

[4] *See* Bribery Act of 2010, ch. 23, § 7(2) (U.K.).

[5] *See* Ministry of Justice, The Bribery Act 2010: Guidance (Mar. 30, 2011), available at www.justice.gov.uk/guidance/docs/bribery-act-2010-guidance.pdf.

[6] Legislative Decree no. 231 of 8 June 2001; *see also* McDermott, Will & Emery, *Italian Law No. 231/2001: Avoiding Liability for Crimes Committed by a Company's Representatives*, (Apr. 27, 2009), *available at* http://www.mwe.com/info/news/wp0409f.pdf.

[7] *See id.*

[8] *See* U.S.S.G. § 8B2.1.

have already identified as key indicators of a strong and effective compliance program – should be considered instead during the liability phase of an FCPA prosecution, as they are under the British and Italian statutes.

In the earlier days of the FCPA, Congress had shown interest in such an affirmative defense to liability for companies that had adopted and vigorously enforced FCPA compliance programs. In 1986, Representative Howard L. Berman proposed a "due diligence" affirmative defense that would be available to any company that had established and implemented procedures designed to prevent FCPA violations and had exercised due diligence to prevent the violation at issue.[9] The defense was adopted by the House of Representatives but not included in legislation ultimately signed into law.[10]

Such a defense merits renewed consideration. The FCPA was not intended nor should it be applied as a strict liability statute under the anti-bribery provisions of the Act. Companies cannot guarantee that all of their thousands or even hundreds of thousands of employees worldwide will comply with the Act at all times. Responsible companies implement and enforce strong compliance measures designed to avoid and promptly address infractions. This is precisely what Congress intended with the passage of the FCPA, and it is exactly what the capital markets and American shareholders expect our companies to do. There is little more that a responsible company can do.

In fact, policies adopted by the DOJ, the SEC, and the U.S. Sentencing Commission over the past two decades have all been designed to give companies reasons and incentives to implement effective compliance measures. Many companies have responded to these initiatives, often at substantial cost. The absence of a compliance defense tells corporate America, in effect, no compliance effort can be good enough -- even if you did everything we required, we still retain the right to prosecute purely as a matter of our discretion. I question whether that is the appropriate signal to send to the business community and to American shareholders.

A company that has a strong pre-existing FCPA compliance program that is effective in identifying and preventing violations should be permitted to present that program as an affirmative defense where employees or agents have circumvented that

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9 Trade and International Economic Policy Reform Act of 1986, H.R. 4800, 99th Cong.. The proposed "due diligence" defense is discussed at 132 Cong. Rec. H. 2946.

10 *See* H.R. Conf. Rep. on H.R. 3, 100th Cong., 2d Sess. 916, 922-23 (1988).

compliance program, rather than be compelled to rely solely on the discretion of prosecutors. It is inherently unfair to impose liability for the acts of rogue employees on a company that had in place a robust FCPA compliance program designed to prevent such acts.[11] The adoption of a compliance defense not only will increase compliance with the FCPA by providing businesses with an incentive to develop and enforce strong compliance programs that effectively deter and identify violations, but also will protect businesses from incurring potentially significant liability as a result of conduct by employees who commit crimes despite a business's diligence. Otherwise, the system in place is one with conflicting and even perverse incentives. On the one hand, an effective compliance program can hold out a qualified promise of indeterminate benefit should a violation occur and be disclosed, as it would have to be as part of such a program. On the other hand, if all that can be achieved is that qualified and indeterminate benefit, there is a perverse incentive not to be too aggressive lest wrongdoing be discovered, and a consequent tendency for standards to seek the lowest common denominator, or at best something that is only a slight improvement over it.

2. Clarifying the Meaning of "Foreign Official"

The FCPA prohibits corrupt payments or offers of payment to foreign officials, but does not provide adequate guidance on who is a "foreign official" for purposes of the statute. Under the FCPA, a "foreign official" is defined as "any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization,[12] or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization."[13] The statute does not, however, define

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[11] It is quite clear that and accepted reality that no system of internal controls can prevent all forms of willful deceit. The SEC itself recognizes this proposition. *See* SEC Div. of Corp. Fin., Staff Statement on Management's Report on Internal Controls Over Financial Reporting (2005) ("[D]ue to their inherent limitations, internal controls cannot prevent or detect every instance of fraud. Controls are susceptible to manipulation, especially in instances of fraud caused by the collusion of two or more people including senior management.").

[12] A "public international organization" is "(i) an organization that is designated by Executive order pursuant to section 288 of title 22; or (ii) any other international organization that is designated by the President by Executive order for the purposes of this section, effective as of the date of publication of such order in the Federal Register." 15 U.S.C. §§ 78dd-1(f)(1)(B), 78dd-2(h)(2)(B), 78dd-3(f)(2)(B).

[13] 15 U.S.C. §§ 78dd-1(f)(1)(A), 78dd-2(h)(2)(A), 78dd-3(f)(2)(A).

"instrumentality."[14] It is therefore unclear what types of entities are "instrumentalit[ies]" of a foreign government such that their employees will be considered "foreign officials." As a result, it is often difficult for companies to determine when they are dealing with "foreign officials," particularly in markets in which many companies are at least partially state-owned.

The DOJ's and SEC's enforcement of the FCPA make clear that they interpret the terms "foreign official" and "instrumentality" extremely broadly. From the government's perspective, once an entity is defined as an "instrumentality", all employees of the entity – regardless of rank, title, role or position – are considered "foreign officials."[15] The DOJ's current perspective is illustrated by a recent statement by an Assistant Chief of the DOJ's Fraud Section, who said, "[i]t's not necessarily the wisest move for a company" to challenge the definition of "foreign official," and "[q]uibbling over the percentage ownership or control of a company is not going to be particularly helpful as a defense."[16]

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[14] By contrast, the Foreign Sovereign Immunities Act includes a clear and time-tested definition of "instrumentality," illustrating that the lack of such a definition in the FCPA can be readily cured:

> "An 'agency or instrumentality of a foreign state' means any entity—
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> (1) which is a separate legal person, corporate or otherwise, and
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> (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and
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> (3) which is neither a citizen of a State of the United States as defined in [28 U.S.C. § 1332 (c), (e)], nor created under the laws of any third country."

28 U.S.C. § 1603(b).

[15] Taken to its logical conclusion, the government's position means that – if the United States were a foreign government – employees of General Motors or AIG could be considered "foreign officials" of the United States government, because the government owns portions of each company.

[16] Christopher M. Matthews, "DOJ Official Warns Against Challenging Foreign Official Definition in FCPA Cases" (May 4, 2011), *available at* www.mainjustice.com/justanticorruption.

The DOJ's position recently has met with some success in the courts: two judges recently rejected defense motions arguing that employees of state-owned enterprises are not "foreign officials" under the FCPA. Yet, in doing so, the courts recognized that there are limits on the definition of instrumentality – but neither court clarified what those limits are. On April 20, 2011, Judge A. Howard Matz of the Central District of California, while concluding that the particular enterprise at issue may be an "instrumentality" of a foreign government, found that Congress did not intend either to include or to exclude *all* state-owned enterprises from the ambit of the FCPA.[17] On May 18, 2011, Judge James V. Selna, also of the Central District of California, denied a similar motion, holding that whether a state-owned enterprise qualifies as an "instrumentality" is a question of fact for the jury to decide based on a variety of factors, including the level of investment in the entity by a foreign state, the foreign state's characterization of the entity and its employees, the foreign state's degree of control over the entity, the purpose of the entity's activities, the entity's obligations and privileges under the foreign state's law, the circumstances surrounding the entity's creation and the foreign state's extent of ownership of the entity.[18]

If the definitions of these fundamental statutory terms vary by circumstance and by case, and therefore must be determined by a jury rather than as a matter of law, it becomes impossible for companies to determine in advance what conduct may and may not present a meaningful risk of violating the FCPA. This approach to which foreign companies qualify as "instrumentalities" of foreign governments and who may be a "foreign official" engenders tremendous uncertainty and creates barriers to U.S. businesses seeking to sell their goods and services in foreign markets. Without a clear understanding of the parameters of "instrumentality" and "foreign official," companies have no way of knowing whether the FCPA applies to a particular transaction or business relationship, particularly in countries like China where most if not all companies are at least partially owned or controlled by the state.

The FCPA should therefore be amended to clarify the meaning of "instrumentality" and "foreign official." The statute should indicate the percentage ownership by a foreign government that will qualify a corporation as an "instrumentality," with majority ownership as the most plausible threshold; whether ownership by a foreign official necessarily qualifies a company as an instrumentality and, if so, whether the foreign official must be of a particular rank or the ownership must

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17 *U.S. v. Noriega, et al.*, No. 02:10-cr-01031-AHM, Criminal Minutes – General (C.D. Cal. Apr. 20, 2011), ECF No. 474, at 2, 14.

18 *U.S. v. Carson, et al.*, No. 08:09-cr-00077-JVS, Criminal Minutes – General (C.D. Cal. May 18, 2011), ECF No. 373, at 5.

reach a certain percentage threshold; and to what extent "control" by a foreign government or official will qualify a company as an "instrumentality."

3. <u>Improving Guidance from the DOJ</u>

The FCPA, as amended, permits the DOJ to issue advisory opinions and guidelines regarding compliance with the statute. In practice, though, such opinions and guidance are issued infrequently by the DOJ. For its part, the SEC has not issued advisory opinions on FCPA-related questions and does not have a process for doing so. This near-absence of a meaningful advisory opinion process represents a lost opportunity for the enforcement agencies to provide practical guidance to the business community and thereby enhance FCPA compliance.

The 1988 amendments to the FCPA require the DOJ to issue opinions in response to questions regarding whether prospective conduct would conform with the DOJ's enforcement policies.[19] A rebuttable assumption of compliance with the FCPA applies to conduct that the DOJ identifies as conforming to its FCPA enforcement policies. Unfortunately, this advisory procedure is rarely used. The opinion archive of the DOJ's Fraud Section shows that the DOJ has issued only 33 opinions in more than 18 years, an average of about 1.8 opinions per year.[20]

The 1988 amendments also required the DOJ to determine, following consultation with other agencies and a public notice and comment period, whether the business community's compliance with the FCPA would be enhanced or assisted by "further clarification of the [FCPA's anti-bribery provisions]."[21] In the event the DOJ concluded such clarification was warranted, it was authorized to issue guidelines describing conduct that would conform to the FCPA's anti-bribery provisions.[22] In addition, or as an alternative, it was authorized to offer "general precautionary procedures" that companies

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19 The 1988 amendments were enacted as Title V of the Omnibus Trade and Competitiveness Act of 1988, P.L. 100-418.

20 *See* http://www.justice.gov/criminal/fraud/fcpa/opinion/ for a complete list of opinions issued from 1993 to 2010. As of June 8, 2011, no opinions had been issued in 2011.

21 Guideline issuance authority remains codified at 15 U.S.C. § 78dd-1(d) and 15 U.S.C. § 78dd-2(e).

22 *Id*.

could implement voluntarily to conform their conduct to the requirements of the FCPA.[23] In accordance with the 1988 amendments, the DOJ invited interested parties to submit their views concerning the extent to which the business community's compliance with the FCPA would be enhanced by the issuance of guidelines.[24] On July 12, 1990, the DOJ formally declined to issue guidelines. The Federal Register notice announcing the decision stated simply that, "[a]fter consideration of the comments received, and after consultation with the appropriate agencies, the Attorney General has determined that no guidelines are necessary."[25] The DOJ does not appear to have reconsidered the issuance of guidelines in the two decades since 1990.

The overwhelming majority of businesses operating in the U.S. or listed on U.S. exchanges seek in good faith to ensure that they do not violate the requirements of the FCPA, and therefore would find meaningful advisory opinions and guidelines from both the DOJ and the SEC to be tremendously useful in reviewing and monitoring their conduct and practices, improving their internal controls and enhancing their compliance programs. An active advisory opinion process and robust guidelines from the enforcement agencies would likely result in a higher level of compliance by companies subject to the FCPA.

4. <u>Limiting Criminal Successor Liability</u>

Currently, a company may be held criminally liable under the FCPA for the actions of a company that it acquires or merges with – even if those actions took place prior to the acquisition or merger and were entirely unknown to the acquiring company.[26] Such criminal successor liability is at odds with the basic principles and goals of criminal law, including punishing only culpable conduct or deterring offending behavior. While a

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23 *Id*.

24 54 Fed. Reg. 40,918 (Oct. 4, 1989).

25 55 Fed. Reg. 28,694 (July 12, 1990).

26 *See, e.g.*, Department of Justice FCPA Opinion Procedure Release No. 03-01 (Jan. 15, 2003), *available at* http://www.justice.gov/criminal/fraud/fcpa/opinion/2003/0301.pdf (advising that a company that conducted due diligence on a target company and self-reported any violations that took place pre-acquisition may be able to escape criminal and/or civil successor liability, thereby suggesting that successor liability was a viable theory of liability under the FCPA).

company may mitigate its risk by conducting due diligence prior to an acquisition or merger (or, in certain circumstances, immediately following an acquisition or merger),[27] such due diligence does not provide a legal defense, but merely a circumstance that the DOJ may consider when deciding whether to exercise its discretion not to prosecute. Thus, even when an acquiring company has conducted exhaustive due diligence and immediately self-reported the suspected violations of the target company, it is still legally susceptible to criminal prosecution and substantial penalties. Its only recourse is an appeal to the prosecutorial discretion of the DOJ.

Examples of the application of criminal successor liability under the FCPA include the recent Snamprogetti and Alliance One cases. Snamprogetti was a wholly-owned Dutch subsidiary of ENI S.p.A. From approximately 1994 to 2004, Snamprogetti participated in a bribery scheme.[28] In 2006, after the conduct at issue had ended, ENI sold Snamprogetti to Saipem S.p.A. The DOJ ultimately reached a deferred prosecution agreement in connection with these charges, and the parties to that agreement included Snamprogetti, ENI and Saipem.[29] Under the terms of the deferred prosecution agreement, Saipem is jointly and severally liable for the $240 million fine imposed on Snamprogetti, and its inclusion in the deferred prosecution agreement reflects that it is being held criminally liable for Snamprogetti's conduct on a theory of successor liability. Alliance One was formed in 2005 by the merger of Dimon Incorporated ("Dimon") and Standard Commercial Corporation ("SCC"). Employees and agents of two foreign subsidiaries of Dimon and SCC committed FCPA violations prior to the merger.[30] In 2010, the DOJ brought a criminal case against Alliance One on a successor liability

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[27] *See* Department of Justice FCPA Opinion Procedure Release No. 08-02 (Jun. 13, 2008), *available at* http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2008/0802.html (providing advice on proper post-acquisition due diligence in the rare situation where it was impossible for the acquiring company to perform due diligence on the target prior to acquisition).

[28] *See* Criminal Information, *United States v. Snamprogetti Netherlands B.V.*, Crim. No. H-10-460 (S.D. Tex. Jul. 7, 2010).

[29] *See* Deferred Prosecution Agreement, *United States v. Snamprogetti Netherlands B.V.*, Crim. No. H-10-460 (S.D. Tex. Jul. 7, 2010).

[30] *See* Press Release, Department of Justice, Alliance One International Inc. and Universal Corporation Resolve Related FCPA Matters Involving Bribes Paid to Foreign Government Officials (Aug. 6, 2010), *available at* http://www.justice.gov/opa/pr/2010/August/10-crm-903.html.

theory, ultimately entering into a non-prosecution agreement.[31] In both cases, the conduct that constituted an FCPA violation took place entirely at a predecessor entity prior to a merger or acquisition, yet the successor entity was subjected to liability for that conduct.

The threat of criminal successor liability even if thorough investigation is undertaken prior to a transaction has had a significant chilling effect on mergers and acquisitions. For example, Lockheed Martin terminated its acquisition of Titan Corporation when it learned about bribes paid by Titan's African subsidiary that were uncovered during pre-closing due diligence; Lockheed Martin was unwilling to assume the risk of successor liability for those bribes under the FCPA.[32]

Under basic principles of criminal law, a company, like a person, should not be held liable for the actions of another company with which it did not act in concert. Yet in the FCPA context, due to the DOJ's position on criminal successor liability, that is just what is happening. The DOJ's position on criminal successor liability contrasts with the application of successor liability in civil litigation, where the doctrine originated. In the civil context, the question of whether such liability can be imposed generally requires a complex analysis of a variety of factors, including whether the successor company expressly agreed to assume the liability and whether a merger or acquisition veiled a fraudulent effort to escape liability. Courts may also look to whether it is actually in the public interest to impose such liability. *See, e.g., United States v. Cigarette Merchandisers Ass'n, Inc.*, 136 F. Supp. 214 (S.D.N.Y. 1955).

Clear parameters for criminal successor liability under the FCPA are needed. A company should not be held criminally liable for pre-acquisition violations by an acquiree. If the successor company inherits employees who continue to commit FCPA violations, such new or continuing conduct may appropriately be imputed to the new

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[31] *See, e.g.,* Complaint, *Securities and Exchange Commission v. Alliance One International, Inc.*, Civil Action No. 01:10-cv-01319 (RMU) (D.D.C. Aug. 6, 2010), *available at* http://www.sec.gov/litigation/complaints/2010/comp21618-alliance-one.pdf (describing the merger in ¶ 1 of the Complaint, and then detailing the actions taken by the Dimon and SCC subsidiaries, which formed the basis for the charges against Alliance One).

[32] *See* Margaret M. Ayres and Bethany K. Hipp, *FCPA Considerations in Mergers and Acquisitions*, 1619 PLI/CORP 241, 249 (Sept. 17, 2007); *see also* SEC Litig. Rel. No. 19107, 2005 WL 474238 (Mar. 1, 2005), *available at* http://www.sec.gov/litigation/litreleases/lr19107.htm.

company. However, criminal conduct by employees of one company, pre-acquisition, should not be imputed to a different company (the acquirer). That would amount to an extraordinary expansion of the doctrine of *respondeat superior* (imputation of current employee conduct to an employer). If a company conducts reasonable due diligence regarding an acquisition, the company should as a matter of law (rather than merely as a matter of the government's discretion) not be subject to criminal liability for pre-acquisition conduct by the acquired entity.[33]

5. <u>Adding a "Willfulness" Requirement for Corporate Criminal Liability</u>

Although the FCPA expressly limits an individual's liability for violations of the anti-bribery provisions to situations in which that individual has violated the Act "willfully," it does not contain any similar limitation for corporations.[34] This inconsistency in the statutory language substantially extends the scope of corporate criminal liability: a company can face criminal penalties for a violation of the FCPA even if there is no identifiable person of authority who knew that the conduct was unlawful or even wrong. Given that corporations act through their employees or agents and therefore can be liable only if an individual for whom the corporation is liable has committed the criminal act, it should not be possible to convict a corporation unless the employee is liable. Such individual liability requires willful conduct, and so should corporate liability.

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[33] What constitutes sufficient due diligence necessarily will vary depending on the risks in a given transaction – e.g., whether the target company does significant business in regions that are known for corruption – and the size and complexity of the transaction. But sufficient due diligence should not require a full internal investigation and the expenditure of extraordinary resources by the company. Instead, guidance from the DOJ could outline standards for such diligence and identify factors that will be considered in determining whether diligence was adequate.

[34] 15 U.S.C. § 78dd-3(a)(2). The anti-bribery provisions do contain a requirement that conduct in furtherance of an improper payment must be "corrupt" in order to constitute an FCPA violation, and this requirement applies to both corporate entities and to individuals. *See* 15 U.S.C. §§ 78dd-1(a), 78dd-2(a), 78dd-3(a). The FCPA does not define the word "corruptly," but courts interpret it to mean an act that is done "voluntarily and intentionally, and with a bad purpose." *See, e.g., United States v. Kay*, 513 F.3d 461, 463 (5th Cir. 2008). The requirement that an individual's conduct be "willful" in addition to "corrupt" necessitates a showing that not only was the act in question performed with a bad purpose, but with the knowledge that conduct was unlawful. *Id.* at 463-64.

Adding a willfulness requirement for corporate criminal liability also will help address another area of concern in the FCPA: the potential liability of a parent company for acts of a subsidiary that are not known to the parent.[35] Nothing in the legislative history indicates that the FCPA was intended to allow a parent corporation to be charged with criminal violations of the anti-bribery provisions if it had no direct or even indirect knowledge of improper payments by a subsidiary. At most, the drafters indicated that if a parent company's ignorance of the actions of a foreign subsidiary resulted from conscious avoidance of knowledge, the parent "could be in violation of section 102 requiring companies to devise and maintain adequate accounting controls."[36]

Furthermore, because the DOJ and SEC have construed their FCPA jurisdiction to extend to acts that have only the most attenuated of connections to the United States, the lack of a "willfulness" requirement means that corporations can be held criminally liable for FCPA anti-bribery violations in situations where they not only do not have knowledge of the improper payments, but also do not even know that U.S. law is applicable to the conduct at issue. In such a case, the parent corporation could be charged with violations of the anti-bribery provisions even if it was unaware that the FCPA could reach such conduct.

The "willfulness" requirement therefore should be extended to corporate criminal liability under the FCPA. This amendment would significantly reduce the likelihood that a company will be criminally sanctioned for FCPA violations of which the company had no direct knowledge. The risk of criminal liability for conduct outside the control or knowledge of any person of authority at the company also would be mitigated by the addition of a rebuttable presumption that gifts of truly de minimis value – a trinket bearing the company logo or a modest business lunch – shall be presumed not to violate the FCPA. Similarly, rather than the current strict liability standard for books and records and internal controls violations, under which companies can be charged regardless of how small the payment in question, there should be a materiality standard. This would bring the FCPA in line with other securities laws.

6. <u>Limiting Parent Liability for Subsidiary's Conduct Not Known to the Parent</u>

The SEC has charged parent companies with civil violations of the anti-bribery provisions of the FCPA based on actions of which the parent is entirely ignorant taken by

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35 *See infra* Section 6.

36 *See* S. Rep. No. 95-114, at 11 (1977).

foreign subsidiaries.[37] This approach is contrary to the statutory language of the anti-bribery provisions, which – even if they do not require evidence of "willfulness," as discussed above – do require evidence of knowledge and intent for liability. It is contrary to the position taken by the drafters of the FCPA, who recognized the "inherent jurisdictional, enforcement and diplomatic difficulties raised by the inclusion of foreign subsidiaries of U.S. companies in the direct prohibitions of the bill" and who made clear that an issuer or domestic concern should be liable for the actions of a foreign subsidiary only if the issuer or domestic concern engaged in bribery by acting "through" the subsidiary.[38] It also appears to be at odds with the DOJ's stated position that a parent corporation "may be held liable for the acts of [a] foreign subsidiary[y] [only] where they authorized, directed, or controlled the activity in question."[39]

I am aware of no explanation or rationale for the government's theory that a parent company can be liable for a subsidiary's violations of the anti-bribery provisions where the activity was not "authorized, directed or controlled" by the parent or where the parent did not itself act "through" the subsidiary, but, to the contrary, where the subsidiary's improper acts were undertaken without the parent's knowledge, consent, assistance or approval. Nor has that theory been tested in court. In the absence of any judicial guidance on the contours and the limits, if any, of this potential parent-company liability, it remains a source of significant concern for American companies with foreign subsidiaries. The fact that a parent may exercise "control" of the corporate actions of a foreign subsidiary should not, without more, expose the parent company to liability under the anti-bribery provisions of the FCPA where it did not direct, authorize or even know of the improper payments at issue.

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[37] For example, in 2009, the SEC charged United Industrial Corporation ("UIC"), an American aerospace and defense systems contractor, with violations of the FCPA's anti-bribery provisions based on allegations that a UIC subsidiary made improper payments to a third party, but did not allege that UIC had any direct knowledge of the improper payments. *See In re* United Industrial Corp., Exchange Act Release No. 60005, 2009 WL 1507586 (May 29, 2009), *available at* http://www.sec.gov/litigation/admin/2009/34-60005.pdf; SEC Litig. Rel. No. 21063, 2009 WL 1507590 (May 29, 2009), *available at* http://www.sec.gov/litigation/litreleases/2009/lr21063.htm.

[38] *See* H.R. Conf. Rep. 95-831, at 14 (1977). *See also supra* fn 36 and accompanying text (the drafters intended that actions of a foreign subsidiary unknown to a parent company could constitute FCPA liability only under the books-and-records and internal controls provisions, and not under the anti-bribery provisions).

[39] Department of Justice, *Layperson's Guide to FCPA*, *available at* http://www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-guide.pdf.

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The reforms I have discussed today, by providing greater clarity and certainty to the business community, will provide incentives for compliance and help ensure that companies operating in the U.S. or listed on its securities exchanges adhere to high legal and ethical standards when doing business abroad. These amendments also will focus the investigative resources of the DOJ and SEC on the corrupt business practices that were the principal concern of Congress when it enacted the FCPA and that both the government and the business community seek to eradicate. The result will be a statute that is both stronger and fairer.