October 13, 2016

Recent DOJ and SEC Actions Underscore Regulators' Pronouncements That "Vigorous Enforcement" of FCPA Violations Remains a "High Priority"

As the end of their fiscal years approached on September 30, the Department of Justice and Securities and Exchange Commission announced a number of resolutions, underscoring their pronouncements that "vigorous enforcement"[1] of violations of the Foreign Corrupt Practices Act remains a "high priority"[2] for both agencies. These resolutions, which we summarize in this memorandum, provide more significant detail about the underlying FCPA violations than did previous resolutions, in keeping with the DOJ's stated "effort to promote both transparency and accountability"[3] through their publication and the SEC's desire to build a "robust disclosure regime."[4] Along similar lines, a new SEC regulation went into effect on September 26, 2016, Rule 13q-1,[5] which is designed to promote transparency in the resource extraction industry.

Two of the DOJ's resolutions at first blush appear to bolster the department's efforts to use the FCPA Pilot Program to "increase the incentive for companies to self-report,"[6] by declining to prosecute certain FCPA violations. However, given that the companies involved were publicly identified, required to pay disgorgement, and their FCPA violations described in significant detail, it remains to be seen whether the FCPA Pilot Program will in fact provide incentives to companies to self-report that otherwise would not.

Public companies continue to struggle with the business climate in much of Asia, as evidenced by recent SEC enforcement activity focused on the region. That recent enforcement activity also reflects a continued focus on the provision of intangible benefits as "things of value" and on financial institutions. Moreover, SEC Chair Mary Jo White spoke recently of the increasing importance of international

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1 Mary Jo White, Chair of the Securities and Exchange Commission, Remarks at International Bar Association Annual Conference (Sept. 21, 2016), *available at* https://www.sec.gov/news/speech/securities-regulation-in-the-interconnected-global-marketplace.html.

2 David Bitkower, Principal Deputy Assistant Attorney General, Remarks at American Bar Association Southeastern White Collar Crime Institute (Sept. 8, 2016), *available at* https://www.justice.gov/opa/speech/principal-deputy-assistant-attorney-general-david-bitkower-delivers-remarks-american-bar.

3 *Id.*

4 White, Remarks.

5 17 C.F.R. § 240.13q-1 (2016).

6 Bitkower, Remarks.

cooperation to the SEC's ability to carry out its mission: "All securities regulators, around the world, share the overarching obligation to protect investors . . . . Fulfilling this all-important function is not possible if we stop our work at country borders or fail in our efforts to achieve robust international cooperation."[7]

Below we briefly summarize these recent developments, including recent FCPA enforcement actions.

Nu Skin Resolves SEC FCPA Investigation Relating to Charitable Contribution in China

On September 20, 2016, the SEC announced a settlement with Nu Skin Enterprises, Inc. ("Nu Skin U.S.") regarding violations of the internal controls and books and records provisions of the FCPA by the company's China-based subsidiary ("Nu Skin China").[8] The SEC alleged that Nu Skin China induced a Chinese Communist Party official to influence an ongoing investigation conducted by a provincial regulatory agency into the subsidiary's purportedly unauthorized direct selling practices. Nu Skin China allegedly sought the assistance of the official, and, in return, made a donation of 1 million RMB (approximately $154,000) to a charity selected by the official and also expedited a pending request that the company help secure college recommendation letters for the official's child. Nu Skin China also allegedly mischaracterized the charitable contribution as a donation in its books and records, rather than as a payment for the purpose of influencing the official. Finally, the SEC alleged that Nu Skin U.S. failed to maintain reasonable and adequate internal accounting controls that could have detected the allegedly illicit payment disguised as a charitable contribution. Nu Skin agreed to pay $465,688 in disgorgement and interest, and a $300,000 civil penalty to resolve the matter.

This resolution is noteworthy for several reasons. First, it is only the second time an FCPA enforcement action has been based principally on a charitable contribution. In contrast to the prior such action, however, where the company, Schering-Plough, was found to have contributed to a charity directly linked to the relevant official,[9] the Nu Skin settlement documents do not allege that the official received a direct benefit or that he had a particularly close association with the charity. Second, while the settlement documents do not clarify what the SEC deemed to be the "thing of value" given to the foreign official, it seems likely that the SEC considered not only the charitable contribution, but also the college recommendation letter. This is consistent with two other recent enforcement actions in which the SEC found some form of non-monetary assistance given to a family member of the foreign official to be a "thing of value" to the official himself.[10] Finally, the Nu Skin action serves as a reminder that FCPA

7 White, Remarks.

8 *See* Nu Skin Enters., Inc., Exchange Act Release No. 78884 (Sept. 20, 2016), *available at* https://www.sec.gov/litigation/admin/2016/34-78884.pdf.

9 *See* Schering-Plough Corp., Exchange Act Release No. 49838, 2004 WL 1267922 (June 9, 2004).

10 *See* The Bank of New York Mellon Corp., Exchange Act Release No. 75720, 2015 WL 4911514 (Aug. 18, 2015); Qualcomm Inc., Exchange Act Release No. 77261, 2016 WL 792232 (Mar. 1, 2016).

enforcement actions do not target only long-term or ongoing schemes or large payments; as illustrated here, a one-time, relatively small payment and a non-monetary benefit can be deemed "things of value" by the SEC and give rise to an FCPA violation.

AB InBev Resolves SEC FCPA Investigation Relating to Payments to Increase Sales in India

On September 28, 2016, Anheuser-Busch InBev ("AB InBev") entered into a settlement with the SEC for violations of the books and records and internal accounting controls provisions of the FCPA for alleged improper payments made to government officials in India to increase sales and production of beer from 2009 through 2012.[11] The conduct covered by the settlement also included a violation of SEC Rule 21F-17(a), which implements the whistleblower protections of the Dodd-Frank Wall Street Reform and Consumer Protection Act. As part of the settlement, AB InBev will pay $6 million, which includes disgorgement of $2.7 million, prejudgment interest of $300,000 and a civil penalty of $3 million.

According to the settlement documents, InBev India International Private Limited ("IIIPL"), a joint venture in which AB InBev held a 49% stake and whose chief financial officer AB InBev had the power to appoint, used third-party sales promoters to make the allegedly improper payments, which were reimbursed by AB InBev's Indian subsidiary, Crown Beers India Private Limited ("Crown"). Crown recorded some of the expenses in its books as legitimate promotional costs, which were in turn consolidated into AB InBev's books and records. Neither Crown nor IIIPL ever executed contracts with the third-party promoters. During the period of the alleged violations, the top financial officer at Crown acted as the top financial officer at IIIPL and Crown's in-house counsel acted as IIIPL's in-house counsel. The SEC alleged that, with respect to its subsidiary Crown, AB InBev had inadequate internal accounting controls to detect and prevent the improper payments as well as to ensure that the payments were properly recorded in its books.

In the settlement documents, the SEC indicated that AB InBev (1) did not report to the SEC complaints made in 2009 and 2011 about the conduct before the SEC contacted AB InBev in October 2011; (2) did not respond to subpoenas in a timely manner; and (3) made broad assertions of privilege, which caused the SEC to expend additional resources on the investigation. Moreover, in December 2012, AB InBev entered into a separation agreement with a former Crown employee that contained language that purported to prevent an employee who had informed about the improper payments from communicating directly with the SEC staff regarding possible securities law violations. Ab InBev was charged with a violation of SEC Rule 21F-17(a) for this conduct.

The SEC did note favorably the fact that AB InBev, among other things: (1) improved some internal controls at Crown and IIIPL after a 2010 internal audit; (2) dissolved IIIPL in 2015; (3) conducted

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11 *See* Anheuser-Busch InBev SA/NV, Exchange Act Release No. 78957 (Sept. 28, 2016), *available at* https://www.sec.gov/litigation/admin/2016/34-78957.pdf.

extensive FCPA training for Crown staff and implemented improved compliance policies and controls; and (4) made amendments to its separation agreements in 2015 which make clear that departing employees of U.S. entities are not prohibited from reporting possible legal violations to government agencies.

The AB InBev settlement is notable for at least two reasons. First, while AB InBev held less than 50% of the voting power in a foreign joint venture, the internal controls prong of the FCPA's accounting provisions still required AB InBev to "proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances, to cause such domestic or foreign firm to devise and maintain a system of internal accounting controls."[12] Without any suggestion that AB InBev's efforts were conducted without good faith, the SEC nonetheless brought an internal controls case on the basis that Crown's procedures were inadequate. Second, although AB InBev was not charged with violating the anti-bribery provisions of the FCPA, nearly half of the settlement amount was comprised of disgorgement of ill-gotten gains. The SEC has long taken the position that the disgorgement remedy is available in connection with violations of either the books and records or the internal controls prong of the FCPA's accounting provisions. The settlement in this case only serves to reinforce that, even in cases where no bribery is charged or officially found, there is a significant risk that a company will nevertheless face a disgorgement remedy.

GSK Resolves SEC FCPA Investigation Relating to Payments to Chinese Healthcare Professionals

On September 30, 2016, GlaxoSmithKline ("GSK") entered into a settlement with the SEC for violation of the accounting provisions of the FCPA in connection with a subsidiary's and a joint venture's providing things of value to Chinese officials, including healthcare professionals, in order to increase sales of GSK products.[13] GSK agreed to pay a civil penalty of $20 million to the SEC. According to the settlement documents, between at least 2010 and June 2013, employees and agents of GSK's China-based wholly-owned indirect subsidiary, GSK (China) Investment Co. Ltd. ("GSKCI"), and a China-based joint venture in which GSK had an indirect 55% ownership interest, Sino-American Tianjin Smith Kline & French Laboratories Ltd. ("TSKF"), made improper payments through third party vendors, such as planning and travel service vendors. The payments took the form of gifts, travel and entertainment expenses, shopping excursions, family and home visits, and cash. The SEC alleged that the improper practices were pervasive among GSKCI's and TSKF's sales and marketing representatives and were condoned by regional and district managers. The expenses were recorded in GSK's books and records as legitimate expenses, such as medical association sponsorships, employee expenses, conferences, speaker fees and marketing costs. During the period of the conduct, local internal audit and compliance reviews identified controls

12 15 U.S.C. §78m(b)(6).

13 *See* GlaxoSmithKline, Exchange Act Release No. 79005 (Sept. 30, 2016), *available at* https://www.sec.gov/litigation/admin/2016/34-79005.pdf.

deficiencies, but they were treated as isolated instances rather than as signs of a larger problem. Even so, as early as 2010, GSK's internal audit had identified problems related to sales and promotional staff practices in China. The SEC further alluded to the impact of deficiencies in GSK's internal accounting controls and compliance program on "similar improper conduct in connection with sales in other countries in which GSK operates."

In accepting GSK's settlement offer, the SEC highlighted certain remedial acts promptly undertaken by GSK and its cooperation with the investigation, including that GSK: (1) provided prompt and regular briefings to the SEC regarding its internal investigation in China and timely conveyed the facts it learned; (2) provided detailed and timely information to the SEC regarding its remedial efforts, enhancements to its compliance program and implementation of key initiatives; and (3) made global changes to its business, including eliminating most payments to doctors, enhancing its global risk assessment and strengthening its oversight of third parties.

The GSK settlement is notable for at least two reasons. First, it is the latest in a series of FCPA settlements between the SEC and pharmaceutical companies for alleged violations by their subsidiaries involving state-owned healthcare providers and institutions in China. Earlier this year both Novartis and AstraZeneca resolved FCPA investigation conducted by the SEC regarding alleged FCPA violations committed by their Chinese subsidiaries.[14] These settlements underscore the need for pharmaceutical companies to pay particular attention to potential FPCA risks arising from operations that involve state-owned healthcare providers and to ensure that measures are in place to minimize such risk. Second, the settlement comes some two years after GSK was found guilty of bribery by a Chinese court and fined $490 million for the same underlying conduct.[15] The SEC settlement and the prior Chinese conviction and fine demonstrate the risk of liability across multiple jurisdictions for conduct that violates both the FCPA and the law of the local jurisdiction.

DOJ Announces Two Declinations with Disgorgement Under FCPA Pilot Program

On September 29, 2016, the DOJ entered into letter agreements with two privately held companies, pursuant to which the DOJ declined to prosecute each company under the FCPA Pilot Program, launched April 5, 2016.[16] These letters offer significantly more details about the FCPA violations than the previous

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14 *See* AstraZeneca, Exchange Act Release No. 78730 (Aug. 30, 2016), *available at* https://www.sec.gov/litigation/admin/2016/34-78730.pdf; Novartis, Exchange Act Release No. 77431(Mar. 23, 2016), *available at* https://www.sec.gov/litigation/admin/2016/34-77431.pdf.

15 *See GlaxoSmithKline fined $490m by China for bribery*, BBC NEWS (Sept. 19, 2014), http://www.bbc.com/news/business-29274822.

16 For more information about the Pilot Program, *see* https://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/doj%E2%80%99s-fraud-section-announces-a-pilot-program.aspx?id=21706.

declination agreements entered into under the Pilot Program.[17] The declination agreements both cite six factors as critical to the DOJ's determination to decline prosecution: (1) voluntary self-disclosure of the potential FCPA violation; (2) a thorough and comprehensive internal investigation; (3) full cooperation and agreement to continue cooperating in any ongoing investigations of individuals; (4) disgorgement of all profits earned from illegal conduct; (5) enhancements to compliance programs and internal accounting controls; and (6) full remediation, including terminating employees responsible for the illegal conduct and severing business relationships with third parties involved in the misconduct.

One of the declination agreements involved HMT LLC, a Delaware-incorporated and Texas-based manufacturer of liquid storage tanks for the petroleum, oil and gas industries.[18] The DOJ stated that HMT's employees and agents made approximately $500,000 in improper payments, over a period extending from approximately 1999 to 2011, to government officials in Venezuela and China to induce state-owned enterprises to purchase the company's products. According to DOJ, two regional managers in Texas oversaw the employees and agents paying bribes and for several years had knowledge of the corrupt payments. Under the declination agreement, HMT agreed to disgorge $2,719,412, the profit to HMT from the illegally obtained sales.

The other declination agreement was with NCH Corporation, a Texas-based industrial supply and maintenance company.[19] The DOJ stated that, from approximately February 2011 to mid-2013, NCH's subsidiary in China provided a total of $44,545 in cash, gifts, meals and entertainment to government officials in China to influence their purchasing decisions. According to DOJ, an executive in the U.S. was responsible for overseeing NCH's business in China and reviewed all of the improper expenditures. These improper payments included expenses for a ten-day trip by several employees of an NCH China government customer to U.S. and Canadian cities, of which only one half-day was business-related, and which NCH had been advised might violate the FCPA. As part of the declination agreement, NCH agreed to disgorge $335,342, the profits it derived from the violation.

Despite the relatively small size of the improper payments at issue, both declination agreements contain factual recitations that make clear that, in the DOJ's view, the underlying conduct had a sufficient nexus to the U.S. to support an FCPA prosecution. Previous declination agreements brought under the Pilot Program had provided fewer details as to the U.S. nexus, raising a question as to whether the DOJ would have prosecuted the case anyway, even absent the factors cited in the letter as supporting declinations.

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17 For more information about the prior declinations under the Pilot Program, *see* https://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/doj-publicly-releases-first-declination-letters-since-launching-its-fcpa-pilot-program.aspx?id=22087 (first two declination letters), https://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/analogic-and-johnson-controls-settlements.aspx?id=22270 (third letter).

18 *See* https://www.justice.gov/criminal-fraud/file/899116/download.

19 *See* https://www.justice.gov/criminal-fraud/file/899121/download.

The declinations in HMT and NHC make clear that the DOJ is willing, in appropriate circumstances, to decline to prosecute in light of the factors cited in the Pilot Program even when the underlying facts would have supported an FCPA prosecution. However, given that the companies were publicly identified and required to pay disgorgement, these resolutions show that relying on the Pilot Program is not without significant cost.

SEC Rule 13q-1 Requiring Disclosures by Resource Extraction Issuers Goes into Effect

On September, 26, 2016, the SEC's new regulation, Rule 13q-1, took effect. Adopted under the Dodd-Frank Act, Rule 13q-1 requires issuers to disclose payments made to the United States government or to a foreign government if the issuer engages in the commercial development of oil, natural gas or minerals ("Resource Extraction Issuers") and requires Resource Extraction Issuers to file annual reports with the SEC under the Securities Exchange Act of 1934.[20] The definition of "foreign government" includes a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality or territory under a foreign national government. Issuers must also disclose payments made by subsidiaries or entities they control.

Resource Extraction Issuers must disclose payments, including taxes, royalties, fees, production entitlements, bonuses, dividends, payments for infrastructure improvements and legally required community and social responsibility payments equal to or exceeding $100,000 in a fiscal year that are made to further the commercial development of oil, natural gas or minerals. The $100,000 threshold includes both single payments and series of payments that reach the threshold in the aggregate. The first report is required within 150 days after the end of an issuer's fiscal year ending on or after September 30, 2018, although the rule allows for a one-year delay in reporting payments related to exploratory activities. In addition, Resource Extraction Issuers that acquire a company not previously subject to the rule will not have to report on payments made by the acquired entity until the filing of Form SD for the first fiscal year following acquisition.

This rule seeks to improve transparency in industries that have historically faced significant corruption risks. Corporate compliance programs will have a new challenge as they seek to track these payments and effectively report on them. The requirement to report on these payments is likely to compel companies to review and understand when and why such payments have been made and perhaps to identify potentially inappropriate activity.

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20 Disclosure of Payments by Resource Extraction Issuers, 17 CFR Parts 240 & 249b (2016), *available at* https://www.sec.gov/rules/final/2016/34-78167.pdf.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

James L. Brochin 212-373-3582 jbrochin@paulweiss.com	David W. Brown 212-373-3504 dbrown@paulweiss.com	Michael E. Gertzman 212-373-3281 mgertzman@paulweiss.com
Mark F. Mendelsohn 202-223-7377 mmendelsohn@paulweiss.com	Alex Young K. Oh 202-223-7334 aoh@paulweiss.com	Farrah R. Berse 212-373-3008 fberse@paulweiss.com
Harris Fischman 212-373-3306 hfischman@paulweiss.com	Peter Jaffe 202-223-7326 pjaffe@paulweiss.com	Justin D. Lerer 212-373-3766 jlerer@paulweiss.com

Associates Erin E. Elmouji, Robby L.R. Saldaña and Laurence Tai, and law clerks Sophia Bertran and Benjamin L. Weintraub, contributed to this client alert.